



TENON*forum*

Quarterly Report on Entrepreneurial Britain

Wave 1: 2004



About the Tenon Forum

The Tenon Forum is an independent think tank made up of leading entrepreneurs from the UK's small and medium sized business community. It has been set up by Tenon, the national provider of business services and advice, in the belief that it is in everyone's interest for SMEs to have vigorous and positive representation. Of the 3.7 million UK businesses, 3 million are small and medium sized. They provide work for 12.5 million people and generate an estimated £400 billion of GDP.

The Tenon Forum Think Tank meets to analyse issues arising from a regular survey, a substantial piece of research carried out by NOP World, the UK's leading specialist business to business research agency. A report based on the research and the Think Tank's commentary – including constructive recommendations for change – is published twice a year.

The research explores key issues facing entrepreneurs in the UK today. This fourth report is based on research conducted by NOP World in February/March 2004. They interviewed 500 MDs, FDs and other senior directors of small and medium businesses – firms with between 5 and 499 employees. The survey covers all business sectors across the whole of England, Scotland and Wales and the results have been weighted to provide a representative sample of the British economy.

The Members of the Tenon Forum Think Tank are:

Sally Anderson	Director	Trinity Executives Limited
Khalid Aziz	Chairman	The Aziz Corporation
Trevor Ellis	Managing Director	C.S.Ellis (Group) Limited
James Goddard	Managing Director	The JJ Group
Jeremy Gorick	Managing Director	Liquid Plastics Limited
Ian Johnston	Managing Director	Tartan Golf International Limited
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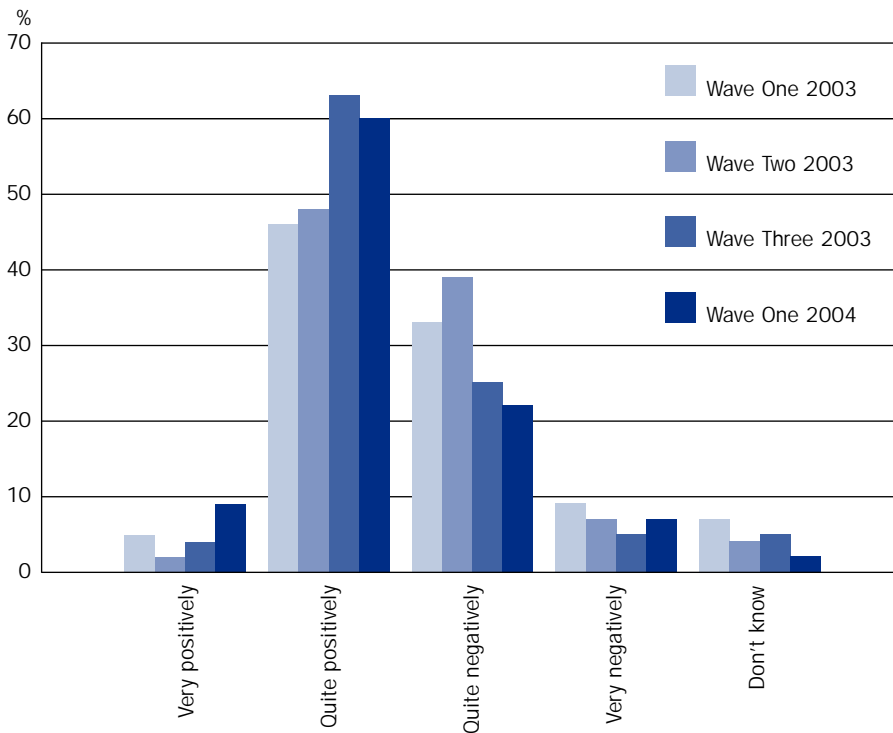
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Wave One 2004: Summary from the Think Tank

The Outlook for Entrepreneurial Britain

Nearly seven out of 10 (69%) of the businesses surveyed said they feel positive or very positive about the impact of the wider UK business environment on the prospects for SMEs in the coming 12 months. This is a record high for the Tenon Forum Report and demonstrates a sustained feeling of confidence in the economy from the SME community.

How positively do you view the impact of the wider UK business environment on the prospects for small and medium businesses for the next 12 months?



The number feeling very positive has more than doubled from 4% to 9% giving more reason to believe that this confidence will last through 2004.

The Tenon Forum believes that it is the stability of the economic environment that is behind this positive outlook. Inflation and interest rates have remained remarkably stable, while fluctuations in foreign exchange rates are less likely to impact on smaller businesses. In addition, it is now looking increasingly unlikely that the UK will join the single currency in the near future, removing another uncertainty for SMEs.

Another pointer towards this being a sustained period of growth for SMEs lies in the sector results. In the last survey, we noted that the recovery was consumer-led to a

'The stability of the economic environment is behind this positive outlook.'



Summary from the Think Tank

large extent with the most positive sectors being retail, utilities and leisure. This time, 73% of SMEs in the manufacturing sector feel positive, up from 63% last time and another indicator of a more sustainable recovery.

We also ask SMEs how optimistic they are about their own business prospects. 84% of our survey say they are positive about their own prospects, a very high proportion and matching the previous survey result. Again, there are strong signs of growth in manufacturing where 85% said they were positive, the only sector to record a rise this time.

Issues facing SMEs

As usual, we talked to SMEs about the external issues they believe are helping – or hindering – their efforts.

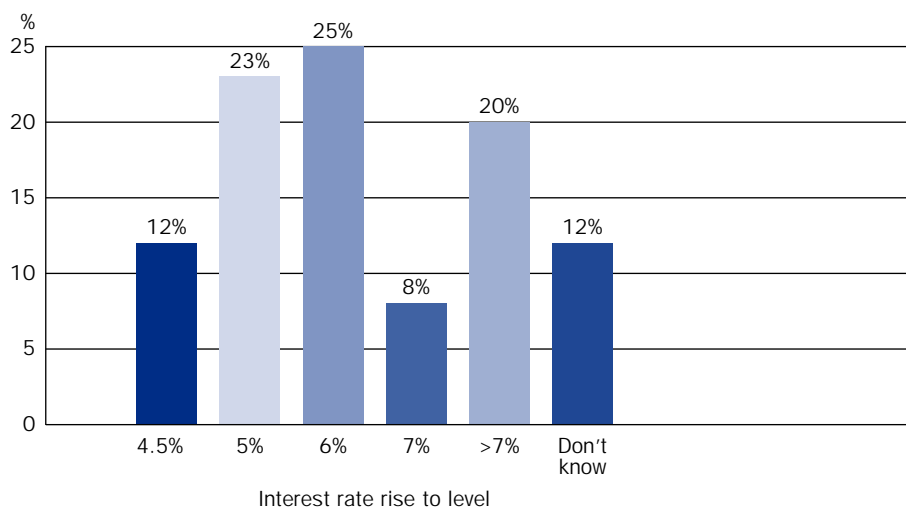
Borrowing and interest rates

We asked them first about borrowing. Just over a quarter (27%) said they were considering borrowing over the next 12 months to grow their business.

Unsurprisingly, a huge proportion of those planning to borrow were doing so to fund capital expenditure (91%) but others were looking at increasing the number of personnel (37%), financing an acquisition (33%) or geographical expansion (27%).

Most likely to borrow were those in the agriculture and mining sector or in transport and communications where 35% were making borrowing plans, while only 21% of SMEs in construction had similar plans.

At what point would a rise in interest rates have a severe negative impact on your business?



The general reticence to borrow may signal a confidence in being able to fund growth through turnover, but a deeper fear of borrowing may be detected. We also asked our SMEs at what point a rise in interest rates would have a severe negative effect on their business plans. When we questioned them in February/March, the rate stood at 4%, and over a third (35% in total) said that if the rate rose to 5% it would severely impact on them. A rise to 6% would have a severe negative effect on 60% of all SMEs.

'A deeper fear of borrowing may be detected.'

This concern over interest rate rises may be more of a visceral reaction than one based on reason. A rise of 1% (say from 4% to 5%) would not cost an SME with average borrowings considerably more in terms of interest payments. What may be behind our survey results is a collective memory of the carnage wreaked on many smaller businesses in the early 90s, and the fact that the majority of SMEs no longer have a personal relationship with their bank manager. This putative fear of banks may lie behind the huge concern over interest rate rises, and the reluctance of the majority of SMEs to consider borrowing to grow their businesses.

The fear of interest rate rises may also be down to fears over the impact it would have on their customers' spending plans, or may be linked to their own personal financial situation in relation to mortgage repayments.

Outsourcing

Outsourcing has become a buzzword in the business media and has been adopted by many large firms – a number of whom have hit the headlines by outsourcing back-office functions to the sub-continent. We asked our survey group whether they had moved any administrative processes outside of the business. Surprisingly, only 12% said that they had. Businesses in manufacturing and regionally those based in the Midlands were most likely to have used outsourcing, but the vast majority have not entertained it. And they are not planning to either, according to our survey. Only 14% of those surveyed said they planned to outsource in the future, either for the first time or to outsource additional processes if they outsourced already.

The benefits of outsourcing to SMEs – particularly owner managers – should be clear: the opportunity to focus on their core business and improvements in efficiency for example. But there is still a barrier for the majority of SMEs, and the smaller the business the bigger the barrier: 18% of firms with between 200 and 499 employees have outsourced administrative processes, compared to 12% of firms with 10 to 199 employees, and just 10% of firms with 5-9 employees.

The concept of outsourcing can seem expensive from the outside, and this may be what is dissuading SMEs. The reality in any outsourcing arrangement is that savings in efficiency and reduced losses in opportunity costs should more than outweigh the cost of outsourcing.



Summary from the Think Tank

Government action

We asked our survey group what they thought the Government's number one priority should be to make it easier for SMEs to grow their business. This was a question we originally asked in March 2003, so the responses offer an interesting indication of what, if anything, has changed in the intervening 12 months.

Which one of the following should be a top priority for the Government, to make it easier for SMEs to grow their business?

	This Wave	Wave 2 2003
Raising the threshold under which smaller firms are exempt from employment regulations	44%	36%
Clarify how much tax they plan to impose on businesses in the long run	25%	26%
Regulate to increase the level of support SMEs can expect from banks	10%	18%
Simplify financial reporting requirements	10%	10%
Reduce the consequences of bankruptcy	2%	5%
Reduce red tape and bureaucracy	2%	1%
Other	5%	3%

Some of the potential steps Government could take have dropped down SMEs' want-list: regulating to increase support from banks, and reducing the consequences of bankruptcy all appear less urgent a year on.

'The Government's number one priority should be to raise the threshold under which small firms are exempt from employment regulations.'

The most significant finding though is that 44% of SMEs – approaching half of all the businesses surveyed – said that the Government's number one priority if they want to encourage SMEs to grow, should be to raise the threshold under which small firms are exempt from employment regulations. This is a significant rise from 36% a year ago, although it was still the top priority.

Employment regulation is clearly a burning issue for many SMEs, who feel overburdened by the wealth of new regulation coming at them from Westminster and Brussels. The burden weighs particularly heavy on the smallest companies, with 51% of firms with 5-9 employees calling on Government to make them exempt.

The increase in calls for a relaxation of employment regulations for a greater number of smaller firms follows a year during which open-ended awards from employment tribunals have been well-publicised in the media. Firms are feeling particularly

vulnerable to being hit by these issues at a time of extremely low unemployment where employees are in greater demand. The Tenon Forum repeats its urging to Government that if it is serious about encouraging enterprise it must give smaller firms the room to grow and the opportunity to develop to a size where they can afford to cope with the demands of employment regulation.

‘Government must give smaller firms the room to grow.’

This survey we also asked SMEs what they felt about the Capital Allowances system, introduced by Government to stimulate growth by encouraging investment in certain capital items. A clear majority (58%) of SMEs however said that they would support getting rid of all such special reliefs and for the Government to use the money saved to reduce the tax rate for businesses as a whole.

The Tenon Forum agreed that investment (in research and development, for example) is determined by the market, rather than tax breaks, and the Capital Allowances system served to affect only the timing of investment decisions (within particular tax years) rather than the decision to invest per se. It was felt that such schemes were an unnecessary complication and that the Government, as advised by the survey results, should look to simplify the whole tax system, and potentially consider merging not only the Inland Revenue and Customs and Excise as it has already announced, but also National Insurance and PAYE.

Advice to Start-Ups

Finally, we asked our SMEs which one piece of advice they would give to someone setting up in business.

The Tenon Forum’s top tips for setting up in business, as prioritised and voted for by SMEs	
1.	Research your market first
2.	Employ the right staff
3.	Find a niche market
4.	Secure adequate funding
5.	Have a good business adviser

SMEs – those who have already successfully started up in business – clearly focus on the market as the most important factor for start-ups. 35% identified researching the market as the most important thing to do, while a further 15% advised on finding a niche market.

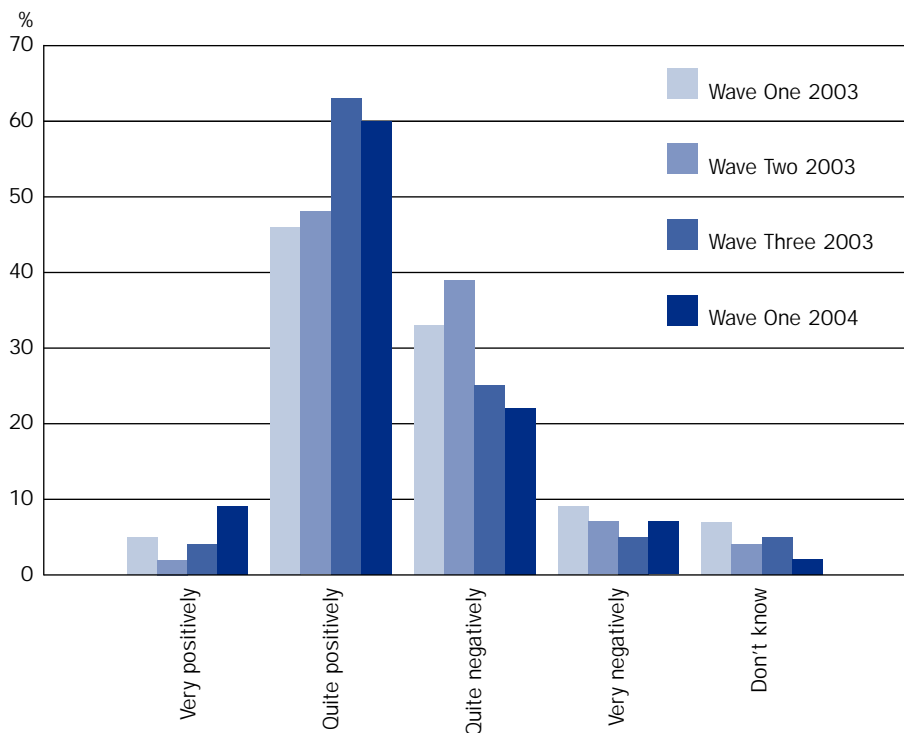


Wave One 2004: Research findings

NOP World, the UK's leading specialist business-to-business research agency, interviewed 500 MDs, FDs and other senior directors at small and medium businesses (between five and 499 employees) between 26th Feb – 15th March 2004. The survey covers all standard industry sectors: Agriculture and Mining, Manufacturing, Construction, Transport and Communications, Retail, Utilities and Leisure and Financial and Business Services, across the whole of England, Scotland and Wales. The results are weighted to provide a representative sample of SMEs in the British economy.

The Economic Climate

1. How positively do you view the impact of the wider UK business environment on the prospects for small and medium businesses for the next 12 months?



Nearly seven out of 10 businesses (69%) now feel positive about the impact of the wider UK business environment on SMEs. We are seeing a sustained confidence in the economic environment and a significant growth in the number of SMEs feeling very positive.

1.1. How positively do you view the impact of the wider UK business environment on the prospects for small and medium businesses for the next 12 months? By sector.

	Ag/mining	Manuf	Const	Transport/comms	Retail/util/leisure	Fin/bus services
Very positively	4%	4%	7%	2%	15%	7%
Quite positively	46%	69%	59%	69%	49%	70%
Quite negatively	44%	23%	24%	15%	22%	18%
Very negatively	6%	4%	6%	8%	11%	4%
Don't know	–	–	3%	7%	3%	1%

The financial and business services sector tops the charts this period, with over three quarters feeling positive, while agriculture and mining continues to be the least positive sector at 50%.

1.2. How positively do you view the impact of the wider UK business environment on the prospects for small and medium businesses for the next 12 months? By region.

	North East, North West Yorks & Humb	East & West Midlands	London, South East East of England	Scotland	South West & Wales
Very positively	10%	6%	13%	9%	6%
Quite positively	57%	58%	48%	66%	75%
Quite negatively	23%	20%	29%	21%	16%
Very negatively	10%	14%	6%	1%	2%
Don't know	–	2%	5%	3%	1%

The slow recovery in the capital keeps London, the South East and the East of England as the least positive region, while the South West and Wales is now the most positive at 81%.



Research findings

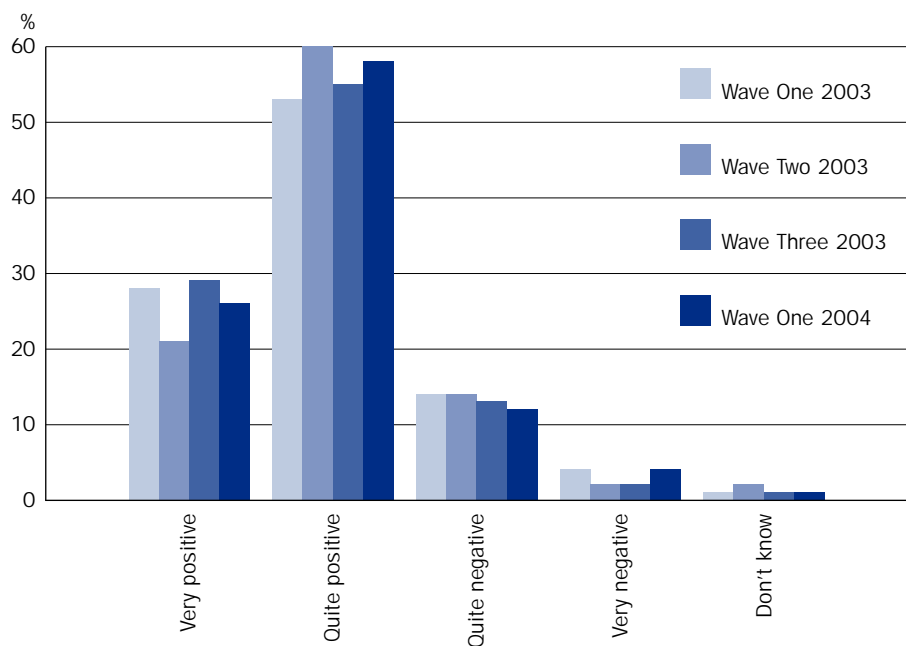
1.3. Percentage of businesses rating the UK business environment as quite positive or very positive. By region.

Ranking	Region	This Wave	Previous Wave	
			Ranking	Percentage
1st	South West & Wales	81%	4th	66%
2nd	Scotland	75%	2nd =	67%
3rd	North East, North West, Yorks & Humb	67%	1st	70%
4th	East & West Midlands	64%	2nd =	67%
5th	London, South East, East of England	61%	5th	61%

1.4. Percentage of businesses rating the UK business environment as quite positive or very positive. By sector.

Ranking	Sector	This wave	Previous wave	
			Ranking	Percentage
1st =	Financial/Business Services	77%	3rd =	63%
1st =	Manufacturing	73%	3rd =	63%
3rd	Transport/Communications	71%	5th	60%
4th	Construction	66%	2nd	64%
5th	Retail/Leisure/Utilities	64%	1st	72%
6th	Agriculture/Mining/Fishing	50%	6th	53%

2. How optimistic are you about your business prospects for the next 12 months?



Confidence in their own business prospects remains extremely high for SMEs at 84%. Of these, 26% are 'very positive' about their prospects for the next 12 months.

'There are strong signs of growth in manufacturing.'

2.1. How optimistic are you about your business prospects for the next 12 months?

By sector.

	Ag/mining	Manuf	Const	Transport/comms	Retail/util/leisure	Fin/bus services
Very positive	18%	13%	20%	24%	36%	23%
Quite positive	55%	72%	65%	60%	43%	67%
Quite negative	21%	12%	14%	13%	13%	8%
Very negative	6%	3%	1%	3%	8%	–
Don't know	–	–	–	–	–	3%

Optimism was extremely high last period and the only sector able to show an increase this time has been manufacturing which has risen from 81% to 85%. All other sectors remain positive, but agriculture and mining is still the lowest at 73%. Construction remains bullish with 85% positive, although this is down from 91% last period.

2.2. How optimistic are you about your business prospects for the next 12 months? By region.

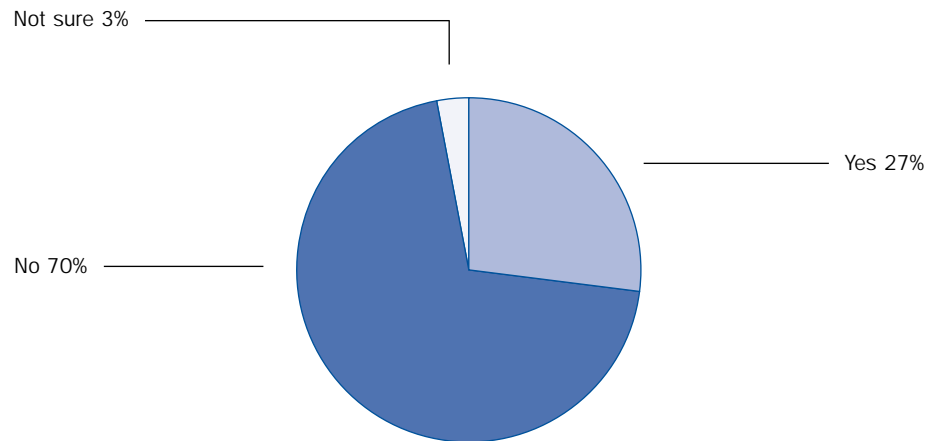
	North East, North West Yorks & Humb	East & West Midlands	London, South East East of England	Scotland	South West & Wales
Very positive	22%	32%	25%	21%	27%
Quite positive	58%	48%	60%	58%	63%
Quite negative	14%	9%	14%	15%	8%
Very negative	6%	9%	1%	3%	2%
Don't know	–	2%	–	3%	–

The South West and Wales is now the most optimistic region with nine out of ten SMEs feeling optimistic about their prospects for the year ahead. Scotland is the least optimistic region at 79%, while the North of England has seen a drop from 90% down to 80%.



Research findings

3. Are you considering borrowing within the next 12 months, to invest in growing your business?



Only a quarter of SMEs surveyed said they were planning to borrow to grow their business this year.

3.1. Are you considering borrowing within the next 12 months, to invest in growing your business? By sector.

	Ag/mining	Manuf	Const	Transport/comms	Retail/util/leisure	Fin/bus services
Yes	35%	32%	21%	35%	24%	26%
No	65%	66%	78%	58%	71%	71%
Not sure	–	1%	1%	7%	5%	3%

Borrowing is off the agenda for many SMEs, but particularly those in the construction sector, in retail, leisure and utilities, and in financial and business services. Transport and communications, and agriculture and mining both show a greater willingness among SMEs to borrow to grow their business.

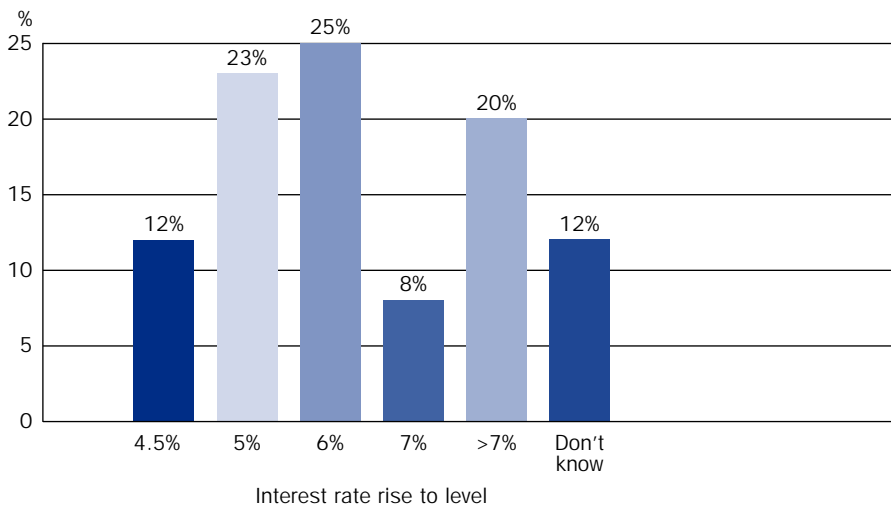
3.2. What are you considering borrowing for, within the next 12 months?

Capital expenditure	91%
Increasing the number of personnel	37%
Financing an acquisition	33%
Geographical expansion	27%
Introducing new business/diversifying our business	8%
Buying out other shareholders	7%
Other	6%

Base: all SMEs who are considering borrowing to grow their business in next 12 months; n=151

The most popular reason for borrowing is capital expenditure, but other reasons cited include increasing staff numbers, financing an acquisition and geographical expansion.

4. At what point would a rise in interest rates have a severe negative impact on your business?



One in eight businesses said they would be affected by a rise of just 0.5% (the rate stood at 4% at the time of the research in February/March 2004). Over a third feel they would suffer badly from a rise to 5% while six out of ten are fearful of the impact of a rise to 6%.



Research findings

4.1. At what point would a rise in interest rates have a severe negative impact on your business? By sector.

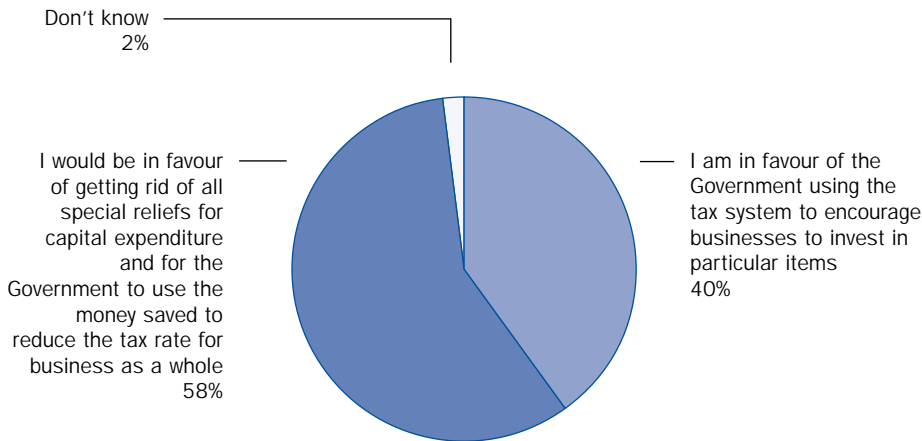
Interest rate rise to level	Ag/mining	Manuf	Const	Transport/comms	Retail/util/leisure	Fin/bus services
4.5%	13%	15%	20%	27%	8%	8%
5%	21%	25%	19%	26%	27%	16%
6%	29%	28%	23%	16%	26%	25%
7%	4%	6%	5%	5%	8%	13%
>7%	24%	19%	24%	16%	21%	18%
Don't know	8%	8%	10%	9%	9%	19%

5. Which one of the following should be a top priority for the Government, to make it easier for SMEs to grow their business?

	This Wave	Wave 2 2003
Raising the threshold under which smaller firms are exempt from employment regulations	44%	36%
Clarify how much tax they plan to impose on businesses in the long run	25%	26%
Regulate to increase the level of support SMEs can expect from banks	10%	18%
Simplify financial reporting requirements	10%	10%
Reduce the consequences of bankruptcy	2%	5%
Reduce red tape and bureaucracy	2%	1%
Other	5%	3%

A significant proportion of SMEs want the Government to reduce the impact of growing employment regulation on more SMEs, an increase on the figure a year ago. Clarification of tax plans remains the second most popular call for action, while regulation of banks is now seen as a less pressing requirement.

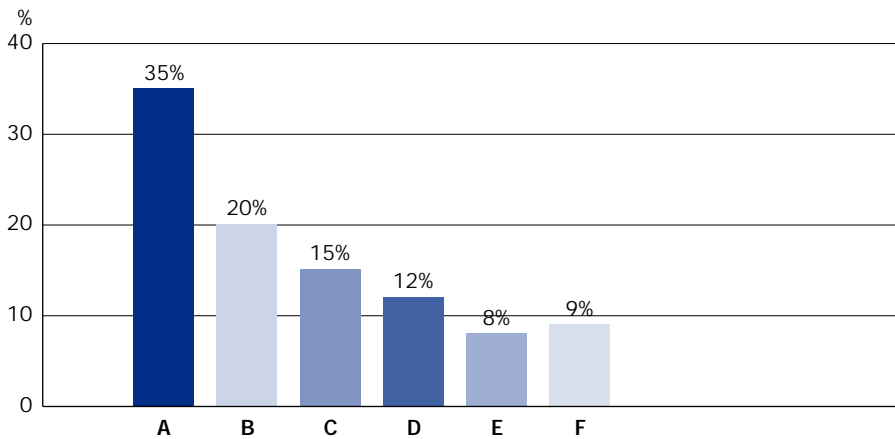
6. The Government uses the Capital Allowances System to encourage investment in certain capital items. Which one of the following two statements best represents your views?



'The Government, as advised by the survey results, should look to simplify the whole tax system.'

Over half of SMEs want the Government to get rid of special reliefs and reduce the tax rate accordingly. A significant minority of 40% however favour the current system.

7. Which one of the following pieces of advice would you give to someone setting up in business?



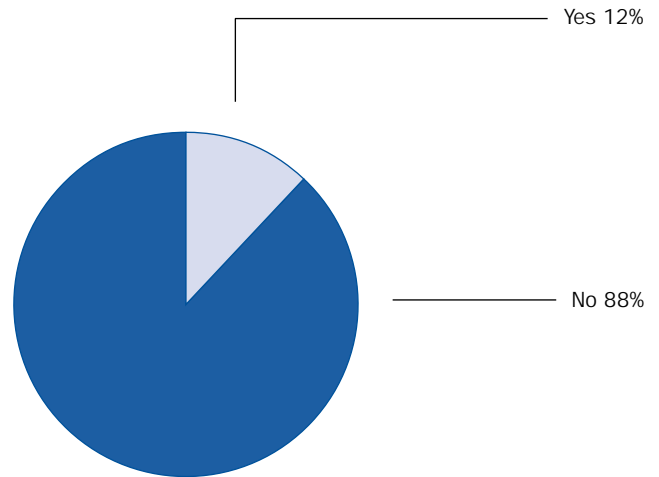
- A** Research your market first
- B** Employ the right staff
- C** Find a niche market
- D** Secure adequate funding
- E** Have a good business adviser
- F** Don't do it

Over a third of our survey advise potential start-ups to research their market first, while a further 15% recommend finding a niche market. 20% say that the most important thing for start-ups is to employ the right staff, while 12% say secure adequate funding and 8% say find a good business adviser. A dispirited 9% say simply, 'Don't do it'.



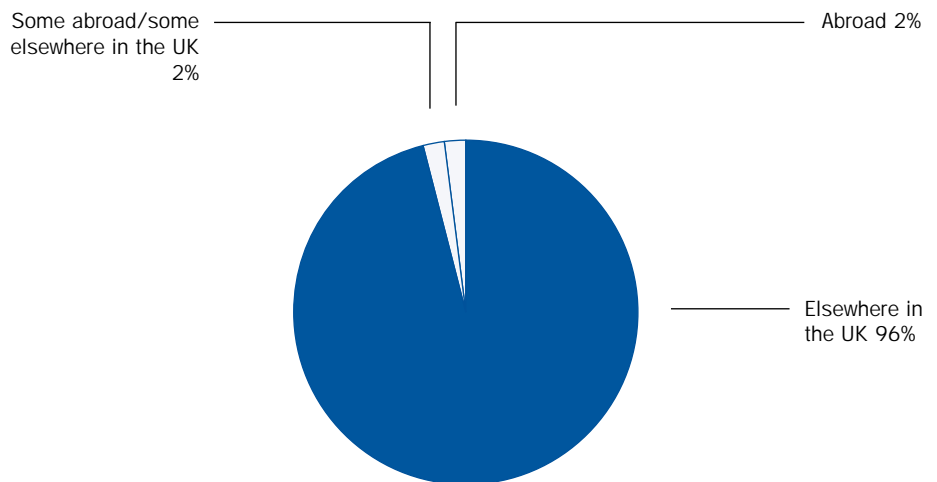
Research findings

8. Have you moved any administrative processes outside of the business?



Only one in eight SMEs has outsourced administrative processes – compared to 88% who have not.

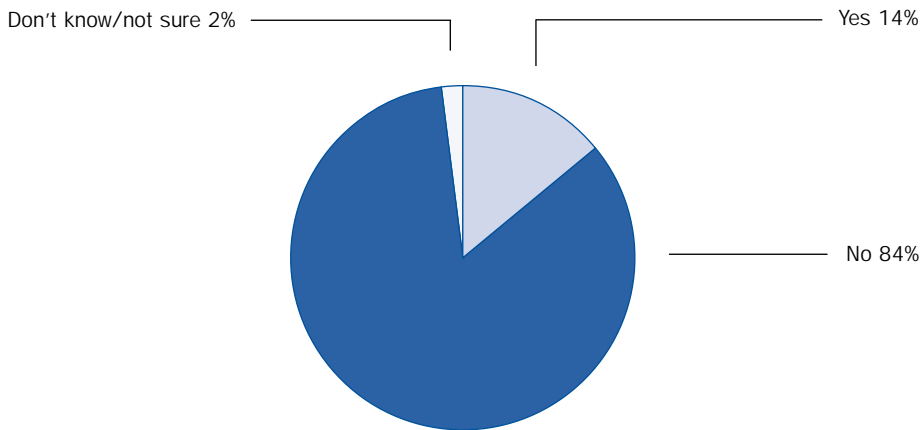
8.1 If so, where have you moved these processes to?



Base: All SMEs who have moved any administrative processes outside of the business; n=58

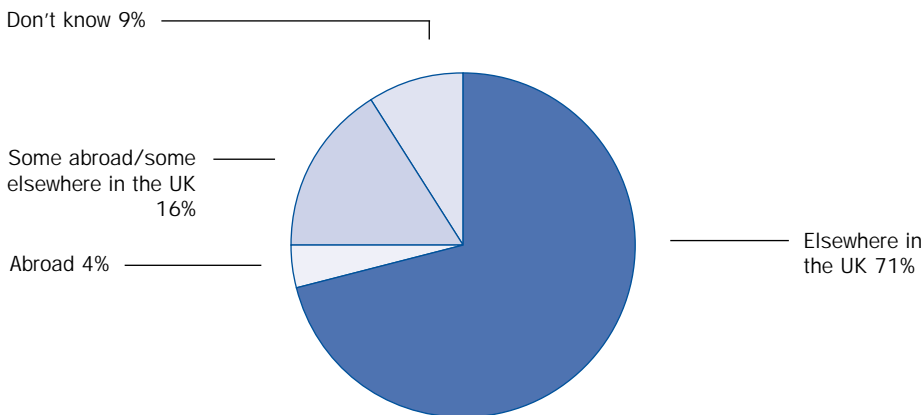
Of those that have, virtually all have outsourced these services elsewhere in the UK, while 4% have gone completely or partly overseas.

8.2. Would you consider moving any (other) administrative processes outside of the business?



Just 14% would consider outsourcing for the first time or trying additional services if they are already outsourcing.

8.3. If so, where would you move these processes to?



Base: All SMEs who would consider moving any (other) administrative processes outside of the business; n=75

And of those who would consider new outsourcing arrangements, 71% would most likely outsource these services elsewhere in the UK.



About Tenon

Tenon is the chosen provider of business services and advice to entrepreneurial Britain. We are expert in protecting and enhancing the wealth of our clients, enabling them to achieve their ambitions.

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