

PO-CH / NL / 0083

PART D

Part D.

**CONFIDENTIAL**  
(Circulate under cover and  
notify REGISTRY of movement)

Begins: 2/3/88

Ends: 2/4/88

  
**PO -CH /NL/0083**  
  
**PART D**

Chancellor's (Lawson) Papers:

**THE NATIONAL ECONOMIC  
DEVELOPMENT COUNCIL**

**PO -CH /NL/0083**  
**PART D**

Disposal Direction: 25 Year

Under

28/7/95

Ch/ you saw this and follow up  
in draft a few wks ago, but  
through some cock-up we  
failed to send. Please  
forgive . . .

OK. mpan 22/4

BF22/3

Ch / content  
to write  
as drafted?

FROM: N G FRAY  
DATE: 21 MARCH 1988

- 1. MR WYNN OWEN
- 2. CHANCELLOR

Res 21/3

cc Sir Peter Middleton  
Mr Monck  
Mr Burgner  
Mr MacAuslan

**NEDC MEMBERSHIPS: TUC SEATS**

OK - hwpw 22/3

The NEDC memberships of Rodney Bickerstaffe and Clive Jenkins expired at the end of December 1987. Those of John Edmonds and Bill Jordan are due to expire at the end of April.

2. Messrs Bickerstaffe and Jenkins have each been members of the Council for two terms; Messrs Edmonds and Jordan, one term each. Sir Peter Middleton has consulted the TUC asking them to let us know their wishes with regard to these seats. The TUC Economic Committee (Mr Willis' letter to Sir Peter Middleton of 11 March, attached) have indicated that they would like to renominate Messrs Bickerstaffe, Jenkins, Edmonds, and Jordan to the NEDC.

3. I attach draft letters to each of these individuals formally inviting them to serve another two-year term on the Council.

  
NIGEL FRAY

*pl type this &  
letters behind  
for*

DRAFT LETTER FROM THE CHANCELLOR OF THE EXCHEQUER TO:

*Rodney*

~~Mr R~~ Bickerstaffe *Esq*  
General Secretary  
National Union of Public Employees  
Civil House  
20 Grand Depot Road  
LONDON SE8 6SF

*Ch to send*

I understand that your latest two-year term on the National Economic Development Council has now expired. After consultation with the TUC, I am now writing to invite you to remain on the Council for a further two-year period. May I take this opportunity to express my thanks for the contribution you have already made to the work of the Council. I hope you accept this invitation to continue.

[NL]

DRAFT LETTER FROM THE CHANCELLOR OF THE EXCHEQUER TO:

*Clive*

~~Mr C~~ Jenkins *Esq*  
General Secretary  
Association of Scientific, Technical  
and Managerial Staffs  
79 Camden Road  
LONDON NW1 9ES

I understand that your latest two-year term on the National Economic Development Council has now expired. After consultation with the TUC, I am now writing to invite you to remain on the Council for a further two-year period. May I take this opportunity to express my thanks for the contribution you have already made to the work of the Council. I hope you accept this invitation to continue.

[NL]

*pl type this  
+ 1 behind pl*

**DRAFT LETTER FROM THE CHANCELLOR OF THE EXCHEQUER TO:**

Mr J Edmonds  
General Secretary  
General Municipal, Boilermakers  
and Allied Trade Union  
Thorne House  
Roxley House  
Claygate Esher  
SURREY KT10 0TL

I understand that your current two-year term on the National Economic Development Council is due to expire at the end of April. After consultation with the TUC, I am now writing to invite you to remain on the Council for a further two-year period. May I take this opportunity to express my thanks for the contribution you have already made to the work of the Council. I hope you accept this invitation to continue.

[NL]

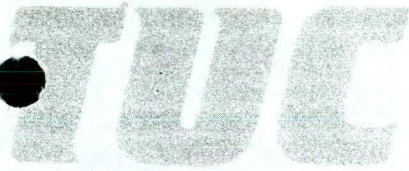
DRAFT LETTER FROM THE CHANCELLOR OF THE EXCHEQUER TO:

Mr W Jordan  
General Secretary  
Amalgamated Union of Engineering  
Workers  
110 Peckham Road  
LONDON SW15

I understand that your current two-year term on the National Economic Development Council is due to expire at the end of April. After consultation with the TUC, I am now writing to invite you to remain on the Council for a further two-year period. May I take this opportunity to express my thanks for the contribution you have already made to the work of the Council. I hope you accept this invitation to continue.

[NL]





Congress House  
Great Russell Street  
London WC1B 3LS  
Telephone: 01-636 4030  
Fax: 01-636 0632  
Telex: 268 328 TUCG

**Trades Union Congress**

Sir Peter E Middleton    KCB  
Permanent Secretary  
H M Treasury  
Parliament Street  
London  
SW1P 3AG

Your reference:

Our reference:    E/BC/JE

Date:    March 11 1988

Dear Sir Peter

NEDC Membership

Thank you for your letters of January 8 and February 19. I am sorry for the delay in replying. The TUC Economic Committee would like to renominate Mr R Bickerstaffe, Mr C Jenkins, Mr J Edmonds and Mr W Jordan to the NEDC.

Yours sincerely

*Norman Willis*

General Secretary ,

8/11/88

General Secretary: Norman Willis    Deputy General Secretary: John Monks  
Assistant General Secretaries: Roy Jackson and David Lea, OBE

CH/EXCHEQUE	
REC.	23 MAR 1988
<del>DESTROY</del>	MR PLYN OVEN
COPIES TO	C ST PMG
	SIR P. M. DUDLEY
	MR ANSON MR MOSE
	MR BURGER MR MACAVULAN

FOR INFO



ELIZABETH HOUSE  
YORK ROAD  
LONDON SE1 7PH  
01-934 9000

*mp*

Ms Moira Wallace  
Assistant Private Secretary to the  
Chancellor of the Exchequer  
Treasury Chambers  
Parliament Street  
London SW1P 3AG

22 March 1988

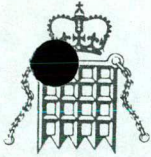
*Dear Moira*

NEDC MEMBERSHIP

I have consulted my Secretary of State about his continuing in membership of the NEDC for a further two years. He has asked me to confirm that he is content with this.

*Yours  
T.B.*

T B JEFFERY  
Private Secretary



HM CUSTOMS AND EXCISE  
STATISTICAL OFFICE  
PORTCULLIS HOUSE 27 VICTORIA AVENUE  
SOUTHEND ON SEA ESSEX SS2 6AL  
TELEPHONE 0702 36 7155

mp  
BF 25/3

CONFIDENTIAL

FROM: M E PRATT

DATE: 23 MARCH 1988

- cc. Chancellor  
Chief Secretary  
Financial Secretary  
Paymaster General  
Sir Peter Middleton  
Mr N Monck  
Mr R Culpin  
Miss C E C Sinclair  
Mr MacAuslan, Treasury  
Mr Wynn Owen, Treasury  
Mr Hyett, Treasury Solicitor

Economic Secretary

**DISCLOSURE OF IMPORTERS' DETAILS**

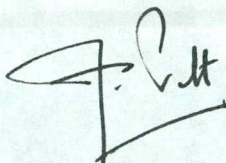
You will wish to see a draft of the Finance Bill clause covering the disclosure of importers names and addresses. We believe that this gives us all that we need to implement the proposed arrangements along the lines we and Treasury officials have discussed with you previously. If at some future period it becomes possible to disclose at a more detailed level of goods description, the clause provides suitable powers without a need to seek further provision. The clause also stands alone leaving the way open to repeal Section 10/<sup>CEMA, 1979</sup>quite separately should that turn out to be a desirable course.

---

**Internal Distribution:** CPS  
Mr B H Knox  
Mrs Strachan  
Mr Nash  
Mr P R H Allen  
Mr B L Wood  
Mr J L Railton  
Mr M Cooper

Our advice is that the clause will appear in the first print of the Bill due to be published tomorrow, there is a possibility that further changes can be incorporated if processed by next Tuesday. A final draft is being produced on Thursday of next week.

I trust the annexed draft meets with your approval.

A handwritten signature in black ink, appearing to read 'M E Pratt', with a stylized flourish at the end.

M E PRATT

DRAFT CLAUSES/SCHEDULES

*Management*

8.—(1) The Commissioners may, for the purpose of supplementing the information as to imported goods which may be made available to persons other than the Commissioners, disclose information to which  
5 this section applies to such persons as they think fit.

Disclosure of information as to imports.

(2) Such information may be so disclosed on such terms and conditions (including terms and conditions as to the making of the information available to other persons) ~~and the payment of fees or charges~~ as the Commissioners think fit.

the payment of fees or charges to the Commissioners and

10 (3) This section applies to information consisting of the names and addresses of persons declared as consignees in entries of imported goods, arranged by reference to ~~imported goods of particular classifications.~~

Such classifications of imported goods as the Commission think fit.

(4) This section shall be construed as if it were contained in the  
15 Customs and Excise Management Act 1979. 1979 c. 2.



H M Treasury  
Parliament Street London SW1P 3AG

Switchboard 01-270 3000  
Direct Dialling 01-270 4360

Sir Peter Middleton KCB  
Permanent Secretary

Sir Robert Reid  
Chairman  
Nationalised Industries' Chairmen's Group  
Hobart House  
Grosvenor Place  
LONDON  
SW1X 7AE

cc

*[Handwritten signature]*  
PS/Chancellor  
PS/Chief Secretary  
PS/Financial Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Mr Monck  
Mr Moore  
Mr Burgner  
Mrs M Brown  
Mr M L Williams  
Mr MacAuslan  
Mr Holgate  
Mr Tarkowski  
Mr Wynn Owen  
Mr A E White  
Mr Cropper  
Mr Call  
Mr Tyrie  
Mr Flanagan

23 March 1988

*Dear Robert,*

NEDC MEMBERSHIP

As you will be aware, Lord Marshall's second two-year term as a member of the NEDC has expired. The Chancellor has written to thank him for his work over the last four years.

This leaves one of the Nationalised Industry seats open. One obvious course of action would be to use this opportunity to regularise the position of Sir Bryan Nicholson. Since leaving the Manpower Services Commission, he has sat on the NEDC in a personal capacity. His current position as Chairman of the Post Office would seem to make him a good candidate for the seat vacated by Lord Marshall.

The final decision, of course, lies with the Chancellor. But I would be grateful if you could let me know your opinion of the course of action suggested above, and for any other suggestions you might have which I could draw to the Chancellor's attention.

*Yours ever,*

*[Handwritten signature]*

P E MIDDLETON



*mp*

Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

24 March 1988

Clive Jenkins Esq  
General Secretary  
Association of Scientific, Technical  
and Managerial Staffs  
79 Camden Road  
LONDON  
NW1 9ES

*Clive*

I understand that your latest two-year term on the National Economic Development Council has now expired. After consultation with the TUC, I am now writing to invite you to remain on the Council for a further two-year period. May I take this opportunity to express my thanks for the contribution you have already made to the work of the Council. I hope you accept this invitation to continue.

NIGEL LAWSON

*Nigel Lawson*



*Handwritten initials*

Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

24 March 1988

Rodney Bickerstaffe Esq  
General Secretary  
National Union of Public Employees  
Civil House  
20 Grand Depot Road  
LONDON  
SE8 6SF

*Handwritten signature: Rodney Bickerstaffe*

I understand that your latest two-year term on the National Economic Development Council has now expired. After consultation with the TUC, I am now writing to invite you to remain on the Council for a further two-year period. May I take this opportunity to express my thanks for the contribution you have already made to the work of the Council. I hope you accept this invitation to continue.

NIGEL LAWSON

*Handwritten signature: Nigel Lawson*



Confederation of British Industry  
Centre Point  
103 New Oxford Street  
London WC1A 1DU  
Telephone 01-379 7400  
Telex 21332  
Facsimile 01-240 1578

From  
Sir David Nickson KBE DL  
President

CBI

24th March 1988

The Rt. Hon. Nigel Lawson MP  
Chancellor of the Exchequer  
H M Treasury  
Treasury Chambers  
Parliament Street  
London SW1P 3AG

25/3

CH/EXCHEQUER	
REC.	25 MAR 1988
ACTION	Mr P Wynn Owen
COPIES TO	CST, PMG, Sir P Middleton
	Mr Anson
	Mr Mowck
	Mr Burgner

BF 2813

29/3

20/4

30/3

12/4

7/4

Dear Nigel, w MacArthur

As you know I hand over the Presidency of the CBI to Sir Trevor Holdsworth on May 12th and therefore April 26th will be my last NEDC meeting.

I am sending a copy of this letter to Peter Middleton and hope that it would be possible for you to make a formal appointment for Sir Trevor Holdsworth to become a member of NEDC in my place at the appropriate time after April 26th.

Yours ever

David



*[Handwritten signature]*

FROM: G R WESTHEAD  
DATE: 28 March 1988

MR PRATT - C&E

cc PS/Chancellor *2*  
Mr N Monck  
Mr R Culpin  
Miss C Sinclair  
Mr MacAuslan  
Mr Wynn Owen  
  
Mr Hyett - Tsy Sol

**DISCLOSURE OF IMPORTERS DETAILS**

The Economic Secretary has seen and was grateful for your minute of 23 March. He is content with the draft Finance Bill clause on the above.

*Guy Westhead.*

GUY WESTHEAD  
Assistant Private Secretary

~~BF 12/4~~

*papers p2e*

- 1. MR MONCK *Nm*
- 2. APS/CHANCELLOR

FROM: N G FRAY  
 DATE: 28 March 1988

cc PS/Chief Secretary  
 PS/Sir P Middleton  
 Mr Burgner  
 Mr MacAuslan  
 Mr Wynn Owen

**NEDC: AUTUMN MEETING**

You will wish to be aware of progress made to date in rearranging the autumn Council meeting, as foreshadowed in my minute to the Chancellor of 15 February.

2. You will recall that Lord Young is unable to chair the Council meeting on 21 September (Jewish New Year). After consulting interested parties, the Secretary to the Council now plans to fix the autumn meeting of the Council for 10.00 am on Tuesday 25 October. This would bring the timings of Council meetings into line with those envisaged by the Chancellor in his 1 July announcement (January, April, July and October). The Chief Secretary's office have confirmed that he is free to attend the Council meeting on 25 October.

Sarah

Can you show me -  
 some time tomorrow -  
 all the recent pp on  
 NEDC membership / meetings pl  
 (some may be on BF)

*Nigel Fray*  
 NIGEL FRAY

5683



ELIZABETH HOUSE  
YORK ROAD  
LONDON SE1 7PH  
01-934 9000

*mpf 28/3*

✓ CH/EXCHEQUER	
REC.	28 MAR 1988
ACTION	Mr P Wym-Owen
COPIES TO	CST, AMG.
	Sir P Middleton
	Mr Anson, Mr Monck
	Mr Burgess,
	Mr MacAuliffe

The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
Treasury Chambers  
Parliament Street  
LONDON SW1P 3AG

28 March 1988

*[Handwritten signature]*

**NEDC MEMBERSHIP**

Thank you for copying to me your letter of 18 March to Lord Young about Sir Bryan Nicholson's NEDC membership.

I am writing to say that I am content with the action that you propose. Copies of this letter go to recipients of yours.

*[Handwritten signature]*



*mp*

# Manufacturing Science Finance

Joint General Secretaries    Ken Gill    Clive Jenkins

29th March 1988

*Not posted!  
envelope*

*Dear Nigel*

I am grateful for your invitation to another two year term on the National Economic Development Council. I accept.

I hope the next two years will be more fun. *!!*

*yours sincerely  
Clive*

Rt Hon Nigel Lawson MP, Chancellor of the Exchequer,  
Treasury Chambers, Parliament Street, London SW1P 3AG.

*84*

CH/EXCHEQUER	
REC.	08 APR 1988
<del>ACTION</del>	Mr Wynn Owen
COPIES TO	CST, PMG Sir P Middleton
	Mr Anson Mr Mack
	Mr Buzg
	Mr MacAulian

*FOR INFO*

*papers ppe*

# Nationalised Industries' Chairmen's Group

Chairman  
Sir Robert Reid, CBE,

Hobart House  
Grosvenor Place  
London SW1X 7AE

01-235 2020

29th March, 1988

Sir Peter Middleton, K.C.B.,  
Permanent Secretary,  
H.M. Treasury,  
Parliament Street,  
London, SW1P 3AG.

PERM. SEC'D. OFFICE	
RECEIVED	
6 APR 1988	
Action	Mr Flanagan
Copies	PS/Charter
To	PS/CST

- Mr Munnick
- Mr Mann
- Mr Burgess
- Mrs M. Brown
- Mr M.L. Williams
- Mr MacArthur
- Mr Hatgate
- Mr Tarkowski
- Mr Wynn-Owen
- Mr A.E. White
- Mr Cooper
- Mr Gull

*Den Belin*

*PS/PMG  
PS/EST*

N.E.D.C. MEMBERSHIP

Many thanks for your letter. N.I.C.G. will be very happy to support your recommendation to the Chancellor that Sir Bryan Nicholson takes the Nationalised Industries' seat vacated by Lord Marshall.

*Mr Tyne*

*Tom*

*BR*

BOB REID

*73-29-3*

cc **PS/CHX Z**  
 Mr Manck  
 Mr McAuslan  
 Mr Wood C+E  
 PS/cte



Treasury Chambers, Parliament Street, SW1P 3AG

Alan Chandler Esq  
 Secretary General  
 United Kingdom Provision Trade Federation Ltd  
 17 Clerkenwell Green  
 LONDON  
 EC1R 0DP

30 March 1988

Dear Mr Chandler

Thank you for your letter of 22 March.

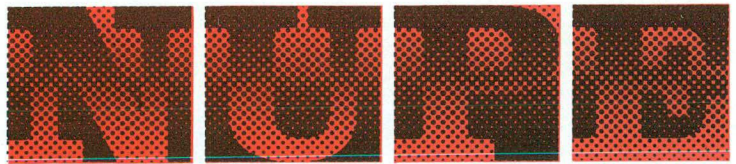
As you say, the knitwear industry have, for a number of years, been amongst the proponents of greater availability of import information. But Clause 8 of the 1988 Finance Bill stems directly from the consultative exercise undertaken last year. A majority of respondents, representing a wide variety of UK trading interests, supported the proposal for the disclosure of importer's names and addresses by commodity code.

I understand that your federation contributed to the consultative exercise through MAFF and that you objected to the proposed disclosure on the grounds that it could be commercially disadvantageous to some importers. Our view remains, however, that our proposals provide equal opportunity for the whole trading community.

We would prefer to gain some experience of this new development before considering, for example, your suggestions of making information on exports and the home trade available also. The proposed disclosure has the benefit of being confined to information which is already collected and can be presented in a marketable form, at a realistic cost, within a reasonable timescale and with minimal disruption to existing systems. But the Government is committed to the free-flow of market information and will consult on other options at an appropriate time.

*Yours sincerely*  
 Peter Lilley

PETER LILLEY



NATIONAL UNION OF PUBLIC EMPLOYEES  
 CIVIC HOUSE  
 20 GRAND DEPOT ROAD  
 LONDON SE18 6SF  
 TELEPHONE 01 854 2244

*RKP*

General Secretary **Rodney K Bickerstaffe**

Your ref.

Our ref. RKB/PML/5.B

30 March 1988

The Rt Hon Nigel Lawson, MP  
 Chancellor of the Exchequer  
 Treasury Chambers  
 Parliament Street  
 SW1P 3AG

*Not phoned:  
 Crawley*

Dear Chancellor,

Thank you for your letter dated 24 March, and I am pleased to accept your invitation to continue on the National Economic Development Council for a further two year period.

Yours sincerely,

*Rodney K. Bickerstaffe*

GENERAL SECRETARY

*3/4*

EXCHEQUER	
REC.	08 APR 1988
FOR INFO	Mr Wynn-Owen
	CST, PMG
	Mr P Middleton
	Mr Anson
	Mr Monck
	Mr Buznes
	Mr Mac Ardian





SPARE

NOT FOR PUBLICATION

National Economic  
Development Council

CHANGE OF AUTUMN MEETING DATE

Note by the Secretary to the Council

Following consultation with the parties, the date of the Autumn 1988 meeting of the Council has been changed from Wednesday 21 September to Tuesday 25 October at 10.00 am. This change will enable the Secretary of State for Trade and Industry to chair the meeting.

I hope this revised date will be generally convenient to members.

For convenience, I confirm below the dates for the three remaining NEDC meetings of 1988:

Tuesday 26 April

Wednesday 6 July

Tuesday 25 October

(all at 10.00 am)

Martin Couchman

National Economic Development Office  
Millbank Tower  
Millbank  
London  
SW1P 4QX

30 March 1988

THIS PAPER IS NOT  
FOR PUBLICATION

# dti

the department for Enterprise

*BE 874*  
*pmg*

The Rt. Hon. Lord Young of Graffham  
Secretary of State for Trade and Industry

The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
Treasury Chambers  
Parliament Street  
LONDON SW1P 3AG

**Department of  
Trade and Industry**

1-19 Victoria Street  
London SW1H 0ET

Switchboard  
01-215 7877

Telex 8811074/5 DTHQ G  
Fax 01-222 2629

Direct line 215 5422  
Our ref DC2AJE  
Your ref  
Date 30 March 1988

*30/3*

<b>CH/EXCHEQUER</b>	
REC.	30MARI988
ACTION	Mr Wynn Owen
COPIES TO	CST, PMG
	Sr P Middleton
	Mr Anson, Mr Monck
	Mr Bryner
	Mr MacArthur

*Nigel*

**NEDC MEMBERSHIP**

Thank you for your letter of 18 March. I am content with your proposal to invite Sir Bryan Nicholson to fill the seat left vacant by Walter Marshall.

I am copying this letter to Norman Fowler, Nicholas Ridley, Kenneth Baker and Cecil Parkinson.

*2/5*  
*Y. S.*  
*Nair*



*prop*

2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434  
My ref:

*Handwritten signature*

Your ref:

The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
HM Treasury  
Parliament Street  
LONDON  
SW1P 3AG

*circulate*

CH/EXCHEQUER	
REC.	31 MAR 1988
<del>NAME</del>	<i>Mr WYND OWEN</i>
COPIES TO	<i>CST. PMG</i>
	<i>S. P. AIDLETON,</i>
	<i>Mr ANDERSON,</i>
	<i>Mr MONCK,</i>
	<i>Mr BARONER,</i>
	<i>Mr MACANSLAN</i>

30 March 1988

*for info*

*✓ 3/3*

*Dear Nigel*

NEDO MEMBERSHIP

Thank you for copying me your letter to David Young of 18 March.

I am content with your proposal.

*Handwritten signature*

NICHOLAS RIDLEY





*my*

2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434  
My ref:

Your ref:

The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
HM Treasury  
Parliament Street  
LONDON  
SW1P 3AG

*Circulate*

30 March 1988

SECRETARY OF STATE FOR THE ENVIRONMENT	
31 MAR 1988	
<i>Mr Wynn Jones</i>	
<i>CST PMS</i>	
<i>S. P. MIDDLETON</i>	
<i>Mr Atkinson</i>	
<i>Mr Monck</i>	
<i>Dear Nigel</i>	
<i>Mr Barber</i>	
<i>Mr MacAuley</i>	

*Mr Flanagan of.*  
1) *All in yet?*  
*and if so,*  
2) *Next stage?*

*for info*

*G*

x1 NEDO MEMBERSHIP

Thank you for copying me your letter to David Young of 18 March.

I am content with your proposal.

*Miss Wallace*  
*perhaps 's*  
*has thrown your*  
*files.*  
*Jan Fe*

*prop.*

*James*  
*Annus*

NICHOLAS RIDLEY





National Economic  
Development Council

~~BF 15/4~~  
TE

NEDC 26 APRIL 1988

Note by the Secretary to the Council

~~BF 18/4~~

The following papers are circulated herewith:

BF 22/4

ITEM 1 (SKILLS):

- Memorandum by the Secretary of State for Employment and the Chairman of the Manpower Services Commission (NEDC(88)9).
- Memorandum by the CBI (NEDC(88)11) - with two annexes (booklets) for Members and Principal Advisers only.

ITEM 2 (COTTON AND ALLIED TEXTILES SECTOR GROUP):

- Memorandum by Mr Stuart Hollander CBE (NEDC(88)13).

ITEM 3 (SMALL FIRMS):

- Memorandum by the Department of Employment (NEDC(88)14).
- Memorandum by the CBI (NEDC(88)15).
- Memorandum by the Director General (NEDC(88)17) with annex.

ITEM 4 - FOR NOTING ONLY - (NEDO PLAN AND BUDGET)

- Memorandum by the Director General (NEDC(88)18).

A note on NEDC lunches is also circulated herewith.

Other papers and the agenda will be circulated shortly.

MARTIN COUCHMAN

From the Secretary to the Council  
Direct Line 01-211 3486  
Personal Secretary 01-211 4320

5/4

CH/EXCHEQUER	
REC.	05 APR 1988
ACTION	Mr P Wynn Owen
COPIES TO	CST, PMG. 50 P Middleton Mr Anson, Mr Monck Mr Burger Mr McCauslan



BF 874  
py

31 March 1988

Miss Moira Wallace  
Assistant Private Secretary  
Chancellor of the Exchequer's Office  
HM Treasury  
Parliament Street  
London  
SW1Y 3AG

National Economic  
Development Office  
Millbank Tower, Millbank  
London SW1P 4QX

Telex 945059 NEDO G  
Fax 01-821 1099  
Reception 01-211 3100

Dear Miss Wallace,

NEDC 26 APRIL

This is the regular letter seeking the Chancellor's clearance of the April agenda.

Item 1 (Skills) will have papers from the Department of Employment (jointly with the MSC), the TUC, CBI and NEDO. Item 2 will be a Sector Group presentation from Cotton and Allied Textiles; the presenting Chairman is Mr Stuart Hollander. For item 3 (Small Firms), there will be papers from the Department of Employment, the CBI and NEDO, and possibly also the TUC. These items were agreed by the Steering Group on Council Programmes at its January meeting. As at previous April meetings there will be a 'below the line' item on NEDO's budget, with a paper from the Director General.

I should be glad if you could confirm that the Chancellor is content with the agenda.

I am copying this letter to the Private Secretary to the Secretary of State for Employment, who will be in the Chair on 26 April.

Yours sincerely,

MARTIN COUCHMAN

FROM: S J FLANAGAN  
DATE: 8 April 1988

1. MR WYNN OWEN  
2. APS/CHANCELLOR - 2

cc PS/Chief Secretary  
PS/Paymaster General  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr MacAuslan

*Ch/ content for me  
to write?*

*OK*

AGENDA FOR NEDC, 26 APRIL

*hupw 8/4*

Martin Couchman wrote to you on 31 March (copy attached) seeking the Chancellor's clearance for the proposed agenda for the 26 April seeking NEDC meeting, which Mr Fowler will be chairing. The Chief Secretary will be attending for the Treasury.

2. The proposed agenda is:

- i. Skills: papers from DE/MSA, TUC, CBI and NEDO
- ii. Cotton and Allied Textiles Sector Group
- iii. Small Firms: papers from DE (with DTI input), CBI and NEDO, and possibly TUC too

plus the normal below-the-line April paper from Sir John Cassels on NEDO's Budget for the new financial year.

3. We see no problem with this. Sir Peter Middleton has already seen a draft of the NEDO budget paper for a recent G4, and we will seek to check a further draft of this before the meeting.

4. I attach a draft letter to Martin Couchman. In parallel with this submission, Mr Fowler is being asked for his approval for the agenda, so you should check with his office before writing.

*Stewart Flanagan*

S J FLANAGAN

*pse type final  
for me to  
send.*

**DRAFT LETTER FROM APS/CHANCELLOR TO:**

Mr M Couchman  
Secretary to the Council  
National Economic Development Office  
Millbank Tower  
Millbank  
LONDON SW1P 4QX

**AGENDA FOR NEDC, 26 APRIL**

Thank you for your letter of 31 March. I can confirm that the Chancellor has seen, and is content with, the agenda you propose.

[M P W]



From the Secretary to the Council  
Direct Line 01-211 3486  
Personal Secretary 01-211 4320

CHEF	CHEQUER
05 APR 1988	
Mr P Wynn Owen	
CST, PMG.	
Sir P Middleton	
Mr Anson	
Mr Monck	
Mr Burgess	
Mr MacArthur	



31 March 1988

Miss Moira Wallace  
Assistant Private Secretary  
Chancellor of the Exchequer's Office  
HM Treasury  
Parliament Street  
London  
SW1Y 3AG

National Economic  
Development Office  
Millbank Tower, Millbank  
London SW1P 4QX

Telex 945059 NEDO G  
Fax 01-821 1099  
Reception 01-211 3100

*Dear Miss Wallace,*

NEDC 26 APRIL

This is the regular letter seeking the Chancellor's clearance of the April agenda.

Item 1 (Skills) will have papers from the Department of Employment (jointly with the MSC), the TUC, CBI and NEDO. Item 2 will be a Sector Group presentation from Cotton and Allied Textiles; the presenting Chairman is Mr Stuart Hollander. For item 3 (Small Firms), there will be papers from the Department of Employment, the CBI and NEDO, and possibly also the TUC. These items were agreed by the Steering Group on Council Programmes at its January meeting. As at previous April meetings there will be a 'below the line' item on NEDO's budget, with a paper from the Director General.

I should be glad if you could confirm that the Chancellor is content with the agenda.

I am copying this letter to the Private Secretary to the Secretary of State for Employment, who will be in the Chair on 26 April.

*Yours sincerely,*  
*Martin Couchman*

MARTIN COUCHMAN



*[Handwritten signature]*

Caxton House Tothill Street London SW1H 9NF  
Telephone Direct Line 01-213 5803  
Switchboard 01-213 3000

*[Handwritten signature]*

Ms Moira Wallace  
Private Secretary to the  
Chancellor of the Exchequer  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AG

11/4

CH/EXCHEQUER	
REC.	11 APR 1988
ACTION	Mr Wym Owen
COPIES TO	CST PMG
	Sr P Middleton
	Mr Anson, Mr Mauck
	Mr Bugner
	Mr MacArthur

8 April 1988

*Dear Moira*

**NEDC MEMBERSHIP**

My Secretary of State has seen the Chancellor's letter of 18 March about the appointment of Sir Bryan Nicholson to NEDC. He is content with this proposal.

I am sending copies of this letter to the private secretaries to Nicholas Ridley, Kenneth Baker and Cecil Parkinson.

*Sincerely,  
Beverley*

**BEVERLEY EVANS**  
Private Secretary

*[Handwritten initials]*



*pmg*

Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

11 April 1988

M Couchman Esq  
Secretary to the Council  
National Economic Development Office  
Millbank Tower  
Millbank  
LONDON  
SW1

cc PS/CST  
PS/PMG  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr MacAuslan  
Mr Wynn Owen  
Mr Flanagan

*Dear Mr Couchman,*

**AGENDA FOR NEDC, 26 APRIL**

Thank you for your letter of 31 March. I can confirm that the Chancellor has seen, and is content with, the agenda you propose.

*Yours sincerely,  
Moira Wallace*

MOIRA WALLACE  
Assistant Private Secretary

National Economic  
Development CouncilNEDC(88)9  
11 April 1988**SKILLS FOR THE FUTURE**

Memorandum by the Secretary of State for Employment, and the  
Chairman of the Manpower Services Commission.

Introduction

1 The background to looking at skills for the future is sustained competition from other countries. We now face global markets in most of the goods and services we produce. Success goes to whoever can produce the quality and quantity of goods and services the markets demand at prices they can afford.

2 The evidence is that the UK has responded successfully to this challenge:

- the economy has grown at an average annual rate of 3% since 1981;
- productivity has grown in the 1980s as fast as Japan and faster than all other major industrialised countries;
- the employed labour force has increased by 1½ million since 1983, the longest period of continuous growth in employment for over 30 years;
- the number of unemployed has fallen by 680,000 (seasonally adjusted) since July 1986, a faster rate of decline than in any other industrialised country.

3 The Government will maintain its economic and social policies so as to provide the framework essential for success to continue into the 1990s and beyond. But there is no room for complacency about the efforts that will be needed to match those of our overseas competitors. Britain can succeed only by developing skills and competence throughout the workforce, particularly given the challenges over the next decade and beyond of:

- demographic change (paras 4-5)
- technological change (paras 6-7)
- occupational changes (paras 8-9)

Above all, the paper highlights our need as a nation to make far more determined efforts to ensure opportunities for education, training and development continue throughout working life. The Government is ready to play its part, as is shown by the White Paper "Training for Employment" (Cm 316). A new spirit of commitment is now needed primarily by employers, but also by trade unions, individuals and training providers if we, as a nation, are to achieve the right skills for the future.

#### Demographic Change

4 Changes in the age structure of the population have profound implications for the labour market. For many years, the British economy has become accustomed to absorbing increasing numbers of people of working age. The population of working age increased by almost 2 million in the decade up to 1986; the proportion of women of working age participating in the labour market has also increased steadily and will continue to do so. The underlying situation from now till 1990 and beyond is quite different: between 1986 and 1990 a rise of under 500,000 in those of working age is expected. In the 1990s, the total will stabilise at around 34 million. Most important, the number of 16-19 year olds will fall from 3.5 million in 1986 to 2.6 million in 1994; but the fall in the numbers in the labour force in this age group is expected to be less both proportionately and in absolute terms. At the same time, the total labour force is projected to increase, albeit less rapidly than in recent years. 83% of labour force entrants between now and 1995 will be women.

5 The implications are:

- (i) many employers accustomed to hiring young people will face increasing competition in recruiting and retaining young staff. Offering young people an attractive career based on quality initial training will become increasingly important;
- (ii) many employers will find it more difficult to recruit people who have recently completed their initial vocational training. Employers will need to invest more in improving the effectiveness of those they already employ;
- iii) employers can only maintain their present level of recruitment of young people by reducing the proportion that enter further and higher education. Provision of higher level skills will then be affected;
- (iv) many employers will easily be able to obtain the skills they need only if they are prepared to remove unnecessary age and qualification barriers and also play their part in training people who have been out of the labour market for some time;

- (v) above all, the nation will need to make the best possible use of all its human resources if expansion of the economy is not to be put at risk by inflationary pressures built up by demand for labour with skills that are not available.

### Technological change

6 The impact of technological change can not be predicted with certainty. However, all sectors of the economy will be faced with opportunities for change over the next decade. Our ability to compete as a nation depends upon taking every advantage of the full range of new technologies and their capacity to generate change that reduces prices and broadens consumer choice. If we fail to take full advantage, then our international competitors will reap the benefits of the new jobs that new technologies help to create and, as we have seen all too clearly with traditional industries which failed to respond to the need for change, we may put at risk continuation of the growth in employment of the past five years.

7 The implications are:

- (i) Employers must be prepared to invest in their employees, manual workers as well as managers, so that they can acquire the skills and flexibility needed to recognise and master the opportunities offered by new technologies. Unions should encourage their members to recognise these opportunities. Individuals will need to invest in keeping their skills up to date. Education and training providers will have to adapt and keep up to date with the needs of their customers;
- (ii) many of the new jobs in the next decade will be open only to workers with the skills and qualifications needed for the new technologies, particularly at technician level and above. In many sectors of the economy, technology will continue to reduce the need for both unskilled and many semi-skilled workers;
- (iii) many of the systems and processes needed to produce goods and services will become more complex and use more capital. The demand for better trained managers and professionals able to implement change will continue to increase;
- (iv) the longer people remain unemployed and out of touch with the skills and attitudes needed in a changing job market, the harder they will find it to re-enter work unless they are given the opportunity to break through the skills barrier;
- (v) new technologies will open up new opportunities for companies and individuals to follow up training programmes at the time, place and pace of their choice. It will become easier to acquire the skills that are needed.

### Occupational change

8 Changes in demography and technology will have profound effects both for the supply of labour and the demand. Our success in coping with these challenges will in itself have longer-term implications for employment and for the mix of skills that is required. In a successful economy, manufacturing productivity continues to increase and rises in real incomes tend to be spent on purchasing services rather than goods. Employment opportunities therefore increase less rapidly in manufacturing than in the service industries such as leisure and tourism or financial and business services. A further characteristic of a successful economy is that competition provides more opportunities for small businesses and self employment.

9 These trends have been present in the British economy over the past five years and seem likely to continue. The implications are:

- (i) increased flexibility of labour will be required in order to compete successfully and make the best possible use of investment in equipment and in human resources. Employers will need both to increase the opportunities to combine work with training or with domestic responsibilities, whilst managing the risk inherent in more flexible patterns of work of loss of commitment to the enterprise;
- (ii) many individuals will have to seek employment in occupations requiring fresh initial training. Employers will have to be ready to provide help with re-training and offer opportunities for the individual to gain experience in practising skills newly acquired or learnt for a different occupation;
- (iii) the competences and aptitudes needed for an enterprise economy will become increasingly important. Personal attributes such as initiative, concern for quality and for meeting customers' needs, essential for success in self-employment or a small business will also be vital for the staff of large companies seeking to compete successfully.

### Short-term trends

10 Against this background of longer-term change, the Annex to this paper summarises the Manpower Services Commission's Skills Monitoring Report, which provides an up to date assessment of particular occupations currently most in demand, including those where employers are experiencing recruitment difficulties. The Annex suggests that the problems that will be faced over the longer-term are already beginning to be felt. The main additional points to highlight are:

- employment growth over the next five years is expected in higher level skills, most notably professional engineers -

particularly electronic and mechanical engineers, computing specialists, and experienced managers. Continued growth is also expected in the service sector and in self-employment;

- these higher level skills are currently most in demand, but there are also other imbalances between demand and supply, most notably engineering and construction craftsmen.

11 Three points need to be made about the nature of the short-term demand for skills:

- most employers reporting recruitment difficulties are seeking experienced staff, not newly qualified people. Such experience can be obtained only if employers have been prepared in the past to provide the necessary opportunities. There is always a shortage of experienced staff in a sector of the economy which is rapidly expanding.
- the demand for more people with certain higher level skills is persisting despite previous steps taken to increase supply. Policies for higher education are intended to help redress the balance.
- the demand at craft level reflects growth in construction work and expansion in manufacturing output, but stems in part from reductions in apprenticeship and other training that took place in the early 1980s, coupled with the loss to industry as firms necessarily slimmed down, of experienced craftsmen many of whom obtained jobs outside the skill in which their experience lay.

#### **THE RESPONSE REQUIRED**

12 The Government's training policies have been designed to meet the challenge of change. It initiated the task of ensuring the skills for the future by its 1981 White Paper "A New Training Initiative: A Programme for Action". Since then, it has taken decisive action to help equip young people for their working life by enabling them to acquire both vocational skills and also the personal characteristics of leadership, flexibility and adaptability needed for success:

- the introduction of the Technical and Vocational Education Initiative, now complementing more recent initiatives in secondary and other schooling and being extended in every Local Education Authority in England and Wales and every Education Authority in Scotland, shows how to improve initial education and prepare young people for working life. Some £83 million will be spent in 1988-89 helping 390,750 children between 14-18 years old;
- under the initiative announced on 7 March MSC will support 12 compacts between employers and schools in inner city areas. It will be a condition of support that,



participating employers guarantee a job with training to children meeting certain performance criteria agreed with the school. The budget for this initiative will be £3m per year for the next 4 years.

- the Youth Training Scheme has created the opportunity for all school-leavers to acquire training and vocational qualifications as the normal start to their working life. It has now been firmly established as a two year programme. £1.15 billion will be spent in 1988-89 on 384,000 trainees aged between 16-18 years old;
- the provision of work-related Non Advanced Further Education has been made more responsive to employers' needs through the three year development plans between the Manpower Services Commission and each local education authority, involving total spending by MSC of £110 million in 1988-89;
- the introduction of the Enterprise and Higher Education programme will help to develop graduates with the aptitudes, competences and knowledge needed by industry and commerce. It complements the Government's policies designed to ensure that further and higher education provision takes full account of employers' needs;

13 With these developments, young people now have within their grasp the opportunity to secure the skills they need for the future. With the initiatives set out in the recent White Paper 'Training for Employment' (Cm 316), the Government is tackling the challenge of ensuring that the unemployed, particularly the longer term unemployed, can also take full advantage of continuing growth in our economy and in the number of jobs. Central to our strategy for the unemployed is the Employment Training programme, which will cover some 600,000 people per year at a cost to Government of £1.4 billion, and aims:

- to give longer term unemployed people the skills they need to get and keep jobs;
- to meet the Government's guarantee of an opportunity to those aged 18 to 24 who have been unemployed for between six and 12 months and the Government's aim of making available opportunities to all those aged 18 to 50 unemployed for more than two years.

The new programme is designed:

- to provide a broad range of training - from motivation, rehabilitation and very basic skills to the skills needed in high technology industries and including skills needed to start up and run a small business;
- to encourage employers to play a much greater part in the training of the country's adult workforce;

- to encourage individuals to take a much greater interest in their own development.

It will make a major investment in the motivation, adaptability and skills of longer term unemployed people and thus improve our human resources.

14 The Government has also helped in a number of other ways to improve investment in people. It is concerned to:

- train those considering starting up in business or recently established;
- help small firms identify and meet their skill needs;
- improve data on skills demand and supply and information on training opportunities so as to help employers and individuals make better decisions;
- improve the relevance and quality of training, and has established the National Council for Vocational Qualifications to develop framework for vocational qualifications, and has started-up links between employers and training providers at local and national level;
- make training more easily accessible;
- explain and promote the importance of investment in skills.

15 The Government will continue to review how its massive investment of £2.6 billion in training can be put to the best effect. The new Training Commission, which replaces the Manpower Services Commission, will have a vital role to play. The objective, and the nation's need, is clear: to achieve investment in training through life. Success depends upon achieving whole hearted commitment to achieving the necessary investment.

16 Employers bear the key responsibility because they alone have the knowledge and ability to invest in the skills of the people they employ. It is crucial for employers to take a long-term view of their manpower needs and:

- be ready to help prepare young people at the start of their working life, taking full advantage of the opportunities presented by the Youth Training Scheme and for links with education system;
- develop strategies to continue their employees' development after initial training, to widen and deepen their experience and equip them with necessary specialist skills;
- develop opportunities for those who have been out of work, including women who wish to return to work, and for those wishing to change jobs; and

- play a full role in developing the relevance and responsiveness of vocational education and training provision.

17 Employers and, where appropriate, trade unions also need to recognise the need to encourage individuals to acquire the skills for the future by reforming inflexible pay arrangements, ending inefficient working practices and avoiding excessive and unwarranted pay increases.

18 Trade unions also have a key role to play in explaining to their members the importance of investing in new skills, including the flexibility that change demands. Trade unions can also help to end restrictive working practices and attitudes which may deny opportunities to unemployed people who learn new skills.

19 The response needed from individuals is also crucial: unless they recognise the need to train through life and to adapt to change, success will not be possible.

### Conclusion

20 We face rapid and continuing change. The challenges can be met only if people's potential is developed to the full. The most important skill for the future is for employers, managers and individuals to learn how to train through life.

21 The Government has taken important steps to prepare the ground for success. Employers and individuals - who benefit from continued growth and prosperity - must now respond.

Department of Employment  
Caxton House  
Tothill Street  
LONDON  
SW1H 9NF

## ANNEX

### SKILLS MONITORING REPORT FEBRUARY 1988

1 The most recent Skills Monitoring Report published by the MSC in February 1988, reports findings from the CBI's Quarterly Industrial Trends Survey and the 1987 annual CBI/MSC Special Survey of Skill Shortages in Manufacturing Industry and a number of other sources. According to the Report recruitment difficulties faced by employers increased significantly during 1987, in line with the exceptional growth in output over the year.

2 For manufacturing industry the CBI's Quarterly Survey showed that the proportion of respondents to the survey expecting skill shortages to limit output increased from a weighted 9% of respondents in January 1987 to 19% in January 1988 (Fig 1). The annual CBI/MSC survey reported a comparable increase, from 19% of respondents in September 1986 to 34% in November 1987. The higher figures in the annual survey reflect the skills focus of this survey and the likelihood that the response to the annual survey, which is lower than the response to the quarterly survey is more biased towards those experiencing skill shortages. The levels of shortages reported in the Quarterly Survey, the more accurate guide, remain less serious than in the 1960s and 1970s.

3 Relatively few respondents to the annual CBI/MSC survey believe that the skill shortages had a severe effect on output, though the majority of those affected thought that the constraint on output was significant. Over 90% of those affected by the most common shortages had difficulties in recruiting experienced staff (Fig 2).

4 Employers appear to have increasing difficulties in recruiting enough professional engineers, particularly electronic engineers, but also mechanical and production engineers. A weighted 14% of respondents to the annual CBI/MSC survey reported that shortages of professional engineers had limited output over the previous four months. Although most require experienced engineers, nearly 60% of those experiencing shortages have also difficulties in recruiting enough newly qualified graduates.

5 Other higher level staff in demand include managers, specialist computing staff and accountants. Reflecting this demand, salaries and remuneration for some accounting occupations appear to have risen considerably in 1987, whereas increases in salaries for computing staff did not appear to be greatly in excess of average increases for all occupations. As with professional engineers, there appears to be an unmet demand for inexperienced recruits to managerial and computing jobs in manufacturing industry, in addition to the more widespread need for experienced people.

6 At craft level, employers continue to report difficulties in obtaining enough experienced engineering machinists, mechanics and welders, though a majority of those experiencing difficulties in recruiting welders believe the effect on output is minor.

Relatively few employers appear to have problems in finding inexperienced recruits for craft occupations, in contrast with some higher level occupations.

7 According to the annual CBI/MSC survey, nearly all respondents experiencing shortages believe that the difficulties are related to an unavailability of labour. Pay and conditions are thought relevant by over 60% of those with shortages of computing staff and by nearly 40% of those with shortages of professional engineers. Shortages of welders and mechanics are believed not to be related to pay and conditions by a majority of respondents affected by them.

8 Most respondents to the CBI/MSC survey reporting shortages are attempting additional recruitment. Fewer than a quarter of those experiencing any of the main shortages retrain existing staff, except in the case of managerial shortages, where nearly 70% report training as a response. A large proportion recruit at a lower level and retrain, particularly for craft shortages. Of respondents reporting shortages of computing staff, relatively few train existing staff (11% weighted), or recruit at a lower level and retrain (21%).

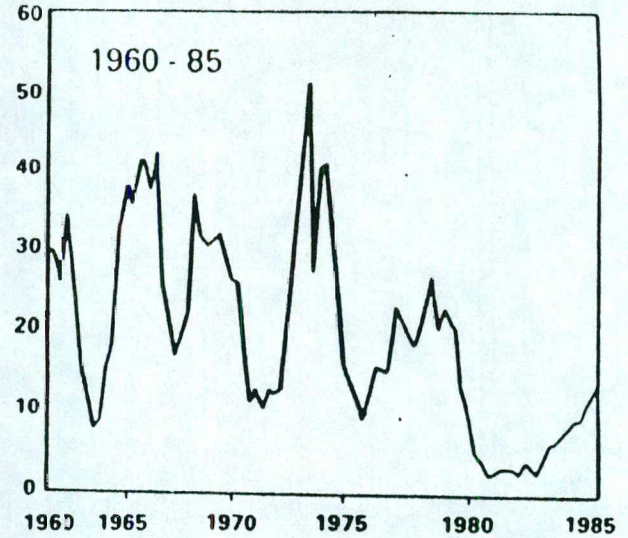
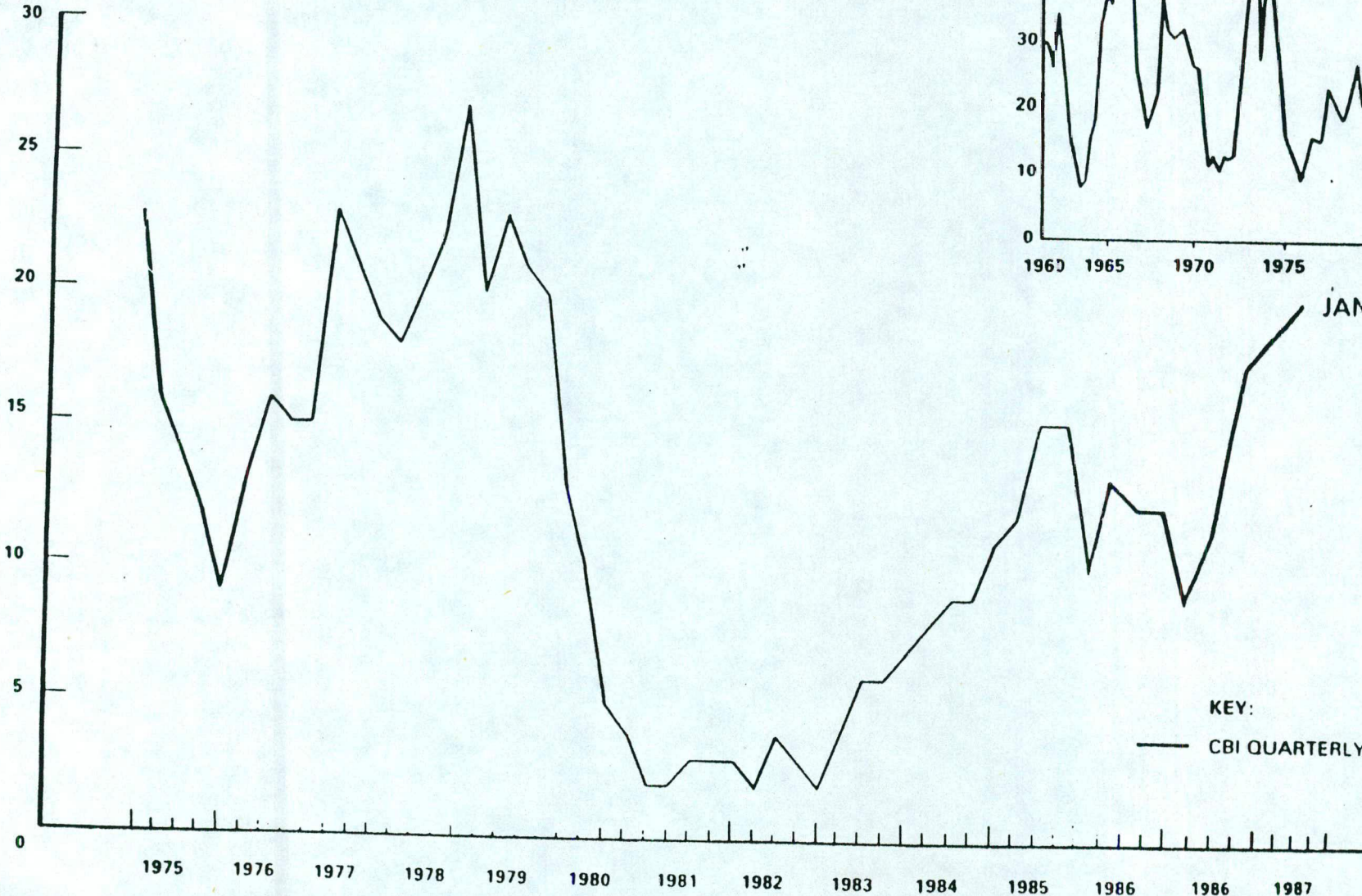
9 Reports of recruitment difficulties in the construction industry increased during most of 1987, probably reflecting the exceptional growth in UK construction output during the year, estimated by NEDO to have been the highest among leading European industrial nations. According to the Building Employers Confederation skilled bricklayers, carpenters and joiners and plasterers are most in demand. The most serious recruitment difficulties in the construction industry, previously confined to the South-East, appeared to be spreading to most parts of the country during 1987.

10 The Skills Monitoring Report also notes the findings of a survey of recruitment and retention in local authorities. This survey finds that no local authority reported any general recruitment difficulties, although nearly three quarters of responding authorities had trouble recruiting to particular occupations. Only 1.7% of local authority employment was covered by these difficulties. Neither did the survey find any serious overall retention problems facing local government, though some authorities in London and the South-East are reported to have above average retention problems which were limited and specific to the same occupations for which there were recruitment problems.

FIG 1

# CBI SURVEY: PERCENTAGE OF FIRMS EXPECTING SKILLED LABOUR TO ACT AS A CONSTRAINT ON OUTPUT

PERCENT



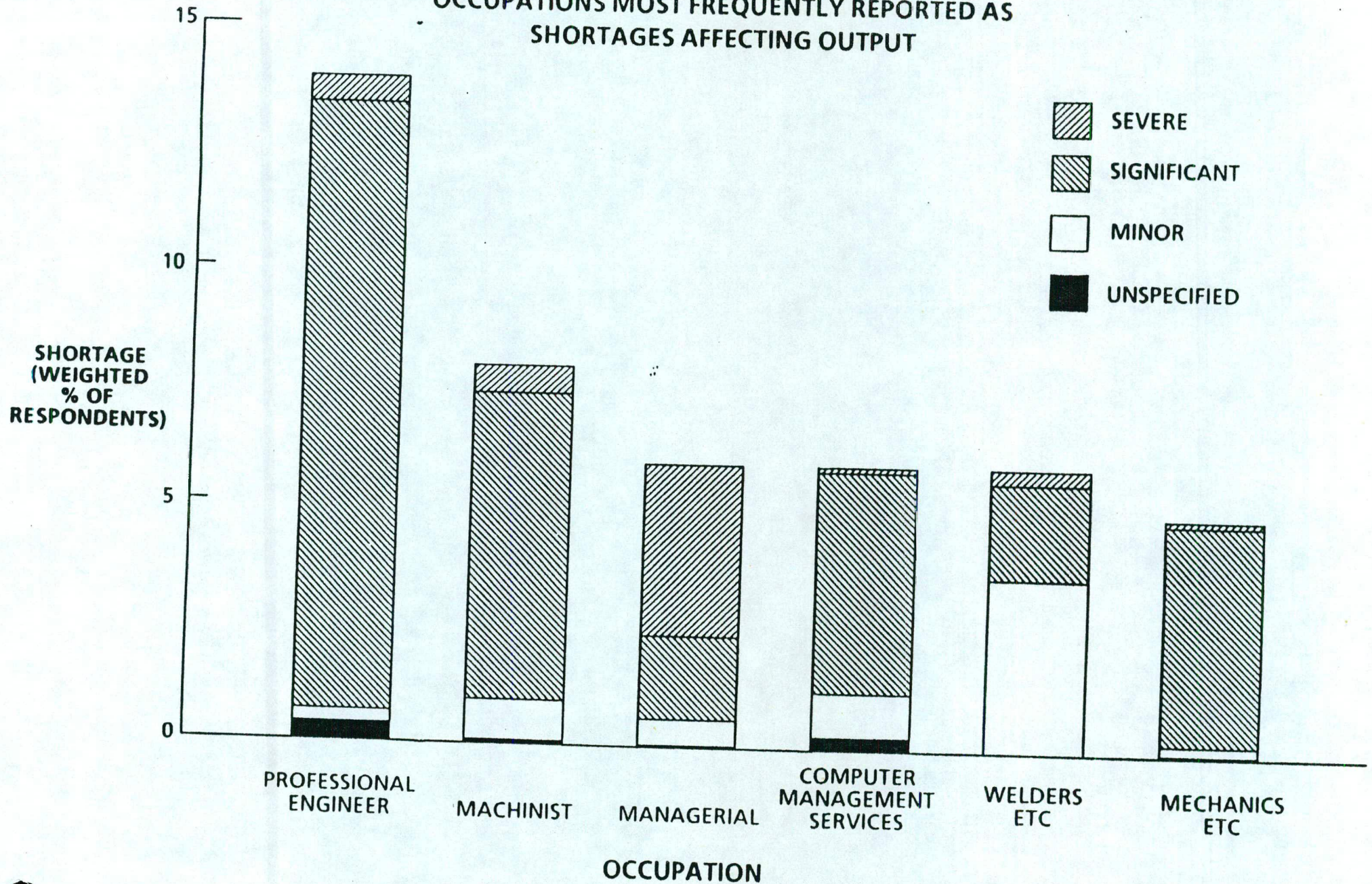
JAN 1988

KEY:  
— CBI QUARTERLY SURVEY

NOTE The CBI survey is carried out quarterly in January, April, July and October

FIG 2

### OCCUPATIONS MOST FREQUENTLY REPORTED AS SHORTAGES AFFECTING OUTPUT





## ENCOURAGING THE SMALL FIRMS SECTOR

## MEMORANDUM BY THE DEPARTMENT OF EMPLOYMENT

Importance of small firms

The contribution of small businesses to the UK economy is now well established. Small firms bring competition, innovation and a large share of new jobs created. But the Bolton Report (1971) drew attention to the small size of the British small firms sector relative to our overseas competitors. Since 1979 it has been the Government's aim to create the economic conditions in which more people would set up businesses and in which businesses that are established can grow.

2 The result of the encouragement given to individual enterprise and the strengthening economy has been a substantial increase in the number of small businesses. Between 1979 and 1986, the number of businesses registered for VAT grew from 1.29m to 1.47m. This represents an increase, on average, of 500 per week. And this growth in the small business sector has been reflected in all parts of the UK. The number of self employed people, which fell between 1971 and 1979, has increased from 1.9 million in 1979 to 2.9 million in 1987. Between 1982 and 1984, very small businesses employing less than 20 people are estimated to have created 1 million additional jobs, while larger firms shed jobs overall.

3 It seems likely that these trends will continue. The service sector, in which small firms are heavily represented, continues to grow. And although the increase in self employment since 1979 has been rapid, some groups are still under-represented in it. In particular, whilst the number of self employed women has recently been growing rapidly, they still represent only 25% of all self employed (46% of all employees in employment are women). Moreover, increasing numbers of people are choosing part time employment for which the flexibility of small firms is well suited.

Government role

4 The main contribution the Government can make to the development of small firms (and business generally) is to create an economic climate which stimulates individual initiative and enterprise. That we will continue to do. But small firms are not simply scaled down large firms - they lack many of the specialised skills that a large firm can call upon. All the problems land up on the same desk - that of the proprietor - who therefore needs a



wider range of skills than a large firm's manager. In addition, markets do not always operate perfectly in the case of small firms. The Government therefore also provides direct assistance to them, the aim of which is not to give small firms an advantage over larger ones but to take account of the specific problems created for them by failure of the market to operate efficiently.

5 The Government does not see itself as the only source of assistance for small firms. Many large businesses support them through local enterprise agencies and in other ways. In the educational sector, universities and polytechnics have developed links with small firms directly or through local support networks. In addition large firms have a direct commercial interest in the improvement of the performance of small firms who are their suppliers or subcontractors and this is reflected in their commercial practices. Accountants, banks and other professionals have seen the potential value of growing small firms as clients and seek them out with special schemes to attract them.

6 The Council might, in the light of the discussion in the following sections:

- note the substantial assistance provided by the public and private sectors to small firms.
- consider what the constraints are on the further growth of the small firms sector and how best they might be removed where they operate to the detriment of the market;
- consider how established businesses should be helped by making the markets work better to create wealth and employment;

## **ASSISTANCE TO SMALL FIRMS**

### Advice, counselling and consultancy

7 There are many sources of this type of practical advice available to small firms. Chambers of Commerce and Trade are able to offer comprehensive services to their members ranging from advice on planning issues to exports. Small firms organisations and trade associations have expanded the facilities they can make available and banks and accountants frequently provide advice to small firms. And there have now been several initiatives by professional bodies such as the Institute of Marketing and the Institute of Chartered Accountants to provide assistance through seminars, videos and other media.

8 The private sector commitment to encouraging local economic development is also reflected in its support for local enterprise agencies. Local enterprise agencies offer a broad range of services - advice, managed workshops, training - to small businesses. Whilst the public sector both nationally and locally has made available some financial support to LEAs, they are principally reliant on the private sector for their resources. The LEA movement has grown strongly in recent years and there are

now some 400 in the UK.

9 In addition to these sources of support for new and growing businesses, the Government believes that there is a need for a source of information, advice and counselling that cannot always easily be met by the private sector. The Small Firms Service, with its 300 experienced counsellors, dealt with 280,000 enquiries in 1987 and provided 38,000 counselling sessions. Demand for the SFS and the Business Development Service (which helps businesses that are beyond the start-up stage and wish to grow further) continues to increase. All information is given free of charge to enquiries on the Service's Freefone Enterprise facility either directly while the telephone caller is on the line or via leaflets and other printed matter through the post. The first three counselling sessions are given free of charge to the business and a modest charge is made for fourth and any subsequent sessions. The Service is currently organised on the basis of ten Regional Small Firms Centres in England, one in Wales and two in Scotland. The speed and efficiency of response from the Service is facilitated by the use of a computer database of local and national information together with a computerised appointment booking system.

10 The Department of Trade and Industry's Enterprise Initiative aims to encourage small and medium sized firms to use consultancy services to improve their efficiency in a number of key areas - quality, design, marketing, manufacturing systems, business planning and financial and information systems. The initiative complements the services provided by the Department of Employment by advising in depth on specific management functions in firms that have developed beyond the stage of requiring basic counselling. It recognises that many small and medium sized firms have the potential to expand but do not know how to go about it or lack the necessary skills. The ultimate objective is to see small firms, where necessary, making use of outside professional expertise for themselves without turning to DTI for help. The response has been encouraging - at the end of March more than 2,500 applications from small and medium-sized firms had been received for the consultancy initiatives alone and more than 1,000 Business Reviews completed.

11 Between the public and private sectors a large amount of advice, much of it free or subsidised, is easily accessible to small businesses in all parts of the country. The Council might wish to consider how best small firms can be made aware of appropriate sources of advice.

### Training

12 It is a characteristic of the small firms sector that there is a high level of turnover of businesses. Not all the businesses that cease trading do so because they have failed; and there are those who argue that a high level of turnover of small firms can be evidence of a vigorous economy. The failure rate of small businesses could, however, be reduced if there were greater emphasis on acquisition of management skills by those running small businesses.

13 Much of the assistance described in the preceding section can help people in business to understand how it operates and to run it better. Many entrepreneurs will learn best through advice and counselling linked to their own business. Nevertheless, there is a place for more formal training in business skills, for start-up businesses, established firms and those seeking to grow. Business training can be obtained through full-time courses, in packages tailored to the times when small businesses can take advantage of it, or through distance learning. The Manpower Services Commission supports much training of this kind.

14 Small firms are encouraged by counsellors and advisers to take advantage of the training that is available and in some cases training is linked to the availability of finance or other assistance. It remains, however, the position that only a small proportion of those running businesses have received training in the skills required. And both large and small firms continue to report skill shortages as an obstacle to growth. The Council might discuss how more small businesses can be persuaded to make use of training, for owner/managers themselves and their employees. What are the implications of continued low levels of training for the management skills of businesses and of technical skills of their employees? How can the problem best be tackled?

#### Finance

15 Obtaining the right type of finance at the right time is a frequent problem for small firms. The UK is, however, well served by a network of banks with a long history of providing loan finance to businesses of all sizes; and there have been dramatic improvements in the availability of equity capital for small firms in recent years. There has been a forty fold increase between 1979 and 1985 in venture capital invested in the UK and such investment is now higher in the UK as a percentage of GDP than in the US. The Loan Guarantee Scheme and the Business Expansion Scheme (targetted more to small firms since the Budget) have both helped increase the supply of finance for small businesses. Support is also available from DTI for firms which meet the criteria for regional selective financial assistance. The range of financial support on offer has been extended from 1 April by the introduction of the Regional Enterprise Grants Scheme aimed specifically at helping businesses in Development Areas with less than 25 employees to expand and diversify. Grants are available under the Scheme covering part of the cost of new capital investment (up to £15,000) and part of the cost of innovation projects (up to £25,000).

16 The major factors affecting the supply of finance for small firms are the risks investors anticipate in this area and the return they foresee on their investments. The improvement in the climate for businesses generally and the strength of the small business sector have made this an attractive sector for investors.

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supply of venture capital is also believed by some people to be unbalanced regionally. Young people may have particular difficulty in securing finance because they lack experience, security and a track record. All these are legitimate factors for banks to take into account but they may be disproportionately averse to lending to young people. The inner cities, too, have not been regarded for some time as attractive areas for investment.

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#### Deregulation

22 A significant problem for the self employed (and larger businesses) has been the burden of requirements imposed upon them by government and others. The Government's aim is to simplify those regulations which are necessary and get rid of those which are not. That helps all firms but it is particularly relevant to small businesses because compliance costs are relatively higher for small businesses which lack both resources and expertise in handling bureaucracy. Similarly, regulatory requirements and regimes can create barriers to entry into markets by small businesses at the time when they can least afford the time and costs of compliance.

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#### Conclusion

25 The small firms sector has become a flourishing part of the UK economy. It is in the commercial interest of large firms, of those such as banks and accountants providing business services, and also of people seeking jobs that this trend should continue. The Government also has a part to play in establishing an economic climate that is conducive to small firms. A strong small firms sector will benefit all aspects of the UK economy.

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## ENCOURAGING THE SMALL FIRMS SECTOR

## MEMORANDUM BY THE DEPARTMENT OF EMPLOYMENT

Importance of small firms

The contribution of small businesses to the UK economy is now well established. Small firms bring competition, innovation and a large share of new jobs created. But the Bolton Report (1971) drew attention to the small size of the British small firms sector relative to our overseas competitors. Since 1979 it has been the Government's aim to create the economic conditions in which more people would set up businesses and in which businesses that are established can grow.

2 The result of the encouragement given to individual enterprise and the strengthening economy has been a substantial increase in the number of small businesses. Between 1979 and 1986, the number of businesses registered for VAT grew from 1.29m to 1.47m. This represents an increase, on average, of 500 per week. And this growth in the small business sector has been reflected in all parts of the UK. The number of self employed people, which fell between 1971 and 1979, has increased from 1.9 million in 1979 to 2.9 million in 1987. Between 1982 and 1984, very small businesses employing less than 20 people are estimated to have created 1 million additional jobs, while larger firms shed jobs overall.

3 It seems likely that these trends will continue. The service sector, in which small firms are heavily represented, continues to grow. And although the increase in self employment since 1979 has been rapid, some groups are still under-represented in it. In particular, whilst the number of self employed women has recently been growing rapidly, they still represent only 25% of all self employed (46% of all employees in employment are women). Moreover, increasing numbers of people are choosing part time employment for which the flexibility of small firms is well suited.

Government role

4 The main contribution the Government can make to the development of small firms (and business generally) is to create an economic climate which stimulates individual initiative and enterprise. That we will continue to do. But small firms are not simply scaled down large firms - they lack many of the specialised skills that a large firm can call upon. All the problems land up on the same desk - that of the proprietor - who therefore needs a

wider range of skills than a large firm's manager. In addition, markets do not always operate perfectly in the case of small firms. The Government therefore also provides direct assistance to them, the aim of which is not to give small firms an advantage over larger ones but to take account of the specific problems created for them by failure of the market to operate efficiently.

5 The Government does not see itself as the only source of assistance for small firms. Many large businesses support them through local enterprise agencies and in other ways. In the educational sector, universities and polytechnics have developed links with small firms directly or through local support networks. In addition large firms have a direct commercial interest in the improvement of the performance of small firms who are their suppliers or subcontractors and this is reflected in their commercial practices. Accountants, banks and other professionals have seen the potential value of growing small firms as clients and seek them out with special schemes to attract them.

6 The Council might, in the light of the discussion in the following sections:

- note the substantial assistance provided by the public and private sectors to small firms.
- consider what the constraints are on the further growth of the small firms sector and how best they might be removed where they operate to the detriment of the market;
- consider how established businesses should be helped by making the markets work better to create wealth and employment;

## ASSISTANCE TO SMALL FIRMS

### Advice, counselling and consultancy

7 There are many sources of this type of practical advice available to small firms. Chambers of Commerce and Trade are able to offer comprehensive services to their members ranging from advice on planning issues to exports. Small firms organisations and trade associations have expanded the facilities they can make available and banks and accountants frequently provide advice to small firms. And there have now been several initiatives by professional bodies such as the Institute of Marketing and the Institute of Chartered Accountants to provide assistance through seminars, videos and other media.

8 The private sector commitment to encouraging local economic development is also reflected in its support for local enterprise agencies. Local enterprise agencies offer a broad range of services - advice, managed workshops, training - to small businesses. Whilst the public sector both nationally and locally has made available some financial support to LEAs, they are principally reliant on the private sector for their resources. The LEA movement has grown strongly in recent years and there are

now some 400 in the UK.

9 In addition to these sources of support for new and growing businesses, the Government believes that there is a need for a source of information, advice and counselling that cannot always easily be met by the private sector. The Small Firms Service, with its 300 experienced counsellors, dealt with 280,000 enquiries in 1987 and provided 38,000 counselling sessions. Demand for the SFS and the Business Development Service (which helps businesses that are beyond the start-up stage and wish to grow further) continues to increase. All information is given free of charge to enquiries on the Service's Freefone Enterprise facility either directly while the telephone caller is on the line or via leaflets and other printed matter through the post. The first three counselling sessions are given free of charge to the business and a modest charge is made for fourth and any subsequent sessions. The Service is currently organised on the basis of ten Regional Small Firms Centres in England, one in Wales and two in Scotland. The speed and efficiency of response from the Service is facilitated by the use of a computer database of local and national information together with a computerised appointment booking system.

10 The Department of Trade and Industry's Enterprise Initiative aims to encourage small and medium sized firms to use consultancy services to improve their efficiency in a number of key areas - quality, design, marketing, manufacturing systems, business planning and financial and information systems. The initiative complements the services provided by the Department of Employment by advising in depth on specific management functions in firms that have developed beyond the stage of requiring basic counselling. It recognises that many small and medium sized firms have the potential to expand but do not know how to go about it or lack the necessary skills. The ultimate objective is to see small firms, where necessary, making use of outside professional expertise for themselves without turning to DTI for help. The response has been encouraging - at the end of March more than 2,500 applications from small and medium-sized firms had been received for the consultancy initiatives alone and more than 1,000 Business Reviews completed.

11 Between the public and private sectors a large amount of advice, much of it free or subsidised, is easily accessible to small businesses in all parts of the country. The Council might wish to consider how best small firms can be made aware of appropriate sources of advice.

### Training

12 It is a characteristic of the small firms sector that there is a high level of turnover of businesses. Not all the businesses that cease trading do so because they have failed; and there are those who argue that a high level of turnover of small firms can be evidence of a vigorous economy. The failure rate of small businesses could, however, be reduced if there were greater emphasis on acquisition of management skills by those running small businesses.



13 Much of the assistance described in the preceding section can help people in business to understand how it operates and to run it better. Many entrepreneurs will learn best through advice and counselling linked to their own business. Nevertheless, there is a place for more formal training in business skills, for start-up businesses, established firms and those seeking to grow. Business training can be obtained through full-time courses, in packages tailored to the times when small businesses can take advantage of it, or through distance learning. The Manpower Services Commission supports much training of this kind.

14 Small firms are encouraged by counsellors and advisers to take advantage of the training that is available and in some cases training is linked to the availability of finance or other assistance. It remains, however, the position that only a small proportion of those running businesses have received training in the skills required. And both large and small firms continue to report skill shortages as an obstacle to growth. The Council might discuss how more small businesses can be persuaded to make use of training, for owner/managers themselves and their employees. What are the implications of continued low levels of training for the management skills of businesses and of technical skills of their employees? How can the problem best be tackled?

#### Finance

15 Obtaining the right type of finance at the right time is a frequent problem for small firms. The UK is, however, well served by a network of banks with a long history of providing loan finance to businesses of all sizes; and there have been dramatic improvements in the availability of equity capital for small firms in recent years. There has been a forty fold increase between 1979 and 1985 in venture capital invested in the UK and such investment is now higher in the UK as a percentage of GDP than in the US. The Loan Guarantee Scheme and the Business Expansion Scheme (targetted more to small firms since the Budget) have both helped increase the supply of finance for small businesses. Support is also available from DTI for firms which meet the criteria for regional selective financial assistance. The range of financial support on offer has been extended from 1 April by the introduction of the Regional Enterprise Grants Scheme aimed specifically at helping businesses in Development Areas with less than 25 employees to expand and diversify. Grants are available under the Scheme covering part of the cost of new capital investment (up to £15,000) and part of the cost of innovation projects (up to £25,000).

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NEDC(88)9  
11 April 1988

## SKILLS FOR THE FUTURE

Memorandum by the Secretary of State for Employment, and the  
Chairman of the Manpower Services Commission.

### Introduction

1 The background to looking at skills for the future is sustained competition from other countries. We now face global markets in most of the goods and services we produce. Success goes to whoever can produce the quality and quantity of goods and services the markets demand at prices they can afford.

2 The evidence is that the UK has responded successfully to this challenge:

- the economy has grown at an average annual rate of 3% since 1981;
- productivity has grown in the 1980s as fast as Japan and faster than all other major industrialised countries;
- the employed labour force has increased by 1½ million since 1983, the longest period of continuous growth in employment for over 30 years;
- the number of unemployed has fallen by 680,000 (seasonally adjusted) since July 1986, a faster rate of decline than in any other industrialised country.

3 The Government will maintain its economic and social policies so as to provide the framework essential for success to continue into the 1990s and beyond. But there is no room for complacency about the efforts that will be needed to match those of our overseas competitors. Britain can succeed only by developing skills and competence throughout the workforce, particularly given the challenges over the next decade and beyond of:

- demographic change (paras 4-5)
- technological change (paras 6-7)
- occupational changes (paras 8-9)

Above all, the paper highlights our need as a nation to make far more determined efforts to ensure opportunities for education, training and development continue throughout working life. The Government is ready to play its part, as is shown by the White Paper "Training for Employment" (Cm 316). A new spirit of commitment is now needed primarily by employers, but also by trade unions, individuals and training providers if we, as a nation, are to achieve the right skills for the future.

#### Demographic Change

4 Changes in the age structure of the population have profound implications for the labour market. For many years, the British economy has become accustomed to absorbing increasing numbers of people of working age. The population of working age increased by almost 2 million in the decade up to 1986; the proportion of women of working age participating in the labour market has also increased steadily and will continue to do so. The underlying situation from now till 1990 and beyond is quite different: between 1986 and 1990 a rise of under 500,000 in those of working age is expected. In the 1990s, the total will stabilise at around 34 million. Most important, the number of 16-19 year olds will fall from 3.5 million in 1986 to 2.6 million in 1994; but the fall in the numbers in the labour force in this age group is expected to be less both proportionately and in absolute terms. At the same time, the total labour force is projected to increase, albeit less rapidly than in recent years. 83% of labour force entrants between now and 1995 will be women.

5 The implications are:

- (i) many employers accustomed to hiring young people will face increasing competition in recruiting and retaining young staff. Offering young people an attractive career based on quality initial training will become increasingly important;
- (ii) many employers will find it more difficult to recruit people who have recently completed their initial vocational training. Employers will need to invest more in improving the effectiveness of those they already employ;
- iii) employers can only maintain their present level of recruitment of young people by reducing the proportion that enter further and higher education. Provision of higher level skills will then be affected;
- (iv) many employers will easily be able to obtain the skills they need only if they are prepared to remove unnecessary age and qualification barriers and also play their part in training people who have been out of the labour market for some time;

- (v) above all, the nation will need to make the best possible use of all its human resources if expansion of the economy is not to be put at risk by inflationary pressures built up by demand for labour with skills that are not available.

### Technological change

6 The impact of technological change can not be predicted with certainty. However, all sectors of the economy will be faced with opportunities for change over the next decade. Our ability to compete as a nation depends upon taking every advantage of the full range of new technologies and their capacity to generate change that reduces prices and broadens consumer choice. If we fail to take full advantage, then our international competitors will reap the benefits of the new jobs that new technologies help to create and, as we have seen all too clearly with traditional industries which failed to respond to the need for change, we may put at risk continuation of the growth in employment of the past five years.

7 The implications are:

- (i) Employers must be prepared to invest in their employees, manual workers as well as managers, so that they can acquire the skills and flexibility needed to recognise and master the opportunities offered by new technologies. Unions should encourage their members to recognise these opportunities. Individuals will need to invest in keeping their skills up to date. Education and training providers will have to adapt and keep up to date with the needs of their customers;
- (ii) many of the new jobs in the next decade will be open only to workers with the skills and qualifications needed for the new technologies, particularly at technician level and above. In many sectors of the economy, technology will continue to reduce the need for both unskilled and many semi-skilled workers;
- (iii) many of the systems and processes needed to produce goods and services will become more complex and use more capital. The demand for better trained managers and professionals able to implement change will continue to increase;
- (iv) the longer people remain unemployed and out of touch with the skills and attitudes needed in a changing job market, the harder they will find it to re-enter work unless they are given the opportunity to break through the skills barrier;
- (v) new technologies will open up new opportunities for companies and individuals to follow up training programmes at the time, place and pace of their choice. It will become easier to acquire the skills that are needed.

### Occupational change

8 Changes in demography and technology will have profound effects both for the supply of labour and the demand. Our success in coping with these challenges will in itself have longer-term implications for employment and for the mix of skills that is required. In a successful economy, manufacturing productivity continues to increase and rises in real incomes tend to be spent on purchasing services rather than goods. Employment opportunities therefore increase less rapidly in manufacturing than in the service industries such as leisure and tourism or financial and business services. A further characteristic of a successful economy is that competition provides more opportunities for small businesses and self employment.

9 These trends have been present in the British economy over the past five years and seem likely to continue. The implications are:

- (i) increased flexibility of labour will be required in order to compete successfully and make the best possible use of investment in equipment and in human resources. Employers will need both to increase the opportunities to combine work with training or with domestic responsibilities, whilst managing the risk inherent in more flexible patterns of work of loss of commitment to the enterprise;
- (ii) many individuals will have to seek employment in occupations requiring fresh initial training. Employers will have to be ready to provide help with re-training and offer opportunities for the individual to gain experience in practising skills newly acquired or learnt for a different occupation;
- (iii) the competences and aptitudes needed for an enterprise economy will become increasingly important. Personal attributes such as initiative, concern for quality and for meeting customers' needs, essential for success in self-employment or a small business will also be vital for the staff of large companies seeking to compete successfully.

### Short-term trends

10 Against this background of longer-term change, the Annex to this paper summarises the Manpower Services Commission's Skills Monitoring Report, which provides an up to date assessment of particular occupations currently most in demand, including those where employers are experiencing recruitment difficulties. The Annex suggests that the problems that will be faced over the longer-term are already beginning to be felt. The main additional points to highlight are:

- employment growth over the next five years is expected in higher level skills, most notably professional engineers -

particularly electronic and mechanical engineers, computing specialists, and experienced managers. Continued growth is also expected in the service sector and in self-employment;

- these higher level skills are currently most in demand, but there are also other imbalances between demand and supply, most notably engineering and construction craftsmen.

11 Three points need to be made about the nature of the short-term demand for skills:

- most employers reporting recruitment difficulties are seeking experienced staff, not newly qualified people. Such experience can be obtained only if employers have been prepared in the past to provide the necessary opportunities. There is always a shortage of experienced staff in a sector of the economy which is rapidly expanding.
- the demand for more people with certain higher level skills is persisting despite previous steps taken to increase supply. Policies for higher education are intended to help redress the balance.
- the demand at craft level reflects growth in construction work and expansion in manufacturing output, but stems in part from reductions in apprenticeship and other training that took place in the early 1980s, coupled with the loss to industry as firms necessarily slimmed down, of experienced craftsmen many of whom obtained jobs outside the skill in which their experience lay.

#### **THE RESPONSE REQUIRED**

12 The Government's training policies have been designed to meet the challenge of change. It initiated the task of ensuring the skills for the future by its 1981 White Paper "A New Training Initiative: A Programme for Action". Since then, it has taken decisive action to help equip young people for their working life by enabling them to acquire both vocational skills and also the personal characteristics of leadership, flexibility and adaptability needed for success:

- the introduction of the Technical and Vocational Education Initiative, now complementing more recent initiatives in secondary and other schooling and being extended in every Local Education Authority in England and Wales and every Education Authority in Scotland, shows how to improve initial education and prepare young people for working life. Some £83 million will be spent in 1988-89 helping 390,750 children between 14-18 years old;
- under the initiative announced on 7 March MSC will support 12 compacts between employers and schools in inner city areas. It will be a condition of support that,



participating employers guarantee a job with training to children meeting certain performance criteria agreed with the school. The budget for this initiative will be £3m per year for the next 4 years.

- the Youth Training Scheme has created the opportunity for all school-leavers to acquire training and vocational qualifications as the normal start to their working life. It has now been firmly established as a two year programme. £1.15 billion will be spent in 1988-89 on 384,000 trainees aged between 16-18 years old;
- the provision of work-related Non Advanced Further Education has been made more responsive to employers' needs through the three year development plans between the Manpower Services Commission and each local education authority, involving total spending by MSC of £110 million in 1988-89;
- the introduction of the Enterprise and Higher Education programme will help to develop graduates with the aptitudes, competences and knowledge needed by industry and commerce. It complements the Government's policies designed to ensure that further and higher education provision takes full account of employers' needs;

13 With these developments, young people now have within their grasp the opportunity to secure the skills they need for the future. With the initiatives set out in the recent White Paper 'Training for Employment' (Cm 316), the Government is tackling the challenge of ensuring that the unemployed, particularly the longer term unemployed, can also take full advantage of continuing growth in our economy and in the number of jobs. Central to our strategy for the unemployed is the Employment Training programme, which will cover some 600,000 people per year at a cost to Government of £1.4 billion, and aims:

- to give longer term unemployed people the skills they need to get and keep jobs;
- to meet the Government's guarantee of an opportunity to those aged 18 to 24 who have been unemployed for between six and 12 months and the Government's aim of making available opportunities to all those aged 18 to 50 unemployed for more than two years.

The new programme is designed:

- to provide a broad range of training - from motivation, rehabilitation and very basic skills to the skills needed in high technology industries and including skills needed to start up and run a small business;
- to encourage employers to play a much greater part in the training of the country's adult workforce;

- to encourage individuals to take a much greater interest in their own development.

It will make a major investment in the motivation, adaptability and skills of longer term unemployed people and thus improve our human resources.

14 The Government has also helped in a number of other ways to improve investment in people. It is concerned to:

- train those considering starting up in business or recently established;
- help small firms identify and meet their skill needs;
- improve data on skills demand and supply and information on training opportunities so as to help employers and individuals make better decisions;
- improve the relevance and quality of training, and has established the National Council for Vocational Qualifications to develop framework for vocational qualifications, and has started-up links between employers and training providers at local and national level;
- make training more easily accessible;
- explain and promote the importance of investment in skills.

15 The Government will continue to review how its massive investment of £2.6 billion in training can be put to the best effect. The new Training Commission, which replaces the Manpower Services Commission, will have a vital role to play. The objective, and the nation's need, is clear: to achieve investment in training through life. Success depends upon achieving whole hearted commitment to achieving the necessary investment.

16 Employers bear the key responsibility because they alone have the knowledge and ability to invest in the skills of the people they employ. It is crucial for employers to take a long-term view of their manpower needs and:

- be ready to help prepare young people at the start of their working life, taking full advantage of the opportunities presented by the Youth Training Scheme and for links with education system;
- develop strategies to continue their employees' development after initial training, to widen and deepen their experience and equip them with necessary specialist skills;
- develop opportunities for those who have been out of work, including women who wish to return to work, and for those wishing to change jobs; and

- play a full role in developing the relevance and responsiveness of vocational education and training provision.

17 Employers and, where appropriate, trade unions also need to recognise the need to encourage individuals to acquire the skills for the future by reforming inflexible pay arrangements, ending inefficient working practices and avoiding excessive and unwarranted pay increases.

18 Trade unions also have a key role to play in explaining to their members the importance of investing in new skills, including the flexibility that change demands. Trade unions can also help to end restrictive working practices and attitudes which may deny opportunities to unemployed people who learn new skills.

19 The response needed from individuals is also crucial: unless they recognise the need to train through life and to adapt to change, success will not be possible.

### Conclusion

20 We face rapid and continuing change. The challenges can be met only if people's potential is developed to the full. The most important skill for the future is for employers, managers and individuals to learn how to train through life.

21 The Government has taken important steps to prepare the ground for success. Employers and individuals - who benefit from continued growth and prosperity - must now respond.

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## SKILLS MONITORING REPORT FEBRUARY 1988

- 1 The most recent Skills Monitoring Report published by the MSC in February 1988, reports findings from the CBI's Quarterly Industrial Trends Survey and the 1987 annual CBI/MSC Special Survey of Skill Shortages in Manufacturing Industry and a number of other sources. According to the Report recruitment difficulties faced by employers increased significantly during 1987, in line with the exceptional growth in output over the year.
- 2 For manufacturing industry the CBI's Quarterly Survey showed that the proportion of respondents to the survey expecting skill shortages to limit output increased from a weighted 9% of respondents in January 1987 to 19% in January 1988 (Fig 1). The annual CBI/MSC survey reported a comparable increase, from 19% of respondents in September 1986 to 34% in November 1987. The higher figures in the annual survey reflect the skills focus of this survey and the likelihood that the response to the annual survey, which is lower than the response to the quarterly survey is more biased towards those experiencing skill shortages. The levels of shortages reported in the Quarterly Survey, the more accurate guide, remain less serious than in the 1960s and 1970s.
- 3 Relatively few respondents to the annual CBI/MSC survey believe that the skill shortages had a severe effect on output, though the majority of those affected thought that the constraint on output was significant. Over 90% of those affected by the most common shortages had difficulties in recruiting experienced staff (Fig 2).
- 4 Employers appear to have increasing difficulties in recruiting enough professional engineers, particularly electronic engineers, but also mechanical and production engineers. A weighted 14% of respondents to the annual CBI/MSC survey reported that shortages of professional engineers had limited output over the previous four months. Although most require experienced engineers, nearly 60% of those experiencing shortages have also difficulties in recruiting enough newly qualified graduates.
- 5 Other higher level staff in demand include managers, specialist computing staff and accountants. Reflecting this demand, salaries and remuneration for some accounting occupations appear to have risen considerably in 1987, whereas increases in salaries for computing staff did not appear to be greatly in excess of average increases for all occupations. As with professional engineers, there appears to be an unmet demand for inexperienced recruits to managerial and computing jobs in manufacturing industry, in addition to the more widespread need for experienced people.
- 6 At craft level, employers continue to report difficulties in obtaining enough experienced engineering machinists, mechanics and welders, though a majority of those experiencing difficulties in recruiting welders believe the effect on output is minor.

Relatively few employers appear to have problems in finding inexperienced recruits for craft occupations, in contrast with some higher level occupations.

7 According to the annual CBI/MSC survey, nearly all respondents experiencing shortages believe that the difficulties are related to an unavailability of labour. Pay and conditions are thought relevant by over 60% of those with shortages of computing staff and by nearly 40% of those with shortages of professional engineers. Shortages of welders and mechanics are believed not to be related to pay and conditions by a majority of respondents affected by them.

8 Most respondents to the CBI/MSC survey reporting shortages are attempting additional recruitment. Fewer than a quarter of those experiencing any of the main shortages retrain existing staff, except in the case of managerial shortages, where nearly 70% report training as a response. A large proportion recruit at a lower level and retrain, particularly for craft shortages. Of respondents reporting shortages of computing staff, relatively few train existing staff (11% weighted), or recruit at a lower level and retrain (21%).

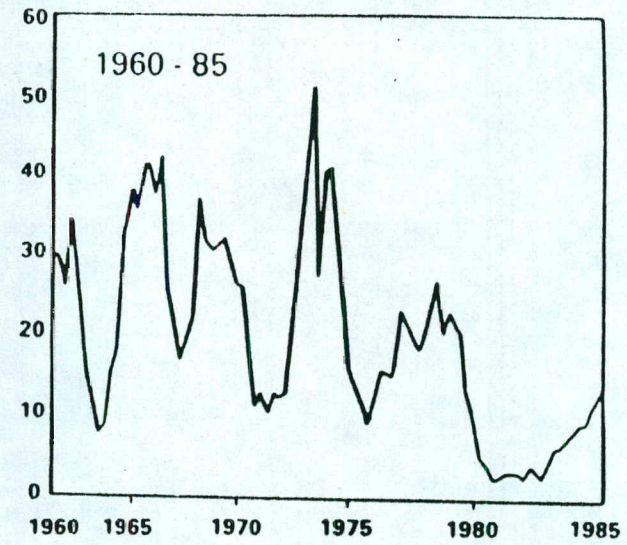
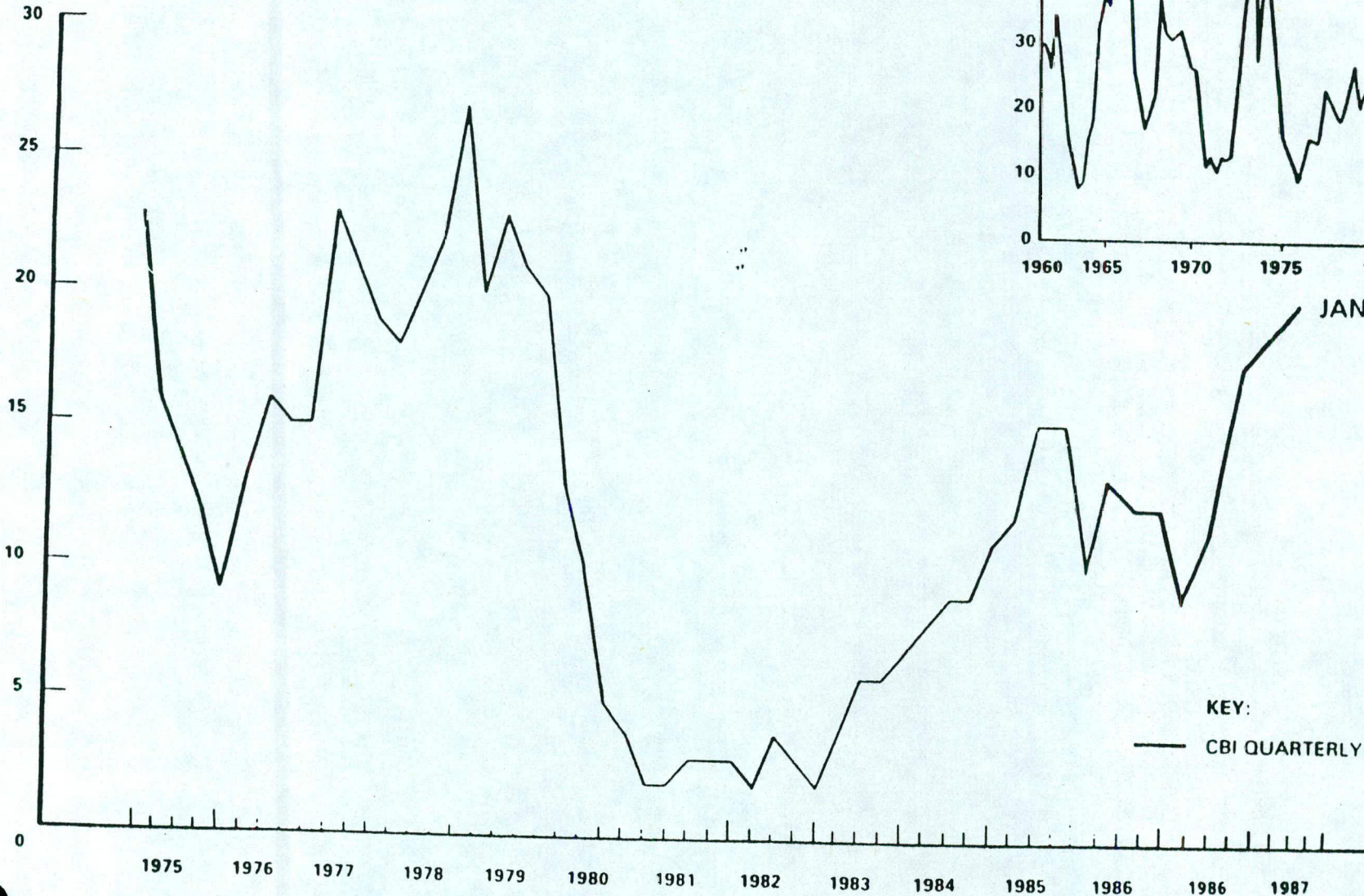
9 Reports of recruitment difficulties in the construction industry increased during most of 1987, probably reflecting the exceptional growth in UK construction output during the year, estimated by NEDO to have been the highest among leading European industrial nations. According to the Building Employers Confederation skilled bricklayers, carpenters and joiners and plasterers are most in demand. The most serious recruitment difficulties in the construction industry, previously confined to the South-East, appeared to be spreading to most parts of the country during 1987.

10 The Skills Monitoring Report also notes the findings of a survey of recruitment and retention in local authorities. This survey finds that no local authority reported any general recruitment difficulties, although nearly three quarters of responding authorities had trouble recruiting to particular occupations. Only 1.7% of local authority employment was covered by these difficulties. Neither did the survey find any serious overall retention problems facing local government, though some authorities in London and the South-East are reported to have above average retention problems which were limited and specific to the same occupations for which there were recruitment problems.

FIG 1

# CBI SURVEY: PERCENTAGE OF FIRMS EXPECTING SKILLED LABOUR TO ACT AS A CONSTRAINT ON OUTPUT

PERCENT

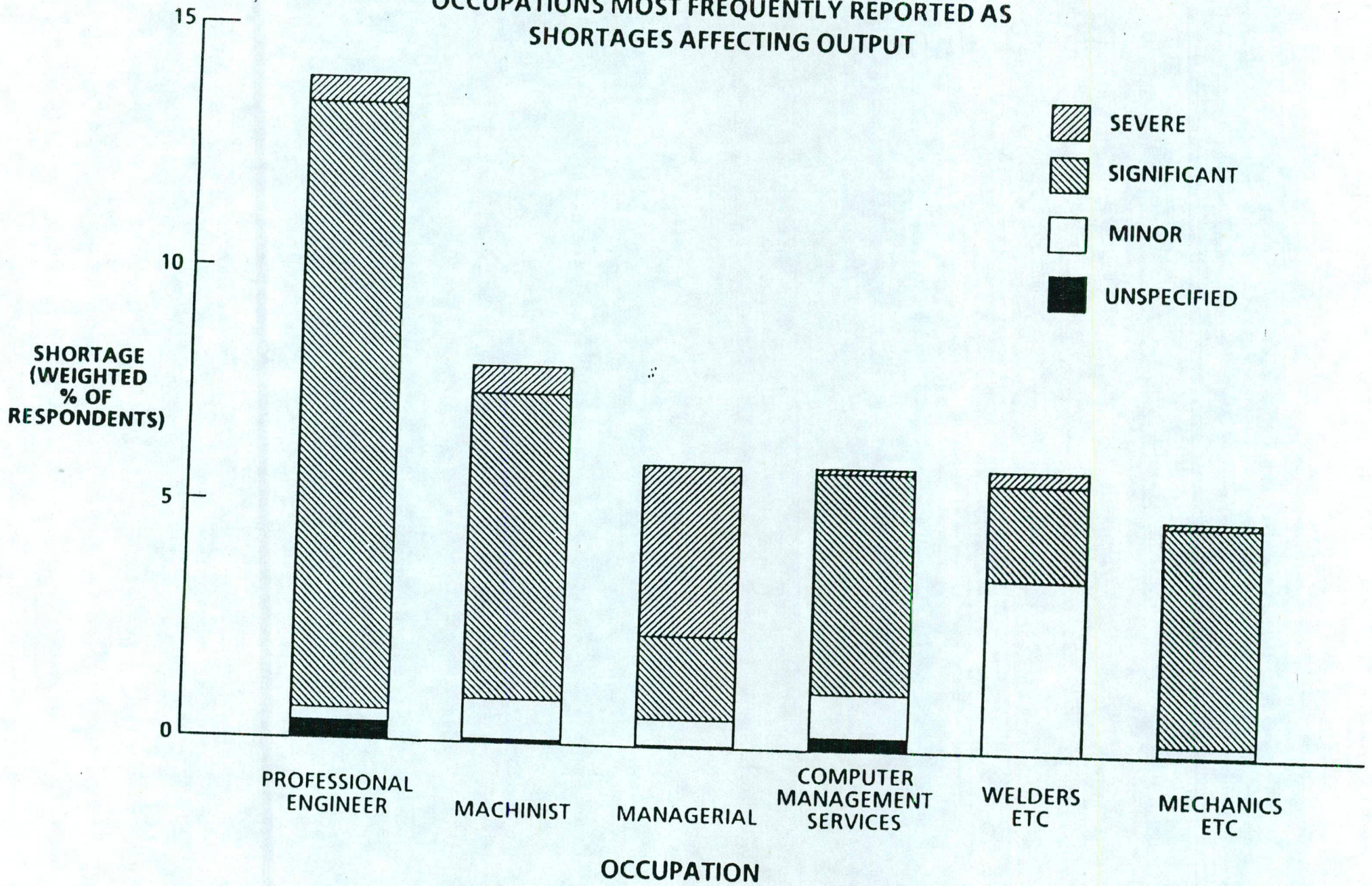


KEY:  
— CBI QUARTERLY SURVEY

NOTE The CBI survey is carried out quarterly in January, April, July and October

FIG 2

### OCCUPATIONS MOST FREQUENTLY REPORTED AS SHORTAGES AFFECTING OUTPUT





*MJ*

NOT FOR PUBLICATION

National Economic  
Development Council

NEDC(88)18  
12 April 1988

NEDO PLAN AND BUDGET FOR 1988/89  
Note by the Director General

Reorientation of the Work of the Council and its Committees

- 1 The last year has seen a fundamental reorientation of the work of the Council and its committees.
- 2 The Council now meets only four times a year, with the effect that a smaller proportion of the Office effort goes into Council work. Under the new pattern of meetings a major macroeconomic discussion takes place in January and otherwise the Council concentrates on such supply-side issues as skills, pay, performance and income distribution, small firms, internationally mobile investment and urban regeneration. There continues normally to be a presentation of sectoral work at each Council meeting and an important task will be to improve the flow of ideas between the Council and Sector Groups. The Steering Group on Council Programmes as before advises on the Council's programme of work.
- 3 The work done by committees set up by the NEDC is now governed by the arrangements set out in the Chancellor's letter of 6 October 1987. This provides for two types of NEDC committee. The first are Sector Groups, the successors to EDCs. They have terms of reference, budgets and deadlines for defined end-products agreed in advance; they are subject to review every 2 years. The second are Working Parties to carry out a specific remit with a set life normally not exceeding one year, again with terms of reference etc. laid down in advance.
- 4 Under the new arrangements there are at present 18 publicly funded Sector Groups and Working Parties replacing roughly double that number of EDCs. The range of economic activity covered remains roughly the same. The Group of 4 has been given the task of overseeing the committee structure.

The Office and the Transition

- 5 The Office has just completed an important stage of transition to the new arrangements. The work of the discontinued EDCs has been brought to an orderly conclusion; some of their output has yet to be published and appropriate follow-up action taken. Seven new Sector Groups and Working Parties have begun work or are in process of being set up. The reduction of the number of staff by some 40% to a new level of 124 on 1 April 1988 has been completed with the help of a programme of voluntary redundancies.

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- 6 Many staff have moved to new areas of work and the Office is adopting a new style of working. The essential feature of this is that project teams are formed under project leaders to take responsibility for carrying out each project successfully, under the guidance of the relevant Sector Group or Working Party. The new system will improve the Office's flexibility and efficiency and enable the available professional skills to be used to best effect. A major training programme is involved.

#### Resources

- 7 Table 1 shows the Office's financial provision for 1988/89 as compared with 1987/88. The total budget for 1988/89 will be £5.1m, of which £320,000 is for transitional expenditure and approximately £100,000 will be carried forward from 1987/88. Table 2 gives information about staff numbers.
- 8 For the future, as in the past, over half the Office's expenditure will be devoted to salary and other staff costs. The tendency for these to increase faster than the overall grant-in-aid is expected to continue and so to provide a spur to improve efficiency and secure increased income from communication and other activities in ways compatible with the Council's fundamental aims.
- 9 Table 3 shows the sums allocated by 31 March from the 1988/89 budget for core and project work by Sector Groups and Working Parties. The total amount so allocated is expected to rise to some £3.3m as the Sector Groups and Working Groups get fully into their stride.

#### Conclusion

- 10 The Council is invited to take note of the Office's Plan and Budget for 1988/89.

	<u>FINANCE</u> (£000)		
		1987/88	1988/89
	Budget	Forecast Outturn	Expected Expenditure
* Salaries	3895	3652	2750
* Commissioned Projects	325	260	220
* Communications	531	340	272
Other Expenses	2422	2748	1858
Total Net Expenditure	<u>7173</u>	<u>7000</u>	<u>5100</u> (a)

\* Net of reimbursements, contributions and (in case of communications) sales.

(a) This includes grant-in-aid provision of £320,000 to cover transitional expenses due to the change in level of activity; excluding that, total net expenditure is budgeted at £4.78m (£4.68m grant-in-aid plus £0.1m unspent balance from 1987/88).

Table 2

<u>STAFF</u>	<u>1987/88</u>	<u>1988/89</u>
	Average level envisaged in 1987/88 Budget	Staff-in-post as at 1 April 1988 including transitional posts
Directorate (inc personal staff)	9½	6
Operations Division	98	55 <sup>+</sup>
Economics and Statistics	19	15 <sup>+</sup>
Manpower and Education	10½	8
Communications	15	10
Administration (Personnel; Finance; Office, Computing and Word Processing Services)	45	30
	<u>197</u>	<u>124</u>

+ The Finance for Industry section of the Office (4 staff) has been transferred from Operations Division to Economic and Statistics Division, and the figures reflect this.

NEDC SECTOR GROUPS AND WORKING PARTIES  
Budget Allocations at 31/3/88

Expenditure* 1988/89 £000	<u>Committee</u>	<u>Projects</u>	
	<u>Core</u>	<u>Firm</u>	<u>Provisional</u>
Agriculture ad-hoc SG	39	141	-
Clothing SG	42	34.5	89.5
Cotton and Allied Textiles SG	34	38	23
Food & Drink Manufacturing SG	30	11	107
Knitting SG	42	94.5	14
Tourism & Leisure Industries SG	55	35	78
Electronic Applications SG	44	15	38
Electronic Component & Technology SG	53	13	46.5
Electronics Industry SG	43	68	98
Engineering Industry SG	64	73	175
Maker/User WP	30	90	110
Packaging WP	-	55	60
Pharmaceuticals SG	26	23	49.5
Plastics Processing SG	54	46	24
Specialised Organics SG	32.5	95	21
Construction Industry SG	65	89	174
Innovation WP	25	102	-
Committee on Industry & Finance	60.5	79.5	21
Co-ordinated programmes			
	TOTAL	739	1102.5
			1128.5

\* The figures relate to NEDO's budget only, and do not therefore include contributions to research projects by industry or Government Departments.

The figures include staff costs and related overheads together with other costs directly attributable to committees



NOT FOR PUBLICATION

National Economic  
Development Council

NEDC(88)11  
13 April 1988

**SKILL SHORTAGES AND EMPLOYER ACTION**  
**MEMORANDUM BY THE CONFEDERATION OF BRITISH INDUSTRY**

**Introduction**

- 1 The Council most recently discussed skill shortages at its meeting in February of last year. This paper considers developments that have taken place since then with particular emphasis on both the latest survey evidence and on what employers need to do and are doing to ameliorate or reduce problems arising from growing skill shortages. It is suggested that, despite some claims to the contrary, we do not face a crisis in this area; but plainly the pace of training of both employed and unemployed people needs to be stepped up and there are other policy responses too, mentioned below. The Government has a major part to play, particularly in terms of the training of unemployed people, but CBI recognises that responsibility for continuing action rests heavily too with employers. Individual employees must also be prepared and encouraged to take the initiative in developing their own skills.
- 2 This paper recognises no role for statutory intervention to compel employers to provide training for their employees - indeed the CBI believes that such intervention would do harm to the progress already made by employers in increasing the level and effectiveness of the training they provide.
- 3 Analysis of skill shortages, and identifying the appropriate policy responses, is not always a precise art: such shortages mean different things to different people. The impact of such shortages can range from marginal short-term inefficiencies to serious loss of output and competitiveness. However, it is common ground that the UK has under-invested in the provision of skills; and the CBI welcomes this opportunity to reopen the subject at the NEDC.

**The Latest Survey Evidence on Skill Shortages**

- 4 When the Council discussed the issue of skill shortages at its meeting in February of last year, there was widespread agreement amongst all parties on the need to raise skill levels throughout the economy. There was recognition too of the other important actions designed to ensure that skill shortages were as limited a constraint as possible on sustaining an improving level of economic activity.
- 5 There has undoubtedly been a tightening of the skills market over the last twelve months. The latest joint 'CBI/MSC Special Survey of Skill Shortages' was issued in early March. The Survey was conducted in November 1987 with 1225 responses, from manufacturing industry. More than one-third of firms expected a shortage of some categories of skilled labour to limit their output over the next four months (34 per cent). This percentage has been rising each year since the survey was first conducted in 1984. Figures for previous years were 13 per cent for 1984, 15 per cent for 1985 and 19 per cent for 1986.

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- 6 Similarly, the CBI Quarterly Industrial Trends Survey also provides evidence of a sharply rising trend of skill shortages, limiting output. The percentage of firms expecting skilled labour to act as a constraint on output rose to 20 per cent according to the latest survey undertaken in January this year. This is double the level of four years ago and the highest figure since the end of 1979.
- 7 While this 'deterioration' in the skills situation is obviously worrying it is important to understand that this upward trend in skill shortages has been associated with a lengthy period of strong economic growth, rising employment, and falling unemployment. The current position should be seen in context. As Figure 1 illustrates, while the proportion of one in five firms reporting skill shortages as a constraint on output in the CBI Quarterly Industrial Trends Survey is high by the standards of the last seven or eight years, it is significantly below the levels reported in the periods of strong growth of output in the 1960's and 1970's. For given levels of capacity utilisation in manufacturing industry skill shortages are actually less widespread now than in the 1960's and 1970's. This is further illustrated in Figure 2 which compares since 1972 the proportion of firms responding to the CBI Quarterly Industrial Trends Survey who have been working below capacity with those citing constraints on output resulting from skilled labour shortages. This chart demonstrates that over the last fifteen years skill constraints have tended to rise increasingly less rapidly with each period of relatively-high capacity utilisation.
- 8 Thus there are in fact encouraging signs that as an economy we have learnt to manage our skills better in the present decade than over the previous two. This is a measure not just of the better organisation of work in UK firms, but also of investment not least in the requisite training and retraining of employees.
- 9 The above analysis attempts to set the problem in a proper context. But problem it is. When all is said and done, the available evidence points to quite widespread skill shortages causing operational and other difficulties. In some sectors the problem is approaching the acute. If strong growth, increasing employment, and falling unemployment continue, the situation could get worse rather than better, despite a number of initiatives that have been taken by Government, employers and others in recent years. The reasons for this include the decline in the number of 16 - 19 year olds entering the labour market (by nearly one quarter by the early 1990's) and the accelerating pace of technological change which will lead to an increasing demand from employers for higher and wider skill levels.

#### Actions to Lessen Skill Shortages

- 10 A number of studies\* have assembled evidence which indicates that the general level of skills in the UK may be significantly below that enjoyed by our main competitors. This in turn has detrimental effects

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\*eg Competence and Competition, NEDC/MSD 1984; Challenge to Complacency MSD/NEDC 1985; The Making of Managers, NEDC/MSD/BIM 1987.

on our productivity, quality of products and services, innovation, research and development and so on. It has been therefore a strategic priority of both the Government and employers to raise the skill level of the workforce at least to those of our competitors and preferably beyond.

- 11 One major cause of the UK's deficiency, as discussed at the February Council meeting last year, is the perceived relatively poor performance of the education system in imparting skills to pupils, especially those not going on into higher education. A number of major reforms are in the pipeline to attempt to rectify this situation but many of them will not be fully effective for several years and will not have a major impact on pupils for even longer. Nevertheless it is encouraging that some major and necessary changes are in train.
- 12 Other initiatives beyond the classroom led by the Government and discussed by the Council in February last year include:
  - the enhanced two-year Youth Training Scheme (YTS)
  - the new framework for vocational qualifications to be created by the National Council for Vocational Qualifications (NCVQ)
  - the Engineering and Technology Programme to increase the supply of people qualified in disciplines related to information technology
  - the establishment of the Open College.
- 13 Since then the Government has brought forward through the Manpower Services Commission proposals for 'Employment Training', a New Adult Training Programme for the unemployed. These are currently being further developed by a working party of the MSC. The need to assist the long-term unemployed to prepare themselves for work by giving them quality work experience and training, is underlined by the demographic trends referred to earlier. It is vital for the economy that the scheme is a success, fully supported by all those concerned - the Government, employers, trade unions and not least the prospective trainees. The CBI for its part is committed to helping to develop the Programme in such a way that it can indeed help to equip unemployed people for work.
- 14 Other developments led by the Government include the new 'Enterprise in Higher Education Initiative' which is designed to give all those at higher education institutions an opportunity to acquire enterprise skills, and the conversion of the MSC into the Training Commission, which will provide a sharper focus for its role of encouraging improvements in training performance. Again, employers will play a major part.
- 15 Initiatives such as those mentioned above are long overdue. They enjoy the support of employers, who will continue to look also for other areas away from the workplace where action can be taken to improve the quality of potential employees. But the rest of this Memorandum concentrates on the employer response inside companies to skill shortages and training needs. It is, of course, at the workplace that the major challenge remains.

### Employer Response to Skill Shortages and Training Needs

- 16 The prime responsibility for ensuring that the skills of employees keep pace with the demands of a fast growing economy, characterised by technological change, rests with employers.
- 17 The latest labour market survey indicates that more employers are becoming involved in providing employees with training and retraining; and that the period spent on training is increasing. The rapid growth of the private sector training industry - one of the faster growing sectors of the economy - confirms this interpretation. So does the evidence that is available about major technological innovations in training methods, particularly in relation to open learning and related fields, where British industry is close to leading the world.
- 18 The MSC is in the process of conducting a major in depth survey of the level of training currently provided by employers in the UK economy. This survey should provide for the first time authoritative information about the level of training expenditure carried out by employers. It should confirm the impression provided by general anecdotal and other evidence that there has been a significant resurgence of interest in training by employers and that this interest has been matched by actions. Indeed the CBI believes that training undertaken by employers may be both more extensive and more effective than is currently appreciated.
- 19 Employers are involved in a number of important initiatives directed at improving training responses to skill shortages. These are designed to influence both the supply of skills and the quality of training.

### Skills Supply

- 20 Three important initiatives are engaging the active involvement of employers:-
  - In the 'high-tech' area (and as an example of where a national approach was needed) the Information Technology Skills Agency (ITSA) was established in 1985 under the auspices of the CBI Education Foundation to monitor and recommend action to overcome skill shortages in information technology. That year through ITSA industry provided £24 million to match a government contribution of £43 million to higher education to increase the output of graduates in engineering and technology, with particular emphasis on information technology. Currently ITSA is involved in working with the DTI in a study of the impact of information technology on manpower needs, with the object of an annual report rolling forward previous reports being made each year. The future of ITSA is currently under review but, irrespective of the outcome, this study is likely to continue.
  - Considerable effort has been made by employers in the sectors involved to improve the effectiveness of the non-statutory training organisations. A recent MSC survey suggests that around two-thirds of these organisations are judged to be effective, these representing around three-quarters of the workforce not covered by Industrial Training Boards. The organisations are currently

considering further means of improving their performance, including the possible establishment of a central resource unit to aid development.

- Another vital initiative in which employers are actively involved is the establishment of local employer networks, covering in the main but not exclusively travel-to-work areas. The CBI and ABCC are in partnership with the MSC to see around 110 such networks established by the end of September. The networks will provide an employers' voice at the local level and will be a focal point for all employer VET matters. The most important specific role for the networks will be to identify current and likely future local employer labour education and training needs and to take steps to ensure that such needs are met by local provision. We hope that more employers will become involved in, and support, the networks believing that local action of this kind is likely to be the most effective response to the majority of skill shortages.

### Quality of Training

- 20 Two initiatives are currently being developed aimed at enhancing existing levels of skills within companies as part of the general effort to ensure not only that existing potential is fully exploited (particularly in the light of new developments in multi-skilling) but also that training is regarded as a continuing activity throughout individuals' working lives:
- The first initiative has been given added significance by the results of the latest CBI/MSK skill shortage survey which provided a reminder that managerial skill shortages are a problem. The industry-led response to the Handy and Constable/McCormick reports is currently being developed by the Council for Management Education and Development. Proposals for a corporate 'code of good practice' on management development are well advanced and likely to be firmed up early in the summer. Other proposals will follow. Business accepts that improvements in management and the spread of best practice are likely to be one of the most important factors - if not the most important - influencing future business performance.
  - The second initiative is designed to encourage employers to consider the scope for developing their training arrangements. A training presentation is currently being prepared which would be the corner-stone of country-wide training conferences so that employers operating in the same or similar labour markets can exchange views and experiences. Regular and detailed contact with CBI members has shown that a great deal of activity is taking place within individual companies to identify actual and likely future skill needs and to take steps to ensure that as far as possible they are met. Considerable investment is being made in the setting of competence-based standards for employment. More sophisticated training-needs analysis is being carried out. New training techniques such as open and distance learning are receiving a more widespread application throughout companies. As investment in training programmes has increased so has the scrutiny of their relevance and effectiveness. Training as an investment should bring a return but it will only do so where it is both appropriate and



properly directed. Together these various developments are strengthening the training culture and are more likely to overcome skill mismatches than generalised or broad brush training solutions.

### Non-Training Responses to Skill Shortages

- 21 Inadequacies in training (and education) systems are not the sole cause of skill shortages. All too often surveys tend to give the impression that skill shortages can only be met by more and better education and training provision. In fact, the nature and effect of skill shortage varies considerably between sectors and indeed between firms in the same sectors. It is important to bear this in mind in the development of policy responses. As already mentioned, disappearing restrictive working practices means that a shortfall in required skills is rather less likely to limit output now in the 1980's because of far greater flexibility and multi-skilling amongst employees. Other factors affecting the nature of any particular shortage include the relative costs of pay for particular jobs and occupations; the level of effective management of the workforce; the firm's tolerance level for the time that it takes to fill a vacancy; the employer's perception of necessary skills and experience for a particular post which may differ from an objective assessment of what is required; and preferences for the degree of experience that a job recruit should have. It follows that the attention companies devote to their human resource management is as important as the attention devoted to development. With this in mind, the CBI is currently preparing material for wide discussion amongst its members on all the ways in which company employment policies can give those companies their competitive edge. A series of discussion documents will be published in the latter half of 1988.
  
- 22 One important cause of skill shortages has been not a training failure but a geographic mismatch with skills which are in surplus in some regions short in others. It was to help improve the effectiveness of the labour market in this respect that the CBI Employee Relocation Council (Annex 1 - circulated to Members and Principal Advisers only) was established. It is modelled along the lines of its counterparts in Canada and the USA and provides employers with a forum to meet and discuss the problems of relocation; and to lobby in the interest of a more efficient and less costly relocation regime. The Council provides a central reference point for identifying sources of expertise on relocation matters such as tax, housing, removals, education for employees' children and so forth. It also provides a clearing house for employers to exchange advice and experience on company policies, allowances and benefits. The CBI has also taken the initiative to establish, with PE-INBUCON (Annex 2 - circulated to Members and Principal Advisers only), a temporary executive service to provide senior managers equipped with special skills and experience for companies faced with sudden gaps to be filled.

\* \* \*

- 23 All the aspects of the supply of skills that have been discussed in this paper support the need for increased commitment and resources to be given to effective, high quality training by the Government, businesses and individuals. However in looking at the perceived problems of skill shortages the role of training must be seen alongside other policy responses. In some cases an individual skill shortage can be a symptom of other inappropriate policies such as the wrong pay differentials, the wrong approach to employee promotion or to job design. This point is not intended to detract from the central importance of training but rather to ensure that sight is not lost of other relevant policy considerations.
- 24 For its part, the CBI will continue to direct its attention to the encouragement of employers to take appropriate actions to anticipate and deal with skill shortages, by:
- monitoring closely developments on the skills front, including identifying likely future constraints on skill supply;
  - achieving a better understanding of the nature and appropriate solutions to skill shortage problems; and
  - seeking increased employer involvement and commitment to bodies such as local employer networks as an important and effective mechanism for identifying and resolving skill problems at the local level.

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NOT FOR PUBLICATION

National Economic  
Development Council

NEDC(88)15  
13 April 1988

## ENCOURAGING ENTERPRISE : THE ROLE OF SMALLER FIRMS

### MEMORANDUM BY THE CONFEDERATION OF BRITISH INDUSTRY

- 1 Smaller firms have a vital role to play in securing the momentum of Britain's economic recovery. That is why it is valuable for NEDC to be considering what further steps can be taken to encourage their growth and development.
- 2 Special treatment for smaller firms is no substitute for an economic climate in which all businesses, irrespective of size or sector, can operate successfully and profitably. Externally imposed cost and regulatory burdens must be no greater than those of our international competitors, particularly if small firms are to seize the opportunities of the completion of the single European Market in 1992.
- 3 But smaller firms do have special needs and problems, which derive in part from their lack of internal resources. Encouraging start-up activity, which the CBI fully supports, has been an important part of this Government's support for the smaller firm sector. We believe increasing emphasis should now be placed on encouraging established smaller firms to grow. In this respect the DTI's Enterprise Initiative is to be warmly welcomed.
- 4 Two of the major factors affecting the growth of a smaller firm are its ability to innovate and to secure access to relevant finance. The CBI's Smaller Firms Council has been looking at both these aspects and this paper identifies a number of the problems involved and possible ways forward. A common theme to emerge is the need to raise the general level of expertise within smaller firms. Specifically this requires continuing and increasing emphasis on the importance of training and the provision of relevant information and advice. These requirements are not exclusive to smaller firms, although the manner in which their needs can be met does require this separate consideration.

### ENCOURAGING ESTABLISHED BUSINESSES

- 5 Much of the effort, both of Government and advisory bodies engaged in helping smaller firms, has been aimed at encouraging business start-ups and self employment. The CBI fully supports help and assistance at this end of the market.

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- 6 According to VAT statistics approximately one third of start-up companies will have ceased trading after three years and a further 30 per cent will have ceased trading after seven or eight years. The difficulties which companies face during their early years are therefore self evident. However, the success rate of such start-ups can be substantially improved with relevant training and counselling at appropriate stages during the company's evolution. Hence the justification for such support.
- 7 Nonetheless, the CBI believes there has been a pre-occupation with start-up companies, and that by any accepted measure of economic performance, eg. employment generation, GDP contribution etc, it is equally, if not more cost-effective to channel assistance to established small firms. It is a question of balance. Recent developments including the DTI Enterprise Initiative and the specific measures in the Budget designed to encourage greater retention of profit within smaller companies, are very welcome steps in ensuring this more desirable balance.

## INNOVATION

- 8 In January 1988 the CBI's Smaller Firms Council produced a document\* reviewing the various policy initiatives being taken by the public and private sectors aimed at encouraging innovation in smaller firms. Various recommendations were made for further discussion with the Government, the education world and among CBI members. Innovation is defined as the process which comprises all those activities which are necessary for new or improved products or processes to be realised in the market. It may incorporate inventions, R&D, licensing, product and process engineering, design, training and patenting, but perhaps above all else marketing. It begins with an original idea and ends with satisfied customers.
- 9 The key points to emerge during our work on this front are:
- a the central role of marketing to successful innovation
  - b the role of Government R&D in stimulating innovation in smaller companies
  - c the need for some form of market for transferring technology

\* Promoting Innovation in Smaller Firms, CBI, Smaller Firms Council, January 1988

- d the importance of the supplier/customer relationship.
  - e the opportunities presented by corporate venturing.
- Each of these is considered briefly below.

### Marketing

- 10 Professional marketing is considered to be one of the keys to successful innovation in smaller firms. Problems exist at two levels. Firstly, a basic lack of understanding by many owner managers of the strategic importance of marketing, and secondly inadequate market intelligence of the quality and in the volume required by smaller firms and an apparent lack of help or assistance to improve this market intelligence.
- 11 Motivation for running a smaller firm and the skills of the individual owner manager vary widely. Many start a business because they have a certain technical expertise, or a flair for design or perhaps are just good salesmen. Few start a small company purely because they are good at marketing. It is not surprising therefore that this is one of the major weaknesses in many smaller firms.
- 12 The DTI's original Support for Marketing scheme, now relaunched as the Marketing Initiative, is welcome and goes a considerable way towards addressing the problem of strategic marketing. It is to be hoped that as the scheme develops, consideration will be given to including support for market intelligence and sectoral schemes within the scope of the Initiative. The scheme really addresses only the question of counselling and advice. Greater efforts need to be made in alerting smaller firms to the marketing training currently on offer and developing more schemes tailor made to their particular needs.

### Government R&D

- 13 The Government has a very substantial R&D and procurement spend on its own account. There is considerable scope for making this important market more accessible to smaller firms as it can often provide core business from which additional markets can subsequently be developed.
- 14 The MoD's Small Firms Initiative both in terms of the research budget allocation to small firms and the advice desk, is a welcome example of the positive steps that can be taken to ensure smaller firms are more widely aware of the possible business opportunities. Another is Defence Technology Enterprises (DTE). The location of DTE staff within MoD research centres, charged with the specific responsibility of identifying and separating out ideas

with potential beyond the Ministry's needs, is a useful mechanism for transferring potentially innovatory ideas to smaller companies. Both these examples could usefully be extended to other Government departments.

### Technology Transfer

- 15 For a variety of reasons many ideas developed within larger companies are not exploited and are effectively put on the shelf, perhaps because they do not fit in with the existing product mix or are deemed unlikely to produce an adequate return. The same may also be true of certain projects in universities or polytechnics which, either because of inadequate knowledge of the market, lack of finance, or failure to recognise a commercial opportunity are not successfully exploited. There is a need for some mechanism to facilitate firstly, the identification of such projects and then to effect technology transfers between interested parties, and particularly to smaller firms, who may be ideally placed to capitalise on such ideas.
- 16 There are some private sector initiatives that undertake this function including exhibitions such as Tech Mart. Various regional networks are also developing of which the North West Association for New and Improved Technology (Nimtech NW) is a good example. This has now been designated as one of the DTI/DES Regional Technology Centres and it is to be hoped that as other Centres become established they will increasingly contribute to this transfer of ideas. An increasing number of initiatives is being introduced in this area and there is a need to avoid duplication and encourage the spread of best practice. The CBI believes that a guide to the various forms of advice and assistance on offer would be useful. We shall be considering how best to produce such a guide.

### Supplier/customer relationship

- 17 At its most basic level co-operation between a customer and supplier consists of securing a mutually advantageous contract or business agreement. But for many small companies it proves particularly difficult to identify the relevant purchasing point of contact within a large organisation. "Can You Make It" and "Meet the Buyer" seminars and exhibitions are an invaluable way of imparting this information to a small firm. The CBI runs a regular programme of such events.
- 18 However, the customer/supplier link can be much more than this, providing positive encouragement for innovation in smaller firms. The development of long-term partnerships between buyers and suppliers,

- Partnership Sourcing - in which each helps the other develop their products to their mutual advantage, is something which the CBI is actively pursuing. Although the initiative is by no means aimed exclusively at helping smaller firms, inevitably many of the suppliers in such relationships will in fact be smaller firms. Successful examples of partnership sourcing will be identified so that the advantages, as well as the pitfalls to avoid, can be passed on to other potentially interested organisations.

### Corporate Venturing

19 One further opportunity for co-operation between large and small firms, which as yet is comparatively unexplored within the UK, is that of corporate venturing. In addition to any financial involvement, corporate venturing can offer the small company:

- the advice of experienced managers
- marketing and distributing networks
- more sophisticated financial control systems
- extra production and R&D support
- greater market place credibility.

20 Although there are some positive examples of corporate venturing in the UK, not all would regard their experiences as successful as pointed out at NEDO's own conference on the issue last year. We would be happy to work further with the Office, identifying benefits and problems and, again, spreading best practice.

21 There is therefore no shortage of initiatives to encourage innovation, although there is certainly scope among some for further development and extension. The main problem which appears to be handicapping innovative performance is a lack of awareness among smaller firms themselves of:

- a The need to innovate. Too many are content to operate in traditional markets with traditional technologies and processes. There is a need to improve the overall level of management expertise and of management awareness of the importance of innovation. This can only be achieved by providing advice and, most importantly, training and this is referred to in later paragraphs.
- b The sources of advice and assistance that are available. Despite the different schemes and advisory agencies designed to encourage innovation in its widest sense, there are still large numbers of smaller firms who remain unaware of the help

available to them or are confused by the sheer number of initiatives on offer. The CBI believes it has an educative role and will be considering the preparation of promotional and guidance material; in essence a simple signposting service.

## FINANCE

- 22 Despite the introduction in recent years of the Loan Guarantee Scheme and the Business Expansion Scheme and welcome developments among the banks and venture capitalists, many smaller firms still experience funding difficulties particularly in the following areas:
- a Loan and equity financing of less than £250,000, but particularly in the £50,000 to £100,000 range.
  - b The supply of patient money where returns take longer than five years.
  - c The provision of finance for new products/processes in which the firm lacks a track record.
- 23 These difficulties do not result from a general shortage of money in the market; on the contrary banks are lending at record levels to smaller firms and venture capitalists have considerable funds available to invest in viable projects. But there are two particular problems. Firstly, probably because of a failure in communication or understanding, there are mismatches between the needs of certain smaller firms and the finance offered. Too often loan or overdraft financing is sought or offered where equity or a mixture of equity and debt would be more appropriate. Secondly, the high cost of appraising and monitoring small tranches of risk capital. The time spent appraising a £50,000 investment can be as great, if not greater, than appraising a £250,000 one and for this reason many venture capitalists will not consider proposals beneath this latter figure.
- 24 With the increasing emphasis on enterprise and the encouragement individuals have been given to start up businesses, there has inevitably been a much larger number of people, with limited business experience, seeking external finance. The fact that some of these may have been refused finance is not automatically an indication that the financing system is at fault. On the contrary, the best advice for certain people contemplating starting a business is don't, at least until you have done more homework.
- 25 The CBI has been looking at these particular difficulties facing smaller firms and although the work is not complete there are three areas which have been identified as important:



- a training and advice for the smaller firms
- b training for the finance providers and advisers
- c improved provision of equity finance and loan/equity packages

#### Training and advice for smaller firms

- 26 The standard of financial management in many smaller firms leaves much to be desired. Lack of sound financial management leads not only to poor quality applications for finance with inadequate business plans, but also to financing needs being translated into the wrong kind of demand ie for debt where equity might be more appropriate.
- 27 This is symptomatic of a wider problem of inadequate management training. Nevertheless assistance for smaller firms in this specific area is vital and the extension of the DTI's Enterprise Initiative to cover consultancy on business plans is a welcome move. There is also a need for better understanding among smaller firms of the most appropriate types of finance for their business and from where these are available. Many firms are reluctant to consider equity because of an understandable fear that they will lose control of the business. The CBI acknowledges that with others it has a role in increasing the awareness of the value of shared equity.
- 28 In a more direct and immediate way, there is also an argument for placing conditions on the provision of finance such as some prescribed training or acceptance of a non-executive director onto the Board. This may be interpreted by some as unnecessary interference in the company's affairs, but if the quality of training or advice is right this could well be a justified condition of an offer.

#### Training of the financial providers and advisers

- 29 As well as the specific agencies and schemes designed to help smaller firms, the professional advisers such as banks and accountants have a key role to play in disseminating information. After all at some stage or other almost every smaller firm has to approach a bank manager or accountant. The banks and accountants are increasingly recognising this role and produce a whole range of guidance material and specialist advice.
- 30 Despite the considerable efforts of the advisers, many small firms still believe that the problems and needs of their type of business are not fully understood. Continuing efforts must be made to ensure that advisers are trained in the realities of running a small business.

One particularly effective method is the secondment of bank personnel to Local Enterprise Agencies. Not only does this provide the agency with much needed resources but it can also be a valuable training opportunity for the secondee. Certainly such training will be important if advisers are to play a part in encouraging owner-managers to undertake appropriate training themselves. Some ability to make at least an initial assessment of the firm's training needs will be necessary.

### Provision of Finance

- 31 The high costs of appraising and monitoring make small scale investment projects particularly unattractive for commercial venture capitalists. An increasing number of Enterprise Agencies and other local support networks are now developing their own investment funds. They are able to offer these smaller tranches of finance because they are not necessarily operating under the same commercial criteria as a traditional venture capitalist. Furthermore, the appraisal and monitoring costs can be significantly lower because they may already have considerable knowledge of the company in question. Although as yet meeting only a small part of the demand, these developments are to be welcomed and encouraged. Even where such agencies do not have an investment fund of their own, their association with a smaller firm can help to give it greater credibility when approaching traditional sources of finance.
- 32 The CBI has been advocating a further mechanism, again possibly linked to a local advisory organisation, to help meet the requirements for small tranches of finance at the local level. These have been referred to as Local Investment Companies (LICs) which would act as intermediaries taking equity in, and making long term loans to, new or established smaller businesses. To minimise bureaucracy and maximise the financial service and business advice so essential to an expanding firm, the LICs could be linked to existing sources of local support for smaller firms, such as Local Enterprise Agencies. To encourage the establishment of LICs and to draw funds into them, the CBI has proposed a fiscal incentive for both corporate and individual investors.
- 33 Although having many similarities to the Business Expansion Scheme, Local Investment Companies would be seen as an extension rather than a replacement for the BES. The CBI still believes that the BES could be substantially improved if the eligibility criteria were extended to cover persons connected with the firms such as employees, directors, partners and their associates. The Treasury's reservations on abuse, could be met by suitable safeguards.

## TRAINING, INFORMATION AND ADVICE

- 34 A recurring theme through this paper has been the need to improve the overall level of expertise within smaller firms. However, before action can be taken the owner-manager must recognise his shortcomings and accept the need for help. This is a notoriously difficult hurdle to overcome. A recent survey of CBI's smaller firms members showed that owner-managers who had undertaken training valued it, and wanted more, but those who had not tried training felt it would be of no benefit to them.
- 35 In many respects the problem is deep rooted and for the longer term people have to be persuaded of the value of training and outside advice. More emphasis could be placed in schools on the value of continuing training/education in adult life and on recognising one's limitations and taking appropriate action to deal with them.
- 36 In the shorter term, the whole question of both the public and private provision of management training for smaller firms needs close attention. Ways must be found to encourage smaller firms who have previously spurned training to recognise its value. This will require both imaginative promotion of the schemes on offer, and the tailoring of these schemes in a form, and at a time and place most convenient to the operation of a small firm and its manager.
- 37 It is also important that the provision of advice, counselling and consultancy is not divorced from training. It is to be hoped therefore that the DTI's Business Review, forming part of the Enterprise Initiative, will be able to prescribe suitable training as well as simply specialist consultancy advice.
- 38 Over recent years the support organisations of one form or another have mushroomed. In one respect this is a very welcome development as it increases the chances of an individual small firm coming into contact with someone who can help him. However, it can also lead to confusion.
- 39 The answer does not lie in trying to impose one single type of advisory organisation or a blue print for a one-stop shop. What is required is a network so that when a small firm makes an initial contact with whatever form of advisory body, be it the Small Firms Service, Local Enterprise Agency, a sectoral business association etc, he is referred directly to the most appropriate source of advice.
- 40 The increasing emphasis now being given by the DTI to support for established businesses is welcome, but it does present at least a potential overlap with the

activities of the Department of Employment. This is particularly true at a regional level with the expanding DTI regional offices and the established Department of Employment Small Firm Service and Regional Enterprise Units. There is clearly a need to look very carefully at the respective roles as the potential for confusion in the eyes of the smaller firms, let alone actual duplication on the ground, would seem to be great.

\* \* \*

- 41 The continuing increase in the number of new firms is a welcome trend in the British economy. If we are to maintain the momentum of the economic recovery it is vital that both new firms and the established small firms sector are able to grow and develop to their full potential.
- 42 This will require the Government to create the right economic climate, ensuring that the burdens of taxation, regulation and other externally imposed costs are no greater than those of our international competitors. But in addition small firms must be helped with some of their specific problems deriving in part from their lack of internal resources. They must have access to the necessary skills and expertise to help them overcome the hurdles to growth. Training, information and advice are central.

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NEDC(88)17  
13 April 1988THE GROWTH OF SMALL FIRMS IN THE UKMemorandum by the Director General

- 1 A striking feature of the development of the UK economy in the 1980s has been the growth in the number of firms. Between mid 1980 and mid 1987 registered firms rose 13% and most of these extra firms have necessarily started "small". Small firms and the self-employed form a significant part of the process by which growth in output and employment has been taking place. This is an intended feature of Government's policy to support individual enterprise. However, the trend is not confined to the UK and forecasters suggest that the structural shift towards small firms is likely to continue for several years. The annex examines how small firms contribute to economic growth and looks at some of the factors in the operation of markets which disadvantage small firms compared with their larger rivals.
- 2 Small firms are generally considered to be more flexible, responsive, have lower overheads and be more ready to take risks than larger enterprises. On the other hand, they cannot attain scale benefits in either production or marketing and on average invest less per employee in capital equipment or training, export less, and produce lower value-added per head.
- 3 In this context I should like to draw the attention of the Council to three aspects of the paper which appear to be especially important. First, only a few of the very large number of small firms will actually become significant international competitors; they should receive every encouragement. Secondly, in paper NEDC(88)12, I draw attention to the continuing need in the UK for an improvement in our skills base; the growth in the proportion of small companies makes this problem harder to solve. Thirdly, large and small firms are not alternatives but mutually interdependent in a healthy industrial economy; large firms can do much to develop smaller ones in their own longer term interest.

Barriers to Growth

- 4 The designation 'small firms' covers everything from small shops to specialist suppliers of internationally competitive products or services. Whilst all are important, the latter are especially so since they provide part of the basis on which our industry is renewed. A study by the Science Policy Research Unit suggested that innovation arose particularly from small and from very large firms. The UK has a number of smaller firms which have grown in recent years to hold significant shares of world markets for high value-added products - but arguably not enough.

- 5 There have been many studies of the barriers to growth. Finance remains one with smaller companies often needing to invest a great deal in developing both markets and successor products in order to capitalise on early success. The growth of venture capital funds in which the UK is clearly the European leader, Government supported schemes and developments in corporate venturing are all most welcome. The debate on whether financial institutions take too short term a view is inconclusive and there remain residual doubts on whether UK investment horizons are sufficiently long or sufficiently ambitious.
- 6 Management resources and capability are a significant barrier to growth. Running a proprietor company is very different from managing an organisation and few individuals excel at both. There are many agencies which offer advice and support in areas where the small businessman may not have expertise or resources but they are fragmented. Time is a most precious resource for a person running a small business and this precludes a lengthy search of multiple agencies to find relevant help. The DTI's move to bring all of its services to small companies into a common focus is very welcome, but only a first step towards what is needed.
- 7 The third major barrier to growth is access to markets. Few customers, especially in the public sector and large companies, will risk an untried small company in preference to a competent known supplier. Central government purchasing has often been used to give very helpful encouragement to smaller companies but generally this has been around specific schemes (such as 'micros in schools'). Perhaps more could be done by the Government's Central Purchasing Unit and its equivalent in other public sector agencies. The newly formed NEDC Maker/User Working Party will also give consideration to this problem.

#### Skills and Training

- 8 The UK workforce is underskilled at all levels. Small companies undertake, on average, less training than larger ones. This is scarcely surprising. Large companies are more likely to have an infrastructure of training facilities, training specialists and an appropriate range of training opportunities. Large companies will tend to find it easier to plan for the absence of key employees. Conversely, those working in small companies often receive much wider experience than those in large.
- 9 There are some very useful initiatives which may help to address this problem supported by the Manpower Services Commission and the Department of Trade and Industry, for example, the Graduate Enterprise Programme and Local Employer Networks. However, it has proved extremely difficult to interest small business and their employees in increased training and there may be a need for a new and systematic study of the reasons for this.

#### Relationships Between Large and Small Companies

- 10 Large and small companies are often mutually interdependent. Smaller companies frequently supply specialist goods and services to the larger; indeed since a recent trend of larger companies has been one of concentrating on core businesses, many services once provided in-house have been 'spun-out' to form small businesses which still supply the original parent. In such circumstances the smaller companies are less likely to be in direct international competition than their customers but still need to be internationally competitive if their customers are to succeed.

- 11 As a consequence, many leading companies such as Marks & Spencer, Lucas and IBM have long adopted programmes of supplier development. They involve themselves constructively in the affairs of their suppliers offering, for example, management support to introduce improved quality systems. A related approach (very common in Japan) is partnership sourcing; the automotive industry, once known for a hard, confrontational style of purchasing, is in the forefront of this development in Britain. Under partnership sourcing every attempt is made to manage a total supply chain in order to ensure its optimal overall performance, thus breaking down barriers within it between supplier and customer. It leads to joint product development, joint quality programmes, just-in-time manufacturing to reduce stocks and openness of contact between companies. It is very difficult to introduce fully and may require the larger company to invest in the skills of its partner where they are relevant to the partnership.
- 12 Another form of mutual assistance between large and small is corporate venturing. The Office has been active in promoting the benefits of corporate venturing, in which large companies invest in smaller ones for both financial and broader business returns. The latter include making the distribution network, technology or management of the larger partner available to the smaller, and the product, technology and enterprise of the smaller available to the larger. In response to the interest aroused we have instituted a corporate venturing register through which large and small companies can search for suitable partners.

#### Issues for the Council

- 13 The Council is invited to welcome the growth of wealth and employment through the rise in the number of small firms and the measures which have helped this to happen. In particular, it is asked to:
- (i) welcome the DTI's new initiative for making advice and assistance available to small firms;
  - (ii) note that the growth of small firms makes the skills and training problems of the UK more difficult to solve and this aspect needs special attention from those concerned;
  - (iii) welcome moves towards partnership sourcing and encourage NEDC Sector Groups and others to facilitate this development;
  - (iv) welcome the operation of the NEDO Corporate Venturing Register.

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## ANNEX to NEDC(88)17

THE GROWTH OF SMALL FIRMS IN THE UKMemorandum by the Director General

1. In the 1980s the structure of the UK economy has altered markedly, with major changes in the balance between sectors, and rapid increases in productivity. Two changes in structure which stand out are the increase in the number of firms registered for VAT by 13% between mid 1980 and mid 1987 and the 52% rise in self-employment between June 1979 and June 1987 following a fall of 7% between June 1973 and June 1979 (as set out in the Appendix Tables). Small firms and the self-employed form a significant part of the process by which growth in output and employment has been taking place. Forecasters suggest that this structural shift towards small firms is likely to continue for several years. This paper examines how small firms contribute to economic growth. It goes on to examine whether there are imperfections in the operation of markets which disadvantage small firms compared to their larger rivals and suggests the steps that could be taken to help markets to work more efficiently and thereby enable small firms to exploit their contribution to the economy still more fully.

2. Firms of all sizes have a part to play in the economy. Large firms are more efficient in industries which require a large capital input and long production runs as in steel-making, shipbuilding and vehicle manufacture. Small firms can have a competitive edge over large companies when it comes to personal and specialised goods and services. They can also have an edge in industries where production has to take place in particular locations. It is thus no surprise that the large majority of small firms in the UK lie in retail distribution (20%), agriculture (12%), catering and hotels (10%), construction (14%) and in other services industries, according to the statistics of firms registered for VAT. Nearly 60% of the self-employed were in these industries in 1986. Self-employment in construction, for example, permits the rapid redeployment of skilled craftsmen between different short-run jobs while maintaining their incomes. In manufacturing industry small firms declined in importance in employment terms after 1935 but this process has begun to be reversed in the last 20 years.

Table 1

Employment by firms with less than 200 employees  
in UK manufacturing industry

Year	Employment '000s	% of Total Employment in Manufacturing
1935	2,078	38
1958	1,812	24
1968	1,390	19
1979	1,498	23
1982	1,367	27
1985	1,471	30

Source: Bolton report  
Annual Census of Production

3. The activities of small and large firms are interrelated. Many small companies depend for their existence on large companies as purchasers of and marketing channels for their output. In manufacturing particularly small firms often use the training resources of the large. In turn large companies rely on small firms for the provision of specialist products and services and as a test bed of high risk initiatives which the larger business can exploit. Emphasis in analysis on one group to the exclusion of the other would be misleading.

4. Small firms make three main contributions to economic growth. First, the increase in the number of very small firms with less than 20 employees increases employment. Second, some of these small firms assist the rate of growth by advancing the pace of innovation, increasing the utilisation of capital and tackling projects with higher risk. Third, some small companies contribute to growth directly by growing into medium and large companies. Small firms also contribute to improving overall efficiency particularly during periods of structural change by providing flexibility and a source of increased competition to larger firms in the economy. By exploiting new "niche" markets which larger firms find uneconomic they increase the variety of new and specialised products and services available.

The Growth in the Number of Small Firms  
and the Number of Self Employed

5 Some striking claims have been made for the value of small firms to the economy. It has been suggested that, between 1969 and 1976, 66% of net new jobs in the United States were created by firms employing fewer than 20 people and that 80% of the net new jobs were created by firms employing less than 100 people. In the UK applying similar techniques to data covering the period 1971-81 leads to the conclusion that 36% of gross new private sector jobs were created by firms employing fewer than 20 people and 52% by those employing less than 100. Smaller figures for the UK are to be expected because small firms form a smaller proportion of employment here and differences in economic structure and culture can be expected to lead to a different outcome.

Table 2

Job creation and small firms

Number of net new jobs generated by size of firm (thousands)

	Size of firm (no of employees)			
	0-19	20-99	100+	Total
<u>UK</u>				
1971-1981	+1,100	-160	-3,230	-2,290
1982-1984	+600	-80	-950	-270
<u>USA</u>				
1969-1976	4,461	1,080	1,218	6,759
1976-1982	4,630	1,662	5,579	11,871

Sources: See Annex

6. These remarkable figures for the United States are of course controversial, and in the UK there is controversy because the information available on the very smallest companies, particularly on those with between 1-20 employees, is of a much lower quality than that for larger firms. The UK results are based on samples which may be biased towards those small firms which are actually successful.

7. In the period 1982-4 small firms with less than 100 employees were net generators of jobs in the UK while large firms were clear net losers. There was a 6% fall in employment per annum in firms employing 1,000 or more and the intermediate categories at best held their own. Department of Employment data for 1976-81 confirm this picture, showing that while manufacturing was characterised by decline in the period examined and services by limited growth both show a clear increase in employment in small firms.

Table 3

Size distribution of firms in main industrial sectors, change in employment '000's 1976 and 1981

	Size of Firm (employees)			
	1-24	25-199	200+	All
All industries and Services	+201	-44	-1,107	-950
Manufacturing	+99	-169	-1,072	-1142
Services	+89	+218	+24	+331

Source: Department of Employment  
Based on size analysis of Inland Revenue Paypoints

8. However, while the numbers of businesses and self-employed are distributed regionally in the same way as GDP, the growth in the net number of businesses since 1979 has been fastest in the South East, Northern Ireland and East Anglia and not just in the areas of highest unemployment (see Appendix Tables). Indeed the smallest increases are in the North West, North and Yorkshire and Humberside regions where unemployment has been relatively high.

(a) The switch towards services

9. The recent shift of activity towards small firms has been common to most advanced countries. Several factors lie behind it in the UK. The first is the structural movement away from manufacturing towards the service sector. Over the period 1971 to 1986 the share of the output of services in the gross national product increased by 6 percentage points in real terms. This in itself is sufficient to account for a considerable proportion of the shift towards small firms as average firm size in the service sector, which has been growing, is considerably smaller than in the manufacturing sector which has been declining.

Table 4

Percentage of total employment in  
small and large establishments 1973-83

	Small (1-19 employees)			Large (500 + employees)		
	1973 (1)	1983 (2)	change (2)-(1)	1973 (3)	1983 (4)	change (4)-(3)
Austria	31.1	33.6	2.5	17.5	15.4	-2.1
Belgium	21.7	22.2	0.5	28.2	29.1	0.9
France	27.4	32.1	4.7	20.7	16.5	-4.2
Japan	44.5	49.4	4.9	11.5	8.2	-3.3
U.K.	22.0	26.1	4.1	32.9	25.2	-7.7
US	24.3	26.1	1.8	25.5	21.5	-4.0

Sources: see Annex for sources and definitions of data

This table refers to establishments not enterprises as enterprise data are not available for the UK. The distribution of enterprises and establishments by size have moved in a similar fashion as is shown in the Annex.

(b) The effect of technology

10. A second explanatory factor is that recent changes in technology have increased the competitiveness of small firms. Information technology and the advent of small computers has meant that the minimum efficient size for many operations has fallen dramatically. There is also an indirect effect in that the sheer pace of technological change means that more and more companies find that they need to employ specialist firms to install new equipment and provide training. This has been observed by the OECD in their study of technical engineering services. Some studies in information technology suggest that this effect may be substantial.

(c) Government assistance

11. Government policy has also contributed to the increase in the number of small firms both directly through schemes aimed at reducing specific barriers, such as the Enterprise Allowance Scheme and the Loan Guarantee Scheme, and indirectly through the general lowering of tax rates. The lower marginal rates of income tax will have made an important contribution to incentives for successful entrepreneurs. Not only has the rate of Corporation Tax fallen but lower rates were introduced for smaller firms. The changes to capital taxes in the 1988 Budget may also help small firms in that more capital can now be retained in a family business as it passes from one generation to the next. The impact of the switch from capital allowances to lower tax rates in the 1984 Finance Act is more complex to unravel. While various industries and firms are affected differently it is not clear that there has been any impact which benefits or disadvantages firms according to size. In some cases the tax regime has actually encouraged self employment; the most striking example here is the construction industry.

(d) The effect of unemployment

12. A further facet of the experience of the 1980s which has had an impact on the formation of small firms is the level of unemployment and the gap between the numbers unemployed and the available vacancies in established firms. The greater number of unemployed seeking employment in difficult conditions has increased the relative attractiveness of self-employment and setting up small firms, where redundancy payments help to provide initial capital. Such employment may be riskier and may result in a lower level of earnings than full-time employment with a large firm. Nevertheless where the effective comparison is with being unemployed and receiving benefit, self-employment and small firm employment may look much more attractive. Hence, there is a strong supply-side motive which may account for some of the growth in the numbers of very small enterprises and the self-employed.

(e) The restructuring of manufacturing industry

13. The process of change over recent years has also been influenced by the nature of the shake-out of labour, particularly in manufacturing industry, during periods of recession. While some firms went out of business, most merely contracted. But that process of contraction was not a uniform cutback in all grades, skills and establishments. Many companies took the opportunity to rationalise, trimming their head offices, contracting out specific services for which they could no longer justify keeping their own organisation and cutting back on peripheral activities to leave a profitable core. Each of these steps is likely to give rise to new companies and to produce work for other companies whilst at the same time reducing the average size of the firms, predominantly in manufacturing, which have rationalised in this way. These changes will result in the statistical observation of a shift from manufacturing although neither the actual tasks performed nor in some cases the people performing them will have changed.

14. The shedding of peripheral business can occur through several routes: - scrapping, in which case there is an opportunity for other companies either new or existing, to take up the market share vacated, sale or management buyout. In the last case a new firm will certainly emerge in addition to the slimmed continuing main enterprise. There are many examples of these changes. A well-known one has been for publishers to disband their copy-editing departments and manage a dispersed group of independent and usually self-employed copy editors who can then be chosen according to their particular skills in relation to any specific manuscript.

15. Some small firms are also able to have lower costs because they are less regulated than large firms but the bulk of survey evidence suggests that overhead costs from compliance with regulations tend to be proportionately higher for small firms. They may also be able to pay lower wages because they are not covered by national agreements or else lack an organised work force. In some cases this provides an opportunity for exploitation but in the bulk of cases there are thought to be considerable incentives to work in a small enterprise. The literature tends to focus on the benefits to the owners of companies through the freedom to act as they think fit quickly without internal bureaucratic control and to operate in less crowded locations. It should be noted that a major reason why small firms have lower average wages than large firms is that they are concentrated in low-paying industries and occupations, with a high preponderance of unskilled and/or part-time workers.

16. These kinds of advantage are clearly well thought of as there have been major attempts in large companies to try to implant many of the facets of small company working within their own organisation. These include removal of bureaucratic head offices and their replacement by simple control systems, greater rewards for staff for their efforts in making their own part of the enterprise profitable, flexible working groups and the encouragement of what is sometimes known as the 'intrapreneur', the entrepreneur within the large organisation. In the United States this has been developed further with the encouragement of competing groups within the firm and 'skunk groups' of innovators who seek to find new ways forward outside the traditional pattern.

17. Of the many new small firms that are created each year less than two-thirds are still in business three years later. Of the survivors the great majority remain small for the whole of their operating lives. Thus the picture of the vibrant rapidly growing small company of today which will be the medium to large company of tomorrow is atypical. Yet from the point of view of the growth of the economy and the growth of employment they are disproportionately important. It would, therefore, appear sensible to see whether there are sources of market failure here and for Council to focus attention on the barriers which inhibit growth as without them more small firms could expand.



Table 5

Lifespan of businesses registered for VAT

		% of all registrations surviving to end of period
0-6	months	95
6-12	months	88
12-18	months	81
18-24	months	74
24-30	months	68
30-36	months	64
54-60	months	49
78-84	months	40
102-108	months	34
114-120	months	31
132-138	months	28

Source: Department of Employment

18. The direct role that self-employment and very small firms play in increasing employment is likely to continue. The Occupational Study Group has argued, on the basis of previous trends, that in the years 1985-1990 there is scope for a further 1 million new jobs in this sector, 700,000 employees in small firms and 300,000 self employed. If the people they surveyed are to be believed, prospects are even better and 1½ million new jobs could be created by small firms between 1985 and 1990. Many of the jobs may be part-time and hence figures in the range of 0.3 to 0.7 million have been quoted as the contribution to the fall in registered unemployment. Whichever forecast is right, all imply a significant contribution by the small firm sector to job creation.

The Role of Small Firms in Increasing the Pace of Innovation

19. While the number and importance of innovations varies by industry, a study by the Science Policy Research Unit at the University of Sussex shows that both small and very large firms make a disproportionate contribution to innovation. A possible explanation is that there are some industries like pharmaceuticals and aircraft manufacturing where only large firms can afford the resources to support research and development, particularly where teams have to work together for many years as they do to get drugs onto the market and have them accepted by the regulatory bodies.

20. At the other end of the spectrum the relative emphasis on innovation in small firms stems in part from the fact that this is inherently risky. We have already observed that entrepreneurs in small firms seem to be more prepared to take risks. One reason why they might be prepared to do that in a small firm is because innovators can reap a much larger proportion of the rewards from the innovation for themselves than is possible within a large organisation. In NEDC 88(5), presented to the last meeting of Council, it was noted that one of the main factors which holds down the rate of research and development in any economy is the fact that the innovators themselves do not get the full benefit from the innovation. In this instance small firms can increase the proportion of the reward which goes to the individual innovators.

21. Although failure rates among small firms may be higher because of this extra risk they perform an essential role for the market in establishing which promising ideas can be matured into successful competitive products and processes. Many of these innovative companies then disappear, not because they fail but because they succeed and are purchased by large companies which can use their much more extensive distributive outlets and expertise to market the new products more efficiently. Successful growth and development does not necessarily entail that a new company should expand under the same ownership at all stages. Indeed it is clear that this form of success is relatively unusual. There are a number of clear examples from the electronics industry where companies have started from nothing and matured into major companies but evidence from the Science Policy Research Unit suggests that in newer areas like bio-technology major existing companies are buying up most of the promising developers. The high turnover in small companies thus is not necessarily a sign of market failure.

22. The resulting cash injections to the original entrepreneurs help to set up further new ventures, permitting valuable specialisation so that those who are good at spotting and developing new ideas can do so in the context of small companies and those who can exploit the fruits of this fully in large companies can also achieve their objective. There is thus a useful interaction between small and larger firms. Small firms provide a means of increasing the motivation for the innovator and hence the pace of change which all firms can build on.

23. The work by the Occupational Study Group showed that the great majority of small firms were not technologically innovative. Less than 10% of small firms responding to an industry wide survey had introduced new technology into their business on a significant scale between 1982 and 1984. But those which were growing rapidly were often ones which were introducing new products and tackling new markets both within the country outside the immediate locality and overseas. This strong innovative contribution of a small proportion of small firms more than outweighs the lack of innovation by the large majority. It could be even greater if some of the restrictions to the development of the innovating small business could be removed and businesses which do little innovation could be motivated to do so.

### Barriers to Entry

#### (a) Start up

24. Smaller firms often face two sets of barriers, one in starting up and the other in expanding. While many aspiring entrepreneurs do not even manage to get started of those small firms which are established half disappear within five years. Some of these disappearances will be of successful companies taken over by others but the large majority will have failed. One reason for that failure is that they faced and were unable to overcome various barriers to entry into markets.

25. Small firms are no different from large firms in facing barriers to entering markets. These barriers may be in the form of regulations protecting the rights of existing firms or set up costs. For example, where the number of taxi cabs or market stalls is restricted a new entrant will have to buy a licence and displace an existing operator. This entry cost puts them at a disadvantage compared with existing operators, who

thereby have a competitive edge. A new firm has to obtain premises and equipment and build up a sales network and customer base. An existing producer may already have covered his initial costs and be able to price profitably at short run marginal cost again deterring the entrant. Failure to market the product is a well-known cause of collapse of small firms. The fact that a disproportionate amount of the new entrepreneurs' time has to go into trying to establish a market means that they can spend less on producing the product and hence are more inefficient than existing firms. Thirdly, even among small firms, the new entrant may have to operate on a smaller scale and hence at a higher cost.

26. For all these reasons therefore the new entrant faces higher costs than existing firms. However, the small firm entrant is particularly disadvantaged when competing with large firms, who have more market power. By cross-subsidising large firms can finance high entry costs or can price at non-economic levels for sustained periods. The small firm is thus under financed and suffers from cash-flow problems compared with the large firm and is probably paying more for that finance anyway both because of higher interest rates and a higher debt equity ratio.

27. Another disadvantage is that small firms can face higher compliance costs than larger firms, not just because complying with tax or planning requirements, for example, takes up proportionately more of their time but because they are liable to be relatively inexpert. This lack of expertise also applies to running the business as a whole and lack of skills and knowledge also forms a major barrier to entry.

28. These barriers can be eased through finding sources of cheaper finance, by getting expert assistance in compliance with regulation, through undertaking training in management skills and by gaining experience in the industry. However, unless a new entrant has a product which is better or better marketed than those of existing suppliers or is prepared to accept lower margins he is unlikely to succeed unless he can find a geographical or product gap as total elimination of these disadvantages compared with large and existing firms would be very difficult to achieve.

(b) Expansion

29. Barriers to expansion for small firms are similar to the barriers to initial start up as they are likely to involve new markets or products, but they differ in relative importance and detail. The orders of magnitude for the finance required may vary considerably and affect the extent to which the entrepreneur's own resources will suffice. Where start up involves development of a new product and expansion an increase in the rate of its production the barriers to start up may be very much higher, whereas when expansion involves developing a second idea or entering a new location it may pose great problems because it involves moving outside the scope of previous experience. This is particularly true where the taking on of staff is concerned - moving from self-employment to the role of employer or moving from personal control to delegated management by others. Setting up a second restaurant, for example, involves all the difficulties of production in a new location and the attraction of a new set of customers but it may also involve the major step of having to appoint a manager who is not from the immediate family.

30. The sections which follow focus on three areas of barriers to growth in which firms face different and disproportionately greater difficulties because of the smallness of their size and suggest ways in which the disparities can be reduced. These areas are finance, access to markets and skills, particularly in management.

### Reducing Barriers to Growth

#### (a) Financial barriers

31. The distribution of government support for small firms shows recognition of the difficulties of start up and the Enterprise Allowance Scheme offers a £40/week allowance to the unemployed who are prepared to put up £1,000 to start a new business. Since small firms often face higher risks than larger companies, it is to be expected that finance for expansion will cost more and the existence of the problem has been recognised in the provision of such as the Business Expansion and Loan Guarantee schemes. Arrangement and appraisal costs are also larger in proportion for a small loan. It may be debatable whether projects undertaken by small firms are actually riskier. All firms experiment. Some new products are abandoned and not marketed, but in the case of the larger firm it merely closes down an operation and can move staff to a more profitable opportunity. For many small firms that product or market may be crucial to the success of the enterprise. A restaurant which cannot attract the necessary clientele in one location may succeed in another. However, if it is a single company the first operation will be shut down and a new company set up for the new venture. Business failure and entrepreneurial failure are not necessarily the same thing.

32. One of the major problems that small firms have is lack of a track record of success. They thus have a much greater problem in persuading others to lend. This is an area where the Council has already been active, through the Committee on Industry and Finance. It is essential for rapidly growing small firms to obtain external finance and for that finance to be suitably balanced between debt and equity. Routes for obtaining fixed interest finance are inherently more straightforward as virtually all companies have to develop a close relationship with their bankers. However, as NEDC (1987) set out, the function 'of measuring, managing and compensating for risk in small firm lending' requires considerable development. Obtaining equity involves finding partners and a careful negotiation so that a working relationship for the future can be developed. Because of these difficulties small firms tend to place too much emphasis on loans and hence can overburden themselves with servicing costs, particularly if there is a 'gap' in the supply of equity covering amounts less than £100,000. To help get the right balance the Office has set up a self financing Corporate Venturing Initiative with the aim of improving the flow of information between small company managers, venture capitalists and corporate sponsors from larger companies through a register of those wishing to participate in ventures.

#### (b) A Role for large companies

33. Larger companies can form strategic alliances with smaller entrepreneurial companies in order to exploit new business opportunities more effectively. This allows smaller firms to gain access to

international markets through the established distribution channels of the larger partner. Gaps in the smaller firm's technical and managerial capacity can be plugged and new sources of long term committed finance established. Such alliances are often cemented by a minority equity holding, and can frequently bring advantages to the larger company. By preserving the identity and culture of the smaller firm and by retaining the commitment of the entrepreneur the drive and direction of the smaller business are not stifled by the involvement of the larger.

34. The Office has been active in encouraging the spread of strategic alliances through its corporate venturing initiative. One of its aims is to encourage large companies to become more involved in the venture capital market in order to ease the flow of finance from conventional sources. To help bring this about the Office has been working to improve awareness and understanding and to facilitate contacts by means of a Register which introduces corporate sponsors to smaller entrepreneurial groups in order to develop mutually beneficial partnerships.

(c) Encouraging the characteristics of success

35. In order to concentrate effort on fostering the conditions which can be expected to lead to an increased rate of success among small firms it is necessary to establish whether there are any common characteristics which successful firms possess. While possession of them may not be a guarantee of success it will increase the probability. Indeed, it is not just characteristics of success which matter but what distinguishes the successful from the less successful.

36. Experience in 'picking winners' suggests that it is unlikely to be profitable to try to organise selective assistance for those who are most likely to succeed. A more fruitful approach is to examine the characteristics which distinguish the successful from the less successful and to identify the barriers which the successful have encountered. However, it is important to assess the ability of firms to benefit from assistance before offering it.

37. In a study of a small sample of successful small firms undertaken for the Department of Employment the following main characteristics were shown to be common among the entrepreneurs involved. They tended to be

aged 35-45, with some qualifications, usually HND or A level rather than degrees, some early experience in large firms, but their immediate experience lay in a small firm in the same industry and included amongst this was experience in management.

Fast growing firms usually had a highly professional management. Only some of that management quality can be achieved from injections by consultants; the basis needs to come from training and experience. These cannot be rapidly acquired at the point that an entrepreneur decides that he wishes to set up a new firm. It is therefore a considerable advantage if they have been acquired beforehand through explicit training and experience in other companies.

(d) Skills and training

38. Most smaller businesses and self-employed people do little or no formal training. There are some notable exceptions to this particularly in the engineering industry where many small firms participate in the system of

Group Training Schemes. The shortfall in training activity in small firms is particularly surprising as the rewards accruing from extra training are potentially much greater for the smaller than the larger company. A variety of useful first steps have been taken to overcome some of the problems of training by smaller firms; by the MSC, local colleges, the Open College and the Open University. Much however remains to be done to improve the training record of small firms. The trend towards more self employment and smaller firms makes the UK's pressing need for a better trained, more skilled, work force harder to achieve.

39. Arguably the management capability of those running small companies is one of the most important issues to be addressed if the small company sector is to flourish. The difficulty of small companies in making the breakthrough into medium sized and potentially large organisations has often been cited. Since this break-through depends upon a significant change in the role of the top manager from a 'hands-on' entrepreneur to a chief executive leading and co-ordinating the work of others, it demands the acquisition of a broad range of management skills. The problem is not so much the quantity of advice available in total for the managers of small businesses but the fact that it is of variable quality and provided by a plethora of different sources. The Agriculture EDC revealed 86 such sources in just one county in its study of rural employment EDC/AG(88)EMPLOY 11. The pressures of running a small business do not allow much time or energy for the assessment of the various sources of advice. To help tackle this the Cotton and Allied Textiles Sector Group has developed a course in management training and development for directors of small and medium sized textile companies with Manchester Business School. There are opportunities in other industries covered by Sector Groups for this and other kinds of initiatives to help overcome the sources of market failure that affect small firms adversely.

40. Larger companies often have their management capability honed in direct contention with international competition. Smaller companies are rarely directly subject to competition of this kind. They are frequently part of a supply chain serving a local or at most a national market. But, although they may not themselves be competing directly in the international arena, the companies that they serve or their customers are often vitally dependent upon the performance of their small suppliers in order to succeed internationally. One of the most encouraging developments of recent years has been the growth of partnership sourcing whereby customers work more closely with their suppliers, sharing knowledge and expertise in order to ensure that they are collectively more competitive. Some companies have gone further than this and committed themselves to a major programme of supplier development whereby they give active management help to their smaller supplier companies.

#### Concluding remarks

41 Starting up a small firm is a high-risk operation (see Table 5 above) but there is considerable assistance available. Indeed, this help exceeds that available to the small business in later years. As a result it has been widely argued that assistance to start up may actually contribute to the high rate of failure of other small firms. To some extent this is merely the desirable outcome of the operation of an efficient market. If there was actually a barrier to entry then existing inefficient firms could continue under the protection of that barrier.

42. Existing forms of financial assistance, both through the Loan Guarantee Scheme and the Business Expansion Scheme have enjoyed a fair measure of success. The provision of lower tax rates and specific incentives for investment in small companies reflects the observation that costs are higher for small firms and hence go some way towards equalising the position across the whole range of firms. These helpful measures are being augmented by new proposals in the White Paper issued by the DTI in January targeted at providing small firms with expert consultancy in key areas of operating the business.

43. However, existing schemes have been subject to considerable criticism because of their sheer complexity and number. For the small business particularly when it is starting, much of the task of raising finance, finding premises and markets and dealing with regulations has to be undertaken by the entrepreneur himself. Yet the entrepreneur's time is the scarcest and most valuable resource in the firm. The most useful improvements to assistance may not therefore be in the form of an expansion but in a rationalisation and a concentration on a few points of access. A single access point to government assistance through people who have experience of the problems involved may considerably improve the effectiveness of existing schemes, as has been the case with CoSIRA in rural areas. An examination of the balance between these schemes, the extent to which they can be simplified, co-ordinated and specifically honed to address the problems of small business and their overall impact would be desirable.

44. Small firms have still to make the full headway in the UK that they have achieved in the United States. There have not been major developments in the UK on the same scale as in Silicon Valley and Boston for example. Small firms are only now beginning to generate new growth centres which in turn have raised incomes and generated further demands for specialised goods and services. There are thus continuing good prospects for the small firm sector if the barriers which face them in start up and expansion can be reduced, with improved provision of finance, better links between small and large enterprises and above all better training and higher skills, particularly in management.

45. The complexities of a highly developed economy and interrelationship between all industrial and commercial sectors mean that it is not profitable to make statements about whether small firms are to be preferred to large or large preferred to small - both are necessary. However, for markets to operate efficiently all businesses irrespective of size should be able to exploit market opportunities without discrimination. As interest in small firms and self-employment has been increasingly rapidly in recent years, this paper has endeavoured to set out the facts and figures about small firms and draw attention to some market imperfections which put the smaller firm at a commercial disadvantage.

Appendix Table 1

Change in number of businesses analysed by sector 1980-1987 (Midyear, UK)

	Number of Businesses in 1987	% share of total	% change 1987/80
Agriculture	180,162	11.6	0.03
Production	160,940	10.3	10.3
of which			
Manufacturing	(159,197)	(10.2)	(10.5)
Construction	224,815	14.4	13.0
Distribution	392,999	25.3	4.3
All other Services	599,390	45.4	25.2
All Businesses	1,558,306	100.0	12.8

\* Legal Units registered for payment of Value Added Tax

Source PA 1003 1987

Appendix Table 2

Employment and Self-employment in 1973, 1979, 1987 (June each year, GB)  
( '000s)

	Number employed			Change in employment	
	1973	1979	1987	73-79	79-87 (%)
Manufacturing					
Employees	7,673	7,107	5,044	-566 (-7.4)	-2,063(-29.0)
Self employed	133	140	246	+7 (+5.2)	+106(+75.7)
Construction					
Employees	1,269	1,201	984	-68 (-5.4)	-217(-18.1)
Self employed	439	343	542	-96(-22.0)	+199(+58.0)
Services					
Employees	12,096	13,260	14,501	+1,164 (+9.6)	+1,241 (+9.4)
Self employed	1,138	1,102	1,767	-36 (-3.0)	+665(+60.3)
All Industries and Services					
Employees	22,182	22,638	21,316	456 (+2.1)	-1,322 (-6.2)
Self employed	1,969	1,842	2,801	-127 (-6.0)	+959(+52.1)

Source: Employment Gazette and Supplements



Appendix Table 3

Regional dispersion of businesses. Self employed,  
and National Income 1985

	All businesses end 1985	Self employed Mid 1985	% share of GDP at factor cost Mid 1985	net change in number of businesses since end 1979 (%)
South East	33.4	35.4	35.3	14.9
East Anglia	4.0	4.5	3.5	12.3
South West	9.5	9.8	7.6	11.7
West Midlands	8.6	7.3	8.4	11.2
East Midlands	6.8	6.2	6.6	12.0
Yorks & Humberside	7.8	8.7	8.1	8.6
North West	9.5	10.5	10.6	6.6
North	4.0	4.1	4.9	8.7
Wales	5.4	5.7	4.4	9.0
Scotland	7.5	7.8	8.6	9.7
Northern Ireland	3.5	NA	2.0	14.8
UK	100	NA	100	11.7

Source: British Business 7 April 1987, Employment Gazette April 1987  
Economic Trends November 1987

Appendix Table 4

Percentage of total employment in  
small and large enterprises 1973-83

	Small (1-19 employees)			Large (500 + employees)		
	1973 (1)	1983 (2)	change (2)-(1)	1973 (3)	1983 (4)	change (4)-(3)
Australia	23.1	26.2a	3.1	36.2	33.4a	-2.8
Belgium	20.6	25.0	4.4	34.9	32.6	-2.3
France	15.2	19.7a	4.5	43.5	39.2a	-4.3
Japan	37.6b	38.8b	1.2	29.1	27.1	-2.0
Sweden	58.6	53.2	5.4	17.4	15.6	-1.8

a 1981

b 1-29 employees

Source: OECD (1985) and Storey and Johnson (1987)

## Definition and Compilation of Tables

1. A variety of definitions of small firms have been used in the paper as have sources of data. This requires some explanation. There are difficulties in deciding what constitutes a small firm. Not only do the definitions used vary among countries but they vary within countries as well. The Bolton Committee in 1971, which made a very comprehensive study of the issue, used no fewer than seven definitions for the industries it covered and omitted consideration of agriculture and financial services altogether. Cut-off points presented in existing legislation are similarly variable with different levels used for taxation, employment legislation and health and safety. This variation occurs because it is traditional to view small firms in a behavioural sense against the backdrop of the market in which they operate. Thus for Bolton

"First, in economic terms, a small firm is one that has a relatively small share of its market. Secondly, an essential characteristic of a small firm is that it is managed by its owners or part-owners in a personalised way, and not through the medium of a formalised management structure. Thirdly, it is also independent in the sense that it does not form part of a larger enterprise and that the owner-managers should be free from outside control in taking their principal decisions".

2. Any cut-off points based on employment or turnover will inevitably be arbitrary with some firms which behave as if they are small being excluded while others, which, say, have little independence, will be included. For manufacturing industry the definition of a small firm is having less than 200 employees but there is clearly no magic transition between 199 and 201 employees.

3. The evidence suggests that, although there are indeed many types of small firm and what constitutes small firms varies from industry to industry, there are three size categories which can be distinguished. First of all there are the self-employed and those who merely employ other members of their immediate family, as in small farms and the traditional corner shop. The second group is made up of the remaining very small firms with up to 20 employees. These include the firms which are newly set up and with self-employment form the main growth areas in employment. The third group is formed of the remaining companies. The paper, when it refers to small firms in general as a group, uses the Bolton Committee's behavioural definition.

## Statistics on small businesses

4. The figures in the tables are drawn predominantly from five official UK sources and the OECD.

the Annual Census of Production  
the Census of Employment Derived Analysis of Pay Points  
the Register of Legal Units (VAT data)  
the Industrial Analysis of Employees and Self-employed  
and Regional Trends

5. The use of different sources is partly explained by the absence of any single comprehensive and up to date source on the significance and characteristics of small firms within the economy. Each set of data excludes from its scope some significant aspect of small firm activity. The Census of Production covers, only about 32% of the economy. A special analysis of data collected by the Census of Employment provides estimates of the number of employees covered by an Inland Revenue pay point; the administrative mechanism used to collect PAYE income tax. For the small firm, pay points largely correspond to a business. However, many of the smallest firms do not have a pay point. This predominantly reflects businesses where self-employed are engaged and where part-time employees may earn less than the income tax threshold.

6. Data drawn from the VAT register relate to sole traders, partnerships and industrial companies. They exclude the very small businesses which are not statutorily required to register for payment of VAT. They also exclude many businesses of any size which are engaged in activities that are VAT exempt. Data on the number of self-employed can only be a very partial measure of the significance of small firms because of the numbers of limited liability companies that are also small. These data difficulties preclude detailed understanding of small firm activity. They do not, however, prevent general observations being drawn and some of these are noted in the paper.

#### International Comparisons

7. Data available from the OECD are used in Table 4 to show shares of employment in small and large establishments in six OECD countries including the UK. Since the main interest is in comparing employment shares in businesses of different size, the data shown in Appendix Table 4 for enterprises are much more valuable. However, suitable data on enterprises are not available for the UK so the comparison has to be on the basis of the establishment. Nevertheless the correspondence in the distribution of employment shares by size of unit and their rates of change are sufficiently close to allow the inference that the unknown picture for UK enterprises is probably similar to that shown for establishment.

Notes to Table 4: Austria - second year for comparison is 1981 not 1983  
France - first year for comparison is 1975 not 1973  
Japan - small firms defined as 1-29 employees; years for comparison are 1972 and 1981 not 1973 and 1983  
U.K. - years for comparison for small firms are 1974 and 1982 and 1973 and 1981 for large firms  
US - second year for comparison is 1981 not 1983



NEDC(88)15  
13 April 1988

ENCOURAGING ENTERPRISE : THE ROLE OF SMALLER FIRMS

MEMORANDUM BY THE CONFEDERATION OF BRITISH INDUSTRY

- 1 Smaller firms have a vital role to play in securing the momentum of Britain's economic recovery. That is why it is valuable for NEDC to be considering what further steps can be taken to encourage their growth and development.
- 2 Special treatment for smaller firms is no substitute for an economic climate in which all businesses, irrespective of size or sector, can operate successfully and profitably. Externally imposed cost and regulatory burdens must be no greater than those of our international competitors, particularly if small firms are to seize the opportunities of the completion of the single European Market in 1992.
- 3 But smaller firms do have special needs and problems, which derive in part from their lack of internal resources. Encouraging start-up activity, which the CBI fully supports, has been an important part of this Government's support for the smaller firm sector. We believe increasing emphasis should now be placed on encouraging established smaller firms to grow. In this respect the DTI's Enterprise Initiative is to be warmly welcomed.
- 4 Two of the major factors affecting the growth of a smaller firm are its ability to innovate and to secure access to relevant finance. The CBI's Smaller Firms Council has been looking at both these aspects and this paper identifies a number of the problems involved and possible ways forward. A common theme to emerge is the need to raise the general level of expertise within smaller firms. Specifically this requires continuing and increasing emphasis on the importance of training and the provision of relevant information and advice. These requirements are not exclusive to smaller firms, although the manner in which their needs can be met does require this separate consideration.

ENCOURAGING ESTABLISHED BUSINESSES

- 5 Much of the effort, both of Government and advisory bodies engaged in helping smaller firms, has been aimed at encouraging business start-ups and self employment. The CBI fully supports help and assistance at this end of the market.

- 6 According to VAT statistics approximately one third of start-up companies will have ceased trading after three years and a further 30 per cent will have ceased trading after seven or eight years. The difficulties which companies face during their early years are therefore self evident. However, the success rate of such start-ups can be substantially improved with relevant training and counselling at appropriate stages during the company's evolution. Hence the justification for such support.
- 7 Nonetheless, the CBI believes there has been a pre-occupation with start-up companies, and that by any accepted measure of economic performance, eg. employment generation, GDP contribution etc, it is equally, if not more cost-effective to channel assistance to established small firms. It is a question of balance. Recent developments including the DTI Enterprise Initiative and the specific measures in the Budget designed to encourage greater retention of profit within smaller companies, are very welcome steps in ensuring this more desirable balance.

#### INNOVATION

- 8 In January 1988 the CBI's Smaller Firms Council produced a document\* reviewing the various policy initiatives being taken by the public and private sectors aimed at encouraging innovation in smaller firms. Various recommendations were made for further discussion with the Government, the education world and among CBI members. Innovation is defined as the process which comprises all those activities which are necessary for new or improved products or processes to be realised in the market. It may incorporate inventions, R&D, licensing, product and process engineering, design, training and patenting, but perhaps above all else marketing. It begins with an original idea and ends with satisfied customers.
- 9 The key points to emerge during our work on this front are:
- a the central role of marketing to successful innovation
  - b the role of Government R&D in stimulating innovation in smaller companies
  - c the need for some form of market for transferring technology

\* Promoting Innovation in Smaller Firms, CBI, Smaller Firms Council, January 1988

d the importance of the supplier/customer relationship.

e the opportunities presented by corporate venturing.

Each of these is considered briefly below.

### Marketing

- 10 Professional marketing is considered to be one of the keys to successful innovation in smaller firms. Problems exist at two levels. Firstly, a basic lack of understanding by many owner managers of the strategic importance of marketing, and secondly inadequate market intelligence of the quality and in the volume required by smaller firms and an apparent lack of help or assistance to improve this market intelligence.
- 11 Motivation for running a smaller firm and the skills of the individual owner manager vary widely. Many start a business because they have a certain technical expertise, or a flair for design or perhaps are just good salesmen. Few start a small company purely because they are good at marketing. It is not surprising therefore that this is one of the major weaknesses in many smaller firms.
- 12 The DTI's original Support for Marketing scheme, now relaunched as the Marketing Initiative, is welcome and goes a considerable way towards addressing the problem of strategic marketing. It is to be hoped that as the scheme develops, consideration will be given to including support for market intelligence and sectoral schemes within the scope of the Initiative. The scheme really addresses only the question of counselling and advice. Greater efforts need to be made in alerting smaller firms to the marketing training currently on offer and developing more schemes tailor made to their particular needs.

### Government R&D

- 13 The Government has a very substantial R&D and procurement spend on its own account. There is considerable scope for making this important market more accessible to smaller firms as it can often provide core business from which additional markets can subsequently be developed.
- 14 The MoD's Small Firms Initiative both in terms of the research budget allocation to small firms and the advice desk, is a welcome example of the positive steps that can be taken to ensure smaller firms are more widely aware of the possible business opportunities. Another is Defence Technology Enterprises (DTE). The location of DTE staff within MoD research centres, charged with the specific responsibility of identifying and separating out ideas

with potential beyond the Ministry's needs, is a useful mechanism for transferring potentially innovatory ideas to smaller companies. Both these examples could usefully be extended to other Government departments.

### Technology Transfer

- 15 For a variety of reasons many ideas developed within larger companies are not exploited and are effectively put on the shelf, perhaps because they do not fit in with the existing product mix or are deemed unlikely to produce an adequate return. The same may also be true of certain projects in universities or polytechnics which, either because of inadequate knowledge of the market, lack of finance, or failure to recognise a commercial opportunity are not successfully exploited. There is a need for some mechanism to facilitate firstly, the identification of such projects and then to effect technology transfers between interested parties, and particularly to smaller firms, who may be ideally placed to capitalise on such ideas.
- 16 There are some private sector initiatives that undertake this function including exhibitions such as Tech Mart. Various regional networks are also developing of which the North West Association for New and Improved Technology (Nimtech NW) is a good example. This has now been designated as one of the DTI/DES Regional Technology Centres and it is to be hoped that as other Centres become established they will increasingly contribute to this transfer of ideas. An increasing number of initiatives is being introduced in this area and there is a need to avoid duplication and encourage the spread of best practice. The CBI believes that a guide to the various forms of advice and assistance on offer would be useful. We shall be considering how best to produce such a guide.

### Supplier/customer relationship

- 17 At its most basic level co-operation between a customer and supplier consists of securing a mutually advantageous contract or business agreement. But for many small companies it proves particularly difficult to identify the relevant purchasing point of contact within a large organisation. "Can You Make It" and "Meet the Buyer" seminars and exhibitions are an invaluable way of imparting this information to a small firm. The CBI runs a regular programme of such events.
- 18 However, the customer/supplier link can be much more than this, providing positive encouragement for innovation in smaller firms. The development of long-term partnerships between buyers and suppliers,

- Partnership Sourcing - in which each helps the other develop their products to their mutual advantage, is something which the CBI is actively pursuing. Although the initiative is by no means aimed exclusively at helping smaller firms, inevitably many of the suppliers in such relationships will in fact be smaller firms. Successful examples of partnership sourcing will be identified so that the advantages, as well as the pitfalls to avoid, can be passed on to other potentially interested organisations.

### Corporate Venturing

- 19 One further opportunity for co-operation between large and small firms, which as yet is comparatively unexplored within the UK, is that of corporate venturing. In addition to any financial involvement, corporate venturing can offer the small company:
- the advice of experienced managers
  - marketing and distributing networks
  - more sophisticated financial control systems
  - extra production and R&D support
  - greater market place credibility.
- 20 Although there are some positive examples of corporate venturing in the UK, not all would regard their experiences as successful as pointed out at NEDO's own conference on the issue last year. We would be happy to work further with the Office, identifying benefits and problems and, again, spreading best practice.
- 21 There is therefore no shortage of initiatives to encourage innovation, although there is certainly scope among some for further development and extension. The main problem which appears to be handicapping innovative performance is a lack of awareness among smaller firms themselves of:
- a The need to innovate. Too many are content to operate in traditional markets with traditional technologies and processes. There is a need to improve the overall level of management expertise and of management awareness of the importance of innovation. This can only be achieved by providing advice and, most importantly, training and this is referred to in later paragraphs.
  - b The sources of advice and assistance that are available. Despite the different schemes and advisory agencies designed to encourage innovation in its widest sense, there are still large numbers of smaller firms who remain unaware of the help



available to them or are confused by the sheer number of initiatives on offer. The CBI believes it has an educative role and will be considering the preparation of promotional and guidance material; in essence a simple signposting service.

## FINANCE

- 22 Despite the introduction in recent years of the Loan Guarantee Scheme and the Business Expansion Scheme and welcome developments among the banks and venture capitalists, many smaller firms still experience funding difficulties particularly in the following areas:
- a Loan and equity financing of less than £250,000, but particularly in the £50,000 to £100,000 range.
  - b The supply of patient money where returns take longer than five years.
  - c The provision of finance for new products/processes in which the firm lacks a track record.
- 23 These difficulties do not result from a general shortage of money in the market; on the contrary banks are lending at record levels to smaller firms and venture capitalists have considerable funds available to invest in viable projects. But there are two particular problems. Firstly, probably because of a failure in communication or understanding, there are mismatches between the needs of certain smaller firms and the finance offered. Too often loan or overdraft financing is sought or offered where equity or a mixture of equity and debt would be more appropriate. Secondly, the high cost of appraising and monitoring small tranches of risk capital. The time spent appraising a £50,000 investment can be as great, if not greater, than appraising a £250,000 one and for this reason many venture capitalists will not consider proposals beneath this latter figure.
- 24 With the increasing emphasis on enterprise and the encouragement individuals have been given to start up businesses, there has inevitably been a much larger number of people, with limited business experience, seeking external finance. The fact that some of these may have been refused finance is not automatically an indication that the financing system is at fault. On the contrary, the best advice for certain people contemplating starting a business is don't, at least until you have done more homework.
- 25 The CBI has been looking at these particular difficulties facing smaller firms and although the work is not complete there are three areas which have been identified as important:

- a training and advice for the smaller firms
- b training for the finance providers and advisers
- c improved provision of equity finance and loan/equity packages

#### Training and advice for smaller firms

- 26 The standard of financial management in many smaller firms leaves much to be desired. Lack of sound financial management leads not only to poor quality applications for finance with inadequate business plans, but also to financing needs being translated into the wrong kind of demand ie for debt where equity might be more appropriate.
- 27 This is symptomatic of a wider problem of inadequate management training. Nevertheless assistance for smaller firms in this specific area is vital and the extension of the DTI's Enterprise Initiative to cover consultancy on business plans is a welcome move. There is also a need for better understanding among smaller firms of the most appropriate types of finance for their business and from where these are available. Many firms are reluctant to consider equity because of an understandable fear that they will lose control of the business. The CBI acknowledges that with others it has a role in increasing the awareness of the value of shared equity.
- 28 In a more direct and immediate way, there is also an argument for placing conditions on the provision of finance such as some prescribed training or acceptance of a non-executive director onto the Board. This may be interpreted by some as unnecessary interference in the company's affairs, but if the quality of training or advice is right this could well be a justified condition of an offer.

#### Training of the financial providers and advisers

- 29 As well as the specific agencies and schemes designed to help smaller firms, the professional advisers such as banks and accountants have a key role to play in disseminating information. After all at some stage or other almost every smaller firm has to approach a bank manager or accountant. The banks and accountants are increasingly recognising this role and produce a whole range of guidance material and specialist advice.
- 30 Despite the considerable efforts of the advisers, many small firms still believe that the problems and needs of their type of business are not fully understood. Continuing efforts must be made to ensure that advisers are trained in the realities of running a small business.

One particularly effective method is the secondment of bank personnel to Local Enterprise Agencies. Not only does this provide the agency with much needed resource but it can also be a valuable training opportunity for the secondee. Certainly such training will be important if advisers are to play a part in encouraging owner-managers to undertake appropriate training themselves. Some ability to make at least an initial assessment of the firm's training needs will be necessary.

### Provision of Finance

- 31 The high costs of appraising and monitoring make small scale investment projects particularly unattractive for commercial venture capitalists. An increasing number of Enterprise Agencies and other local support networks are now developing their own investment funds. They are able to offer these smaller tranches of finance because they are not necessarily operating under the same commercial criteria as a traditional venture capitalist. Furthermore, the appraisal and monitoring costs can be significantly lower because they may already have considerable knowledge of the company in question. Although as yet meeting only a small part of the demand, these developments are to be welcomed and encouraged. Even where such agencies do not have an investment fund of their own, their association with a smaller firm can help to give it greater credibility when approaching traditional sources of finance.
- 32 The CBI has been advocating a further mechanism, again possibly linked to a local advisory organisation, to help meet the requirements for small tranches of finance at the local level. These have been referred to as Local Investment Companies (LICs) which would act as intermediaries taking equity in, and making long term loans to, new or established smaller businesses. To minimise bureaucracy and maximise the financial service and business advice so essential to an expanding firm, the LICs could be linked to existing sources of local support for smaller firms, such as Local Enterprise Agencies. To encourage the establishment of LICs and to draw funds into them, the CBI has proposed a fiscal incentive for both corporate and individual investors.
- 33 Although having many similarities to the Business Expansion Scheme, Local Investment Companies would be seen as an extension rather than a replacement for the BES. The CBI still believes that the BES could be substantially improved if the eligibility criteria were extended to cover persons connected with the firms such as employees, directors, partners and their associates. The Treasury's reservations on abuse, could be met by suitable safeguards.

## TRAINING, INFORMATION AND ADVICE

- 34 A recurring theme through this paper has been the need to improve the overall level of expertise within smaller firms. However, before action can be taken the owner-manager must recognise his shortcomings and accept the need for help. This is a notoriously difficult hurdle to overcome. A recent survey of CBI's smaller firms members showed that owner-managers who had undertaken training valued it, and wanted more, but those who had not tried training felt it would be of no benefit to them.
- 35 In many respects the problem is deep rooted and for the longer term people have to be persuaded of the value of training and outside advice. More emphasis could be placed in schools on the value of continuing training/education in adult life and on recognising one's limitations and taking appropriate action to deal with them.
- 36 In the shorter term, the whole question of both the public and private provision of management training for smaller firms needs close attention. Ways must be found to encourage smaller firms who have previously spurned training to recognise its value. This will require both imaginative promotion of the schemes on offer, and the tailoring of these schemes in a form, and at a time and place most convenient to the operation of a small firm and its manager.
- 37 It is also important that the provision of advice, counselling and consultancy is not divorced from training. It is to be hoped therefore that the DTI's Business Review, forming part of the Enterprise Initiative, will be able to prescribe suitable training as well as simply specialist consultancy advice.
- 38 Over recent years the support organisations of one form or another have mushroomed. In one respect this is a very welcome development as it increases the chances of an individual small firm coming into contact with someone who can help him. However, it can also lead to confusion.
- 39 The answer does not lie in trying to impose one single type of advisory organisation or a blue print for a one-stop shop. What is required is a network so that when a small firm makes an initial contact with whatever form of advisory body, be it the Small Firms Service, Local Enterprise Agency, a sectoral business association etc, he is referred directly to the most appropriate source of advice.
- 40 The increasing emphasis now being given by the DTI to support for established businesses is welcome, but it does present at least a potential overlap with the

activities of the Department of Employment. This is particularly true at a regional level with the expanding DTI regional offices and the established Department of Employment Small Firm Service and Regional Enterprise Units. There is clearly a need to look very carefully at the respective roles as the potential for confusion in the eyes of the smaller firms, let alone actual duplication on the ground, would seem to be great.

\* \* \*

- 41 The continuing increase in the number of new firms is a welcome trend in the British economy. If we are to maintain the momentum of the economic recovery it is vital that both new firms and the established small firms sector are able to grow and develop to their full potential.
- 42 This will require the Government to create the right economic climate, ensuring that the burdens of taxation, regulation and other externally imposed costs are no greater than those of our international competitors. But in addition small firms must be helped with some of their specific problems deriving in part from their lack of internal resources. They must have access to the necessary skills and expertise to help them overcome the hurdles to growth. Training, information and advice are central.

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NEDC(88)11

13 April 1988

**SKILL SHORTAGES AND EMPLOYER ACTION**  
**MEMORANDUM BY THE CONFEDERATION OF BRITISH INDUSTRY**

**Introduction**

- 1 The Council most recently discussed skill shortages at its meeting in February of last year. This paper considers developments that have taken place since then with particular emphasis on both the latest survey evidence and on what employers need to do and are doing to ameliorate or reduce problems arising from growing skill shortages. It is suggested that, despite some claims to the contrary, we do not face a crisis in this area; but plainly the pace of training of both employed and unemployed people needs to be stepped up and there are other policy responses too, mentioned below. The Government has a major part to play, particularly in terms of the training of unemployed people, but CBI recognises that responsibility for continuing action rests heavily too with employers. Individual employees must also be prepared and encouraged to take the initiative in developing their own skills.
- 2 This paper recognises no role for statutory intervention to compel employers to provide training for their employees - indeed the CBI believes that such intervention would do harm to the progress already made by employers in increasing the level and effectiveness of the training they provide.
- 3 Analysis of skill shortages, and identifying the appropriate policy responses, is not always a precise art: such shortages mean different things to different people. The impact of such shortages can range from marginal short-term inefficiencies to serious loss of output and competitiveness. However, it is common ground that the UK has under-invested in the provision of skills; and the CBI welcomes this opportunity to reopen the subject at the NEDC.

**The Latest Survey Evidence on Skill Shortages**

- 4 When the Council discussed the issue of skill shortages at its meeting in February of last year, there was widespread agreement amongst all parties on the need to raise skill levels throughout the economy. There was recognition too of the other important actions designed to ensure that skill shortages were as limited a constraint as possible on sustaining an improving level of economic activity.
- 5 There has undoubtedly been a tightening of the skills market over the last twelve months. The latest joint 'CBI/MSA Special Survey of Skill Shortages' was issued in early March. The Survey was conducted in November 1987 with 1225 responses, from manufacturing industry. More than one-third of firms expected a shortage of some categories of skilled labour to limit their output over the next four months (34 per cent). This percentage has been rising each year since the survey was first conducted in 1984. Figures for previous years were 13 per cent for 1984, 15 per cent for 1985 and 19 per cent for 1986.

- 6 Similarly, the CBI Quarterly Industrial Trends Survey also provides evidence of a sharply rising trend of skill shortages, limiting output. The percentage of firms expecting skilled labour to act as a constraint on output rose to 20 per cent according to the latest survey undertaken in January this year. This is double the level of four years ago and the highest figure since the end of 1979.
- 7 While this 'deterioration' in the skills situation is obviously worrying it is important to understand that this upward trend in skill shortages has been associated with a lengthy period of strong economic growth, rising employment, and falling unemployment. The current position should be seen in context. As Figure 1 illustrates, while the proportion of one in five firms reporting skill shortages as a constraint on output in the CBI Quarterly Industrial Trends Survey is high by the standards of the last seven or eight years, it is significantly below the levels reported in the periods of strong growth of output in the 1960's and 1970's. For given levels of capacity utilisation in manufacturing industry skill shortages are actually less widespread now than in the 1960's and 1970's. This is further illustrated in Figure 2 which compares since 1972 the proportion of firms responding to the CBI Quarterly Industrial Trends Survey who have been working below capacity with those citing constraints on output resulting from skilled labour shortages. This chart demonstrates that over the last fifteen years skill constraints have tended to rise increasingly less rapidly with each period of relatively-high capacity utilisation.
- 8 Thus there are in fact encouraging signs that as an economy we have learnt to manage our skills better in the present decade than over the previous two. This is a measure not just of the better organisation of work in UK firms, but also of investment not least in the requisite training and retraining of employees.
- 9 The above analysis attempts to set the problem in a proper context. But problem it is. When all is said and done, the available evidence points to quite widespread skill shortages causing operational and other difficulties. In some sectors the problem is approaching the acute. If strong growth, increasing employment, and falling unemployment continue, the situation could get worse rather than better, despite a number of initiatives that have been taken by Government, employers and others in recent years. The reasons for this include the decline in the number of 16 - 19 year olds entering the labour market (by nearly one quarter by the early 1990's) and the accelerating pace of technological change which will lead to an increasing demand from employers for higher and wider skill levels.

#### Actions to Lessen Skill Shortages

- 10 A number of studies\* have assembled evidence which indicates that the general level of skills in the UK may be significantly below that enjoyed by our main competitors. This in turn has detrimental effects

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\*eg Competence and Competition, NEDC/MSD 1984; Challenge to Complacency MSD/NEDC 1985; The Making of Managers, NEDC/MSD/BIM 1987.

on our productivity, quality of products and services, innovation, research and development and so on. It has been therefore a strategic priority of both the Government and employers to raise the skill level of the workforce at least to those of our competitors and preferably beyond.

- 11 One major cause of the UK's deficiency, as discussed at the February Council meeting last year, is the perceived relatively poor performance of the education system in imparting skills to pupils, especially those not going on into higher education. A number of major reforms are in the pipeline to attempt to rectify this situation but many of them will not be fully effective for several years and will not have a major impact on pupils for even longer. Nevertheless it is encouraging that some major and necessary changes are in train.
- 12 Other initiatives beyond the classroom led by the Government and discussed by the Council in February last year include:
  - the enhanced two-year Youth Training Scheme (YTS)
  - the new framework for vocational qualifications to be created by the National Council for Vocational Qualifications (NCVQ)
  - the Engineering and Technology Programme to increase the supply of people qualified in disciplines related to information technology
  - the establishment of the Open College.
- 13 Since then the Government has brought forward through the Manpower Services Commission proposals for 'Employment Training', a New Adult Training Programme for the unemployed. These are currently being further developed by a working party of the MSC. The need to assist the long-term unemployed to prepare themselves for work by giving them quality work experience and training, is underlined by the demographic trends referred to earlier. It is vital for the economy that the scheme is a success, fully supported by all those concerned - the Government, employers, trade unions and not least the prospective trainees. The CBI for its part is committed to helping to develop the Programme in such a way that it can indeed help to equip unemployed people for work.
- 14 Other developments led by the Government include the new 'Enterprise in Higher Education Initiative' which is designed to give all those at higher education institutions an opportunity to acquire enterprise skills, and the conversion of the MSC into the Training Commission, which will provide a sharper focus for its role of encouraging improvements in training performance. Again, employers will play a major part.
- 15 Initiatives such as those mentioned above are long overdue. They enjoy the support of employers, who will continue to look also for other areas away from the workplace where action can be taken to improve the quality of potential employees. But the rest of this Memorandum concentrates on the employer response inside companies to skill shortages and training needs. It is, of course, at the workplace that the major challenge remains.



### Employer Response to Skill Shortages and Training Needs

- 16 The prime responsibility for ensuring that the skills of employees keep pace with the demands of a fast growing economy, characterised by technological change, rests with employers.
- 17 The latest labour market survey indicates that more employers are becoming involved in providing employees with training and retraining; and that the period spent on training is increasing. The rapid growth of the private sector training industry - one of the faster growing sectors of the economy - confirms this interpretation. So does the evidence that is available about major technological innovations in training methods, particularly in relation to open learning and related fields, where British industry is close to leading the world.
- 18 The MSC is in the process of conducting a major in depth survey of the level of training currently provided by employers in the UK economy. This survey should provide for the first time authoritative information about the level of training expenditure carried out by employers. It should confirm the impression provided by general anecdotal and other evidence that there has been a significant resurgence of interest in training by employers and that this interest has been matched by actions. Indeed the CBI believes that training undertaken by employers may be both more extensive and more effective than is currently appreciated.
- 19 Employers are involved in a number of important initiatives directed at improving training responses to skill shortages. These are designed to influence both the supply of skills and the quality of training.

### Skills Supply

- 20 Three important initiatives are engaging the active involvement of employers:-
  - In the 'high-tech' area (and as an example of where a national approach was needed) the Information Technology Skills Agency (ITSA) was established in 1985 under the auspices of the CBI Education Foundation to monitor and recommend action to overcome skill shortages in information technology. That year through ITSA industry provided £24 million to match a government contribution of £43 million to higher education to increase the output of graduates in engineering and technology, with particular emphasis on information technology. Currently ITSA is involved in working with the DTI in a study of the impact of information technology on manpower needs, with the object of an annual report rolling forward previous reports being made each year. The future of ITSA is currently under review but, irrespective of the outcome, this study is likely to continue.
  - Considerable effort has been made by employers in the sectors involved to improve the effectiveness of the non-statutory training organisations. A recent MSC survey suggests that around two-thirds of these organisations are judged to be effective, these representing around three-quarters of the workforce not covered by Industrial Training Boards. The organisations are currently

considering further means of improving their performance, including the possible establishment of a central resource unit to aid development.

- Another vital initiative in which employers are actively involved is the establishment of local employer networks, covering in the main but not exclusively travel-to-work areas. The CBI and ABCC are in partnership with the MSC to see around 110 such networks established by the end of September. The networks will provide an employers' voice at the local level and will be a focal point for all employer VET matters. The most important specific role for the networks will be to identify current and likely future local employer labour education and training needs and to take steps to ensure that such needs are met by local provision. We hope that more employers will become involved in, and support, the networks believing that local action of this kind is likely to be the most effective response to the majority of skill shortages.

#### Quality of Training

20 Two initiatives are currently being developed aimed at enhancing existing levels of skills within companies as part of the general effort to ensure not only that existing potential is fully exploited (particularly in the light of new developments in multi-skilling) but also that training is regarded as a continuing activity throughout individuals' working lives:

- The first initiative has been given added significance by the results of the latest CBI/MSK skill shortage survey which provided a reminder that managerial skill shortages are a problem. The industry-led response to the Handy and Constable/McCormick reports is currently being developed by the Council for Management Education and Development. Proposals for a corporate 'code of good practice' on management development are well advanced and likely to be firmed up early in the summer. Other proposals will follow. Business accepts that improvements in management and the spread of best practice are likely to be one of the most important factors -if not the most important - influencing future business performance.
- The second initiative is designed to encourage employers to consider the scope for developing their training arrangements. A training presentation is currently being prepared which would be the corner-stone of country-wide training conferences so that employers operating in the same or similar labour markets can exchange views and experiences. Regular and detailed contact with CBI members has shown that a great deal of activity is taking place within individual companies to identify actual and likely future skill needs and to take steps to ensure that as far as possible they are met. Considerable investment is being made in the setting of competence-based standards for employment. More sophisticated training-needs analysis is being carried out. New training techniques such as open and distance learning are receiving a more widespread application throughout companies. As investment in training programmes has increased so has the scrutiny of their relevance and effectiveness. Training as an investment should bring a return but it will only do so where it is both appropriate and

properly directed. Together these various developments are strengthening the training culture and are more likely to overcome skill mismatches than generalised or broad brush training solutions.

### Non-Training Responses to Skill Shortages

- 21 Inadequacies in training (and education) systems are not the sole cause of skill shortages. All too often surveys tend to give the impression that skill shortages can only be met by more and better education and training provision. In fact, the nature and effect of skill shortage varies considerably between sectors and indeed between firms in the same sectors. It is important to bear this in mind in the development of policy responses. As already mentioned, disappearing restrictive working practices means that a shortfall in required skills is rather less likely to limit output now in the 1980's because of far greater flexibility and multi-skilling amongst employees. Other factors affecting the nature of any particular shortage include the relative costs of pay for particular jobs and occupations; the level of effective management of the workforce; the firm's tolerance level for the time that it takes to fill a vacancy; the employer's perception of necessary skills and experience for a particular post which may differ from an objective assessment of what is required; and preferences for the degree of experience that a job recruit should have. It follows that the attention companies devote to their human resource management is as important as the attention devoted to development. With this in mind, the CBI is currently preparing material for wide discussion amongst its members on all the ways in which company employment policies can give those companies their competitive edge. A series of discussion documents will be published in the latter half of 1988.
  
- 22 One important cause of skill shortages has been not a training failure but a geographic mismatch with skills which are in surplus in some regions short in others. It was to help improve the effectiveness of the labour market in this respect that the CBI Employee Relocation Council (Annex 1 - circulated to Members and Principal Advisers only) was established. It is modelled along the lines of its counterparts in Canada and the USA and provides employers with a forum to meet and discuss the problems of relocation; and to lobby in the interest of a more efficient and less costly relocation regime. The Council provides a central reference point for identifying sources of expertise on relocation matters such as tax, housing, removals, education for employees' children and so forth. It also provides a clearing house for employers to exchange advice and experience on company policies, allowances and benefits. The CBI has also taken the initiative to establish, with PE-INBUCON (Annex 2 - circulated to Members and Principal Advisers only), a temporary executive service to provide senior managers equipped with special skills and experience for companies faced with sudden gaps to be filled.

- 23 All the aspects of the supply of skills that have been discussed in this paper support the need for increased commitment and resources to be given to effective, high quality training by the Government, businesses and individuals. However in looking at the perceived problems of skill shortages the role of training must be seen alongside other policy responses. In some cases an individual skill shortage can be a symptom of other inappropriate policies such as the wrong pay differentials, the wrong approach to employee promotion or to job design. This point is not intended to detract from the central importance of training but rather to ensure that sight is not lost of other relevant policy considerations.
- 24 For its part, the CBI will continue to direct its attention to the encouragement of employers to take appropriate actions to anticipate and deal with skill shortages, by:
- monitoring closely developments on the skills front, including identifying likely future constraints on skill supply;
  - achieving a better understanding of the nature and appropriate solutions to skill shortage problems; and
  - seeking increased employer involvement and commitment to bodies such as local employer networks as an important and effective mechanism for identifying and resolving skill problems at the local level.

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UNRESTRICTED

National Economic  
Development Council

14 April 1988

*Jarathuan*  
*has come /*  
*missed lunch*  
*with Sir R Halstead?*  
*M.*

NEDC LUNCHES

Note by the Secretary to the Council

As most members will know, the Office provides luncheon for members and attending advisers after morning meetings of the NEDC.

The Director General hopes that as many members and attending advisers as are able will stay for lunch on Tuesday 26 April.

Mrs Bogod of this Office will phone round several days before the meeting to confirm the attendance list and to find out which members and advisers are likely to be able to stay for lunch.

Martin Couchman

UNRESTRICTED

NEDC(88)12  
14 April 1988

THE SUPPLY OF SKILLS: SOME QUESTIONS  
Paper by the Director General

~~BF 1874~~ 19/12

Introduction

- 1 On a number of occasions in recent years the Council has considered the training and skills of the UK workforce. Evidence has been brought forward (NEDO, MSC, NIESR) that major competitor countries have, in general, a better trained and more skilled workforce than our own. There are now some indicators that the outlook for training in the UK is better than it has been for some time. This paper draws attention to these and points to three particular areas where the Government, employers and trade unions might all contribute to more effective action. The Annex draws together evidence about the UK's training performance.

The Developing Situation

- 2 Training by industry appears to be on the increase. Numbers of young people in the Youth Training Scheme and of employees generally undergoing job-related training have increased (see Figure 1 and Table 1).
- 3 At least three factors may help to explain why industry's training performance is improving. First, there appears to be a growing awareness in industry of the advantages of investing in human resources. One cause of this is the realisation by larger companies competing internationally that overseas competitors derive advantage from taking training seriously. To some extent moreover these companies pass on this message to their suppliers. Secondly, the tax regime is more favourable in the sense that investment in capital is no longer given especially favourable treatment, so that companies' decisions about investment in training are taken on more level terms than before. Thirdly, profits in industry are higher than they have been for many years. Industry has the funds to finance more training and the motivation to do so which comes from seeing encouraging prospects for the future. Nevertheless, despite the grounds for encouragement, it must still be remembered that yardsticks for performance are set internationally, there is much ground to be made up and our competitors do not stand still.
- 4 In the labour market there are important trends which increasingly have to be taken into account. First, there has been a rapid rise in employment and a sharp reduction in unemployment. Skill shortages are

at the highest level reported since 1979. Secondly, demographic trends mean that there will be a steep fall in the number of school leavers becoming available for employment over the next few years, a trend which will continue until 1992/93. Simultaneously the increase in the number of people of working age will slow: as against an increase of 1.7 million in the five years to 1988 there will be an increase of only 0.5 million in the five years to 1993. Thirdly, there is a marked long-term shift of demand towards higher skills in the labour market (see Figure 2 for trends in the engineering industry). There is also a marked association of unemployment with poor education/training attainment. Fourthly, occupational change is now faster than ever before and in view of technological and other trends looks certain to continue to be so.

- 5 This paper leaves on one side problems related to the reform of the schools and the development of higher education and also the reform of managerial education, training and development, crucial as these are. Instead it raises three particular questions which need now to be addressed in the light of the trends just described. They concern (1) the Youth Training Scheme, (2) training for adults, and (3) middle range skills.

#### Youth Training Scheme

- 6 In all the major industrial countries against which we compete, including the USA, Japan, West Germany and France, the minimum age at which a young person enters the labour market proper is normally 18 or higher. The United Kingdom has been alone in accepting it as normal for 16 and 17 year olds to go into ordinary jobs if they have left full-time education.
- 7 For that reason the introduction of the Youth Training Scheme and the progress made with it has been one of the most encouraging features of the British manpower scene in recent years. Under YTS 16 and 17 year olds are offered up to 2 years of training and work experience with the aim of giving them skills and competence of permanent value to them. Most of the places are provided by employers. While on the scheme young people receive an allowance of £28-50 a week (if they are 16) or £35 a week (at 17). Many of the places under the scheme already provide high quality training leading to widely accepted qualifications, and the scheme has the potential to ensure that all school-leavers have the opportunity to secure accepted qualifications of a high standard across the whole employment field.
- 8 A fundamental problem concerning the future of YTS is however beginning to emerge. Young people who enter ordinary jobs are paid far more than the allowance available under YTS. The average weekly earnings of 16 and 17 year olds in jobs in April 1987 were about £79 a week and are no doubt significantly higher than that today. Meanwhile as the labour market tightens, and especially in the South East, many more jobs for young people are available. Demographic trends ensure that competition for young people will in any case strengthen in the next few years. There is therefore a strong possibility that young people who might have gone into YTS will be attracted into jobs which offer little or no training.

- 9 The nearest parallel to our situation is that of West Germany, where nearly all young people who have left full-time education go into apprenticeships in which they receive a comparatively modest allowance. This situation has been made possible by the widespread and long-standing acceptance and support of the apprenticeship system in Germany, coupled with a virtually complete withdrawal of job opportunities for 16 and 17 year olds by tacit agreement among employers.
- 10 The question arises whether a similar position might be reached in this country. It would be an obvious prerequisite that the quality of YTS should be, and should be generally accepted as being, of a high standard. But it would also be necessary, in one way or another, to discourage employers from using the lure of higher pay to attract 16 and 17 year olds into jobs which offer little or no adequate training.

#### Adults

- 11 Employees already often undergo training in their jobs in order to cope with change, keep their knowledge up to date, widen their skills or qualify for upgrading. The latest Labour Force Survey shows that nearly 12 per cent of the workforce undertook job-related training in the survey period - see Table 1.
- 12 It is however clear that the amount of training of employed adults will have to increase very considerably. In particular, the decrease in the numbers of young people entering the labour market over the next few years makes it essential to develop the skills of existing employees further.
- 13 The recent White Paper "Training for Employment" (Cmn 316) aims to improve training for unemployed people. This is essential to enable many unemployed people to get back into jobs. Even so, there are limits to the ability of unemployed people to fill the requirements for more skilled labour to be expected in the 1990s. Such requirements will more often be filled by upgrading present employees and if necessary attracting people already in employment away from their existing employers. It will on the whole, and with exceptions, be the less skilled jobs that are filled by recruiting unemployed people; the Government's scheme will be especially relevant for training related to these jobs.
- 14 Clearly, skilled jobs will go unfilled if the pay is insufficient to retain existing skilled workers or to persuade young people to train for them. Nor is it unknown for employers to complain of skill shortages without making the best use of the skilled workers already available to them. But even if such problems did not exist, there would still be great need to train existing employees to take on more skilled work.
- 15 It has become routine to emphasise the importance of training and re-training for adults but it is by no means clear that industry has done enough to turn generalities into practical action. This is the



more important because as long as more skilled jobs are unfilled that will often be a bottleneck on the growth of other less skilled jobs, and to that extent the Government's plans for training unemployed people will be frustrated. Thus an important question about the balance of effort arises.

- 16 Typically what is acceptable to adults and to their employers is short intensive modules of training which equip them to start in a job which is unfamiliar to them. This is well enough accepted where, for example, office skills such as word processing are concerned but there is a long way to go where more traditional manual skilled jobs are concerned, eg building skills or various engineering occupations usually classified as skilled. In some cases industrial relations difficulties may need to be resolved. Nor is it necessarily easy for a person already in a job to obtain training to suit his or her needs if the employer is unwilling to provide it. There is therefore a strong case for employers and training organisations doing much more to develop new training approaches closely tailored to the needs of employed (as well as unemployed) workers, with appropriate encouragement and help from the MSC.

#### Middle Range Skills

- 17 In comparison with competitor countries, British industry suffers from insufficiently educated and trained people in middle range technical and managerial positions, including notably technicians and foremen. These people have traditionally progressed to technician jobs from apprenticeships and other long term training or have been promoted from the ranks of the skilled and semi-skilled workers. The use of part-time education - City and Guilds ONC and HNC, NEBSS, and similar courses - have characterised the educational side of this process.
- 18 More recently, new career routes have opened up as apprenticeship opportunities have fallen and an increasing number of young people have been recruited at age 18 and 20 years after full time education. At the top of this group are to be found some entrants with degrees and HND qualifications. However, compared with such countries as Germany and France our stock of middle-range skills is poorly developed. It should be noted that skill shortcomings at this level do not generally lead to high levels of reported vacancies: the jobs are filled, but by people whose skills may be limited. The effects of deficiencies in supervisory skills have been charted by EDCs, including those for the Gauge and Tool Industry (1981) and for Paper and Board (1987). The inadequacies of technical education have been highlighted by the NIESR in a series of reports.
- 19 Changes in technology and in particular the computerisation of process control and management systems are causing many companies to rethink the role and hence the education, training and development of the technician and foreman. There is no single answer. Certain desirable characteristics for technicians and supervisors can however be identified and there is much that could be learned from the experiences of particular sectors and companies.

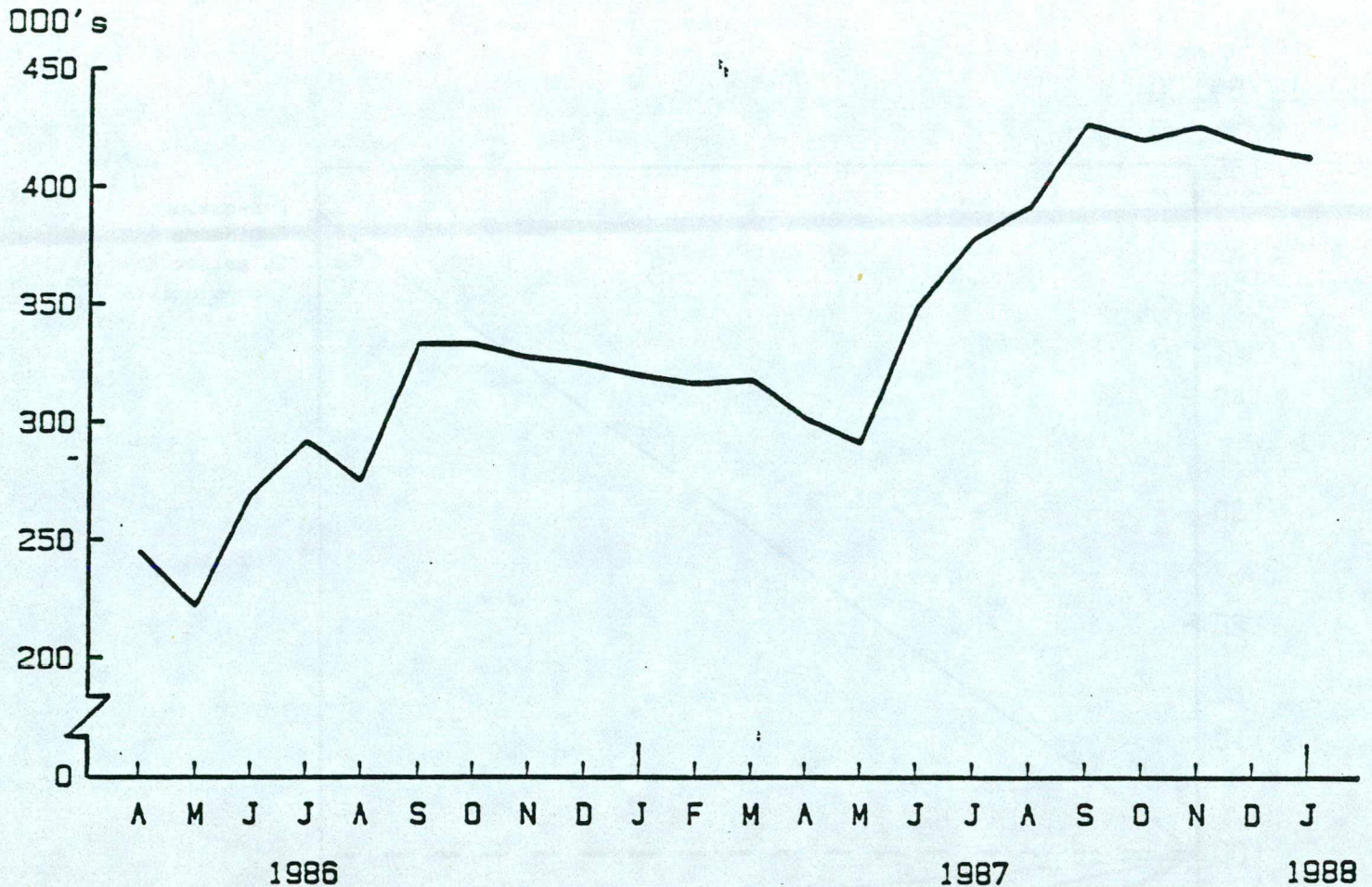
- 20 It is not possible to increase the stock of these skills quickly, and indeed the supply of suitably qualified young people is restricted by the current shortages of maths and physics teachers. It is important however to make sure that attractive and well sign-posted ways into these jobs are available for well-qualified young entrants and others. Experience with the provision of such courses has been provided through the development of "Meister" training for foremen toolmakers, by the CGLI, MSC, EITB and NEDO, following the recommendations of the Gauge and Tool EDC. There is scope for a great deal more similar work by the various relevant training organisations and employers' associations.

#### Conclusion

- 21 Against a background of some improvement in industry's training performance this paper raises some important questions about future provision. In each case given our industrial history there must be possibilities that the action we take will be inadequate. Failure would bring with it heavy penalties in that we are faced by competitor countries who have found or are finding their own solutions to these same questions. Conversely, success would make a very valuable contribution to building up the competitiveness of Britain.
- 22 The Council is invited to discuss in particular:

- (1) the future development of training for young people;
- (2) the further development of training and re-training for adults;
- (3) the improvement of the supply of middle range skills in industry.

## Numbers in Youth Training Scheme



Source: Department of Employment

Table 1

Employees receiving training in the last 4 weeks, as a percentage of all employees in the age group (GB)

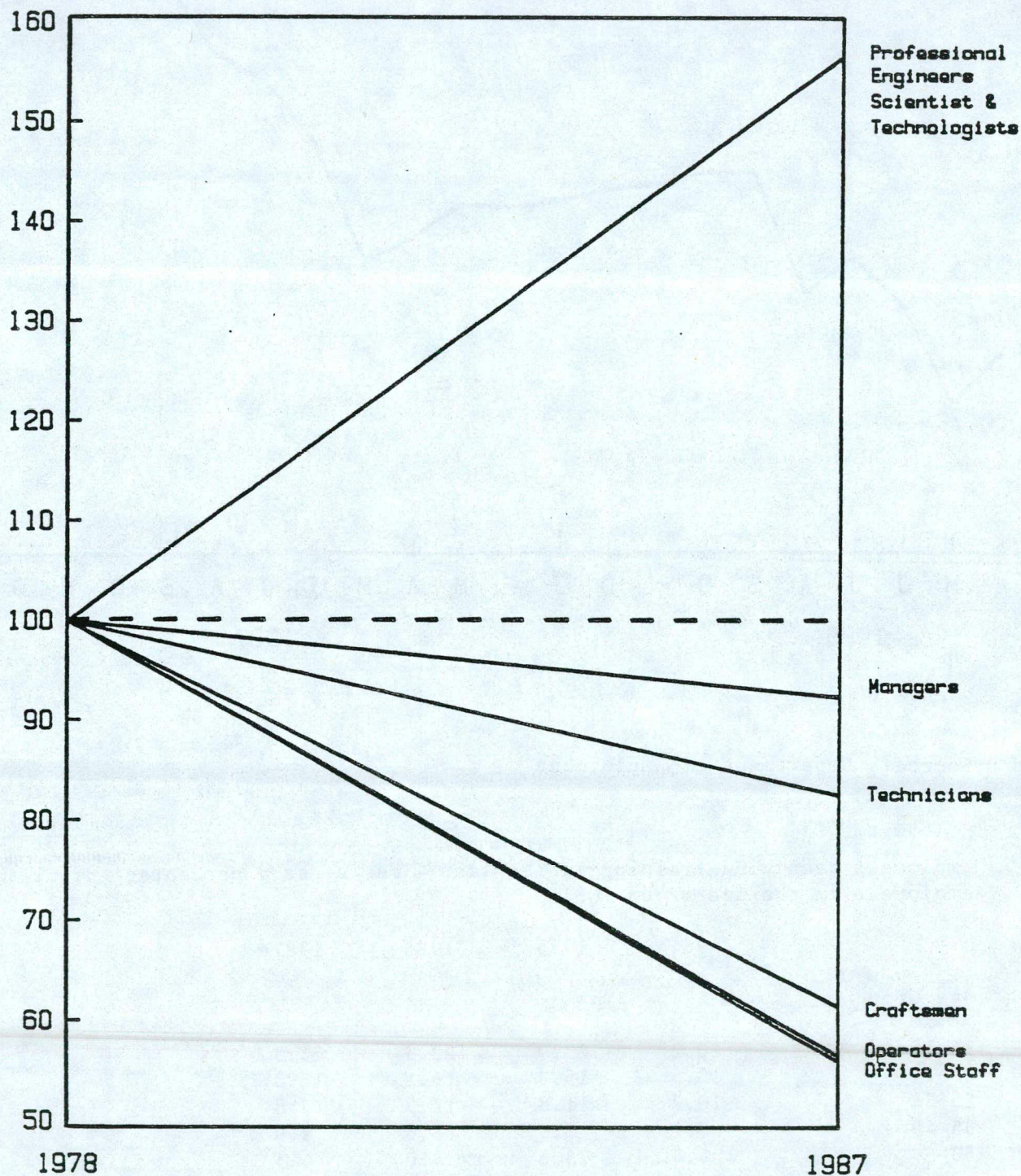
	1984	1985	1986	1987*
<u>Age Group</u>				
16-19	20.2	23.9	22.3	21.3
20-24	13.5	15.9	16.1	16.8
25-34	10.7	11.8	12.5	13.8
35-49	7.1	7.9	8.6	9.9
50-64	5.4	3.6	4.0	4.5
Total	9.1	10.4	10.8	11.7

\* preliminary figures

NB data exclude those on government employment and training schemes such as YTS. Their inclusion as trainees would increase the "total" figure to about 12.5% in 1986.

# Occupational Trends in the Engineering Industry 1978-87

Index  
1978=100



Source: EITB



NEDC(88)16  
15 April 1988

SMALL FIRMS

Memorandum by the TUC

Introduction

1 Small firms are an important part of the British economy. Moreover, their contribution to national output and employment is likely to grow in the future. However, exaggerated claims have been made about the potential role of the small and particularly the new firm sector and the alleged burdens imposed on business by Government regulations. Small firms need to grow but regulation is needed to ensure that as small firms grow they become more efficient as well as meeting their social responsibilities. This Memorandum looks at the evidence and sets out some policy issues.

Main conclusions

2 The main conclusions of the attached Memorandum are as follows:

- (i) The contribution small firms make to economic and employment growth is important and likely to grow, but has often been exaggerated. There is not a strong case for any general discrimination towards small firms in Government policy.
- (ii) Small firm policy is too narrowly defined and seems at times to be over-concentrated on issues - such as deregulation - which are of far less importance than questions of finance or demand.

- (iii) The main focus of small firm policy should not be on business start ups or the new firm, but on more mature firms with some potential to expand. In short, policy should be more concerned with why most firms stop growing.
- (iv) For an increasingly important policy area it is striking how little is known for certain about small firms from official statistics. This is a major weakness which needs to be remedied. Policy measures need to apply flexible definitions of small firms taking account of sectoral differences.
- (v) The regional and inner city dimension to small firm policy is of particular importance, however, far more than an active small firm policy will be required to generate significant employment opportunities in the North, and in cities in all regions. Moreover, the policy approach needs to embrace the full range of local economic initiatives, including the work of local authorities and the contribution of trade unions and employers. Of particular importance in the cities are measures to promote ethnic minority business, and increased willingness by Government to provide funds where private sector institutions appear reluctant. Also important is the development of worker co-operatives.
- (vi) The existing schemes to promote finance into small firms are unsatisfactory, and fail to address the problem identified by the Wilson Committee. A new form of financial intermediary is required.

#### Conclusions and Suggested Action

3 The Council are invited to comment on the above conclusions and the attached Memorandum.

Trades Union Congress

April 15 1988

## SMALL FIRMS

### Memorandum by the TUC

#### Introduction

1 Small firms are an important part of the British economy. Moreover, their contribution to national output and employment is likely to grow in the future. However, exaggerated claims have been made about the potential role of the small and particularly the new firm sector, and the alleged burdens imposed on business by Government regulations. Moreover, the small firm sector is heavily dependent on large firms - particularly in manufacturing - for their continued survival. Small firms need to grow but regulation is needed to ensure that as small firms grow they become more efficient as well as meeting social responsibilities. This Memorandum looks at the evidence and sets out some policy issues.

#### Bolton Committee

2 The only comprehensive official examination of the new and small firm sector remains the report of the Bolton Committee, published in 1971. This is surprising given the increased importance attached to small firms policy from the mid 1970s onwards, and particularly since 1979. Moreover, the underlying position has changed markedly since Bolton. A major concern behind the inquiry was that the small firm sector in the 1950s and 1960s was declining and apparently at a faster rate than in other, more successful, industrial economies. However, in the 1970s and 1980s the reverse would appear to be true, with the small firm sector growing - in numbers, output and employment.

### Official statistics

3 Improvements have been made in official statistics on small firms, but there remain serious inadequacies. It is still not possible to be certain how many small firms there are, how many people work in them, and their exact contribution to national output. Academic studies have failed to show conclusively one way or the other how important small firms really are to economic and industrial success, thus leaving the field open to champions and detractors alike of small firms to make selective use of the findings. Moreover, even if good statistics existed, there is no up to date and commonly agreed set of definitions of small firms, whether by turnover or employment. Finally, confusion is frequent between enterprises and establishments, and between new and small firms (in the latter case, not all small firms are new).

4 The main official source of small firm statistics are those provided by the Business Statistics Office (BSO), in turn derived from data supplied by HM Customs and Excise from VAT registers. The statistics are not comprehensive, for example, excluding many firms whose turnover is too small to require registration or whose main product is exempted from VAT, and there are other reasons for being cautious in their use, particularly when looking at trends over time. Nonetheless, for all their weaknesses, they remain the only broad-based official source of information on enterprises in Britain in the 1980s.

### Small firms in the 1980s

5 The BSO registers show that in 1987 there were nearly 1.6 million legal units registered for VAT (including some firms who registered voluntarily even though not legally obliged to do so). About 10 per cent were in manufacturing; 11 per cent were in agriculture; and 14 per cent were in construction. The remaining 65 per cent were in the service industries.

6 Since 1980 the net increase (ie registrations less deregistrations) in the number of VAT registered enterprises was 13 per cent. The net number of enterprises in the financial property and professional services and in the "other services" sectors has increased by 40 per cent and 47 per cent respectively. Indeed, the net growth in businesses in wholesale, finance services and other services accounts for 70 per cent of the total increase



since 1980 and 86 per cent of the increase since 1983. In contrast, the net increase in manufacturing enterprises has been just over 2 per cent since 1983. This is shown in Table 1 below.

7 The vast majority of firms registered for VAT are, by any definition, small. Nearly two thirds had a turnover of below £100,000 and over 80 per cent had a turnover of below £250,000. Both would comfortably fall within the Bolton Committee's definitions of small firms in the non-manufacturing industries (see Annex A), and 90 per cent of enterprises on the BSO register are in the non-manufacturing sector. The BSO register is essentially a register of small firms in the non-manufacturing sectors of the economy.

8 Research by the DTI (published in "British Business") has also shown that the VAT registers are subject to great volatility. For example, between 1980 and 1985 it is estimated that there were over one million registrations and nearly 0.9 million deregistrations. Moreover, it is likely that a high proportion of deregistrations were comparatively new firms. Further research by the DTI suggests, for example, that between 1974 and 1982 about 40 per cent of businesses registering during this period had failed by 1982, and that 70 per cent of such failures occur in the first three years. These figures must be treated cautiously however, as VAT deregistrations are not the same as a firm going out of business; and evidence from the DTI suggests that at least part of the high level of turnover may be related to ownership changes and changes in main product. Nonetheless, the evidence suggests a high level of volatility, particularly among comparatively young firms.

Table 1: Net Business formation by sector 1980-87

	<u>1980-83</u>	<u>1983-87</u>	<u>1980-87</u>
	(%)	(%)	(%)
Manufacturing	+ 8.1	+ 2.2	+ 10.3
Construction	+ 8.3	+ 4.3	+ 13.0
Wholesale	+15.6	+ 6.5	+ 23.1
Financial	+11.7	+25.1	+ 39.7
Other Services	+18.1	+24.1	+ 46.6
All Other sectors	+ 1.8	n.c	+ 1.8
Total	+ 6.7	+ 5.7	+12.8

Notes: all other sectors include agriculture, mining, transport, postal services, retailing, catering, and motor trades. Wholesale includes dealing. Financial includes property and professional services. Other services includes business and central office services.

Source: BSO Business Monitor, PA1003, Table 1, 1987

#### Small firms and economic success

9 As mentioned earlier, one of the concerns that prompted the Bolton inquiry was that Britain's small firm sector was declining faster than that of our major rivals and this in part was one reason for Britain's relative economic decline. This argument usually focuses on the role of small firms in supporting the large firm sector, for example, as sub-contractors; but also that the small firm is often seen as providing entrepreneurial skills and being more innovative. However, as noted earlier, it is the small firm which is more likely to depend on the strength of the large firm sector than vice versa. Moreover, it is not entirely clear what the direction of causality is between economic success and small firm formation: for example, the 1988 DTI White Paper on industrial policy implies that current rates of net enterprise formation are a consequence of national economic success. However, at the aggregate level there appears little to suggest a clear link between

increasing numbers of enterprises and economic growth, either as a cause or a consequence. The net annual increase in businesses - cited in the 1988 White Paper - has not increased significantly since 1981, although economic growth has been high. This is shown in Table 2 below. Indeed, the net average annual increase since 1981 is rather similar to net business formation in 1978 and 1979.

10 It could be argued that simply taking the aggregate figures are misleading, as they cannot take account of qualitative improvements in the business stock - such as better management or entrepreneurial flair, or improvements in design and quality. Those could lead to a more competitive and stronger small firm sector without necessarily being reflected in an acceleration in the rate of net business formation. However, any improvements should lead to improved survival rates, and hence to a higher rate of net business formation and this is not the case to date. It could also be argued that the aggregate figures mask important changes at the bottom end of the scale, and it is true that the official figures are particularly weak with very "small" small firms. However, as pointed out earlier, the BSO register is overwhelmingly a small firm register: closures of very large enterprises in, say, manufacturing would have relatively little impact on the overall figures because such enterprises form a tiny part of the total enterprises registered by BSO.

Table 2: Net Business formation and economic growth

<u>Year</u>	<u>Net Business formation</u>	<u>Growth (GDP)</u>
	<u>Annual %</u>	<u>Annual %</u>
1981	+ 4.2	- 1.2
1982	+ 0.5	+ 1.5
1983	+ 1.9	+ 3.4
1984	+ 1.6	+ 2.4
1985	+ 1.1	+ 3.7
1986	+ 1.3	+ 3.0
1987	+ 1.6	+ 4.5

Note: "business formation" is net increase in businesses on VAT register over previous year; growth is average estimate of GDP in 1980 prices.

Sources: BSO Business Monitor PA1003, Table 1, 1987;  
CSO Economic Trends Supplement, 1988;  
Financial Statement 1988-89

11 Whatever the link between small firm formation and economic success, it is therefore clearly not a simple one. Indeed, Bolton concluded that the decline in the small firm sector in the 1950s and 1960s "does not constitute proof of fundamental weaknesses in the sector or of a basic disequilibrium in the economic system". Bolton pointed out that it was often unavoidable but often desirable economic forces affecting markets, distribution systems and the nature of processes and production which affected the size of the small firm sector. Indeed, in certain industries it is likely that such forces are leading to fewer and not more small firms - for example, in retailing, where the number of VAT registered businesses fell between 1983 and 1987. Moreover, as indicated earlier, financial services and business services have been the mainstay of recent increases in enterprises registered for VAT. The changes observed in the BSO enterprise registers may reflect particular industrial structural shifts within the economy and within certain industries rather than an across the board increase in "enterprise".

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### Small firms in employment creation

12 The interest in small firms is, however, perhaps greatest in terms of their contribution to job creation. However, the debate has often suffered from confusion between "net" job creation (the difference between job losses and gains) and "gross" job creation (job gains only). Most studies in the US and the UK suggest that "small" firms (definitions vary) in the late 1970s and early 1980s have been net employment generators, while large firms have been net employment losers. However, there is little agreement about the actual figures.

### Self-employment

13 The growth in self-employment in the 1980s can be seen as further evidence of a growth in enterprise and small firms. Indeed, self-employment has grown rapidly, from 1.8m in 1979 to an estimated 2.2 million in 1983 to 2.8 million in 1987 (all figures are for Great Britain). However, in construction at least, much of the increase in self-employment appears to have been at the expense of direct employment, and is associated more with tax avoidance rather than new firm formation in any meaningful sense.

14 The increase in the self-employed is concentrated in a narrow band of industrial sectors. Between mid-1983 and mid-1987 self-employment increased by 640,000, but 38 per cent was accounted for by business services, banking and finance and "other services" and another 21 per cent by construction. However, as with the increase in employees in employment, it must be remembered that much of this increase has been in part-time self-employment. According to recent DE estimates, 28 per cent of the increase in self-employment since March 1983 has been part-time, and this increased to 37 per cent between September 1986 and September 1987.

15 The increase in self-employment has not been confined to Britain. A comparative study by the OECD showed that self-employment as a proportion of civilian non-agricultural employment had increased in all major OECD economies since 1979, with the exception of Japan. The increase in Britain has been particularly marked, but this is in part because employee employment fell more sharply than in other OECD economies in this period. However, there seems no obvious connection between changes in self-employment and economic success. For example, in 1984 the proportion of non-agricultural self-employment in civilian employment was higher in Britain than in Canada, Germany and the

United States, lower than Japan and Italy, and about the same as France.

16 Nevertheless, given the general background of rising self-employment within the OECD as a whole, the conclusion of the OECD's comparative study on the contribution of self-employment to job creation - published in September 1986 - is worth quoting at length. How far it is a fair picture of self employment in Britain is open to debate, but at the least it should give pause for thought. The OECD said:

"Most self-employment businesses remain very small, employing fewer than four persons. In this sense, the role of self-employment in job creation is limited. It seems that only a few rapidly growing self-employment firms become incorporated. The evidence also suggests that most new self-employed employ no one but themselves... The self-employed tend to work longer hours for lower earnings than do their wage and salary counterparts, and the proportion of the self-employed with relatively low earnings has been growing".

#### Productivity

17 The above assessment raises an important question, namely to what extent is the growth in small business and self-employment in the 1980s associated with the low pay-low productivity sector of the economy. The 1988 Budget Statement shows that for manufacturing, productivity growth in the 1980s is close to that achieved in the 1960s. However, growth in the rest of the non-oil economy has been barely half and this in turn has dragged down productivity growth for the economy as a whole. It is also clear that the growth of small firms and self-employment in the 1980s is taking place in the non-manufacturing sector. There is a concern that the two developments are related. In other words, that the existing growth in small business and self-employment is adding to the low pay-low productivity sector of the economy. There are also closely related concerns that as a consequence industry's training effort is being weakened.

18 It is worth pointing out that the most striking productivity gains - in large plants in manufacturing in particular - have been made in sectors and industries where trade unions are well represented. Against this, the low productivity areas of the economy - which may include most of the small firm sector - are those in which a relatively low proportion of workers are

organised in trade unions. It is unfortunate, to say the least, that the impression is given that the reverse is the case. Trade unions are in fact an essential part of any strategy in raising productivity in small firms, particularly in the service industries.

19 The OECD study makes a further important point, namely that it is a relatively small number of small firms who develop and grow, and start to take on significant numbers of employees. Research in the UK seems not only to back this up, but to suggest that compared with the United States the UK "small" firm stops growing much sooner than its US counterpart. An article by Gallagher and Doyle of the University of Newcastle in "British Business" (October 1986) concluded: "small firms in Britain are running out of steam at only 20 employees whereas in the US the figure is near 100". This point is taken up in the next section, particularly in the light of the assertion in the 1986 White Paper "Building Businesses, Not Barriers" that "new business start ups are the essential source of jobs for the future".

#### POLICY ISSUES

20 The main thrust of Bolton's recommendations was that there was no case for general discrimination in favour of small firms, but there was a need to make sure small firms were not unfairly discriminated against. This has been broadly the approach of Government policy since, with particular concern about the provision of finance to small firms. However, the main case for general policy measures is that small firms make a disproportionately important contribution to economic success, or to job generation.

21 As the earlier analysis in this Memorandum suggests, any link - either cause or consequence - between national economic growth and net business formation is not a simple one. Nor does there seem an obvious link between increases in self-employment and relative economic success. The role of small firms and self-employment in employment growth is important, but many claims appear exaggerated. Moreover, the evidence suggests that what growth has been taking place since 1983 has been increasingly concentrated in a narrow range of industries and sectors. This suggests industrial structural changes within the economy and within industries may be far more important factors than general change within the economy resulting in an across the board increase in "enterprise". There does not seem to be a strong case for abandoning the Bolton Committee's approach of no general discrimination towards small firms.

22 However, even if it was agreed that general measures of assistance were desirable there is still no agreed measure of what constitutes a small firm. Indeed, as Bolton suggested, it would be more realistic to use a range of measures suited to particular industrial circumstances. For example, a small firm in manufacturing - defined by Bolton as employing fewer than 200 - would be a medium to large sized firm in construction and many service industries. Policy measures in the UK have tended to use 25 employees as the cut-off point, which may be too small in manufacturing and indeed too small more generally. The EC Commission, for example, applies a more generous definition of small and medium sized firms of 500 employees.

23 The relatively narrow industrial base for net business formation in recent years suggests such an approach is required. There also appears to be a tendency in recent years for small firms policy to concentrate on the smallest of "small firms", and the new business start up. Of course, there are important policy measures which can be taken to help new businesses survive, such as advice and training. And, as the analysis presented earlier suggests, the key characteristic of this part of the small firm sector is one of great volatility and high failure rates in the early years. Net business formation rates have shown steady growth over the past fifteen years, and the basic concern about new firm formation no longer seems as strong. It may be far more cost-effective to concentrate resources on "established" firms (failure rates appear to drop significantly after three years); and on growing firms, particularly those in the "medium" to "large" small firm categories. The more relevant policy question in the late 1980s may be why expanding small firms stop growing, rather than how can the business start up rate be increased.

### Regulations

24 The Government has been particularly concerned to remove what are said to be "burdens on business", in the form of regulations and requirements. There is no doubt these often enrage businessmen, and particularly owners of small firms: and the TUC fully accepts that outmoded procedures should be changed, and that the need for particular requirements kept under review. However, it is questionable whether this is really an important determinant of firm development. The Government's own report, "Burden on Business" published in 1985 concluded: "There is no evidence that regulatory burdens borne by business in our main international competitors are significantly higher than in the United Kingdom". Moreover, the report also said:



"Most small businesses are managing to cope with Government requirements, about which only a minority are openly critical. And most small businesses see problems with finance, sales and so on as more serious than problems with compliance costs".

Looking at the more detailed results, even for those small firms who thought business was bad only 15 per cent mentioned "Government" - in all its forms, including foreign trade policy, interest rates and grant availability. Nearly 30 per cent mentioned the business climate. Moreover, for those firms for whom business was good, about 10 per cent of responses mentioned the Government - while individual effort and demand featured in 33 per cent and 23 per cent of responses respectively. The "burden" most frequently identified was VAT and even then not by a majority of firms (39 per cent). The report said on VAT: "in relation to a firm's total business problems, VAT is not of first importance".

#### Health and Safety

25 Moreover, in some areas regulations are essential. This is particularly true in relation to health and safety in small firms. It is a matter of deep concern that the accidents at work rate in small firms appears to be on the increase in recent years. The TUC has strongly supported initiatives to try to combat this, for example, by the small firms working party of the Health and Safety Executive (HSE) and the Health and Safety Commission's Industry Advisory Committee. A clear conclusion of this work is that small firms in particular may need additional help to ensure health and safety requirements are properly understood and complied with, but this also requires the agencies charged with enforcing this work to be properly resourced. At present the HSE is at least 25% below strength and the TUC is continuing to campaign for its expansion. The Executive's own report in 1983 on Manufacturing and Service Industries said of small firms: "the majority are not alert to hazards to which their employees are exposed and are not well briefed on health and safety legislation and practice". The introduction to the 1984 report by HM Chief Inspector of Factories said many small firms "are completely ignorant about what the law requires". A 1985 report made similar points concentrating particularly on the accident rate of the construction industry. The TUC first set out proposals for a new approach to health and safety in small firms in evidence to the Secretary of State for Employment's

working party on the impact of health and safety requirements on business in 1986. More recently, the 1987 TUC statement "Health and Safety at Work: the Way Forward" makes the point that the real burden facing small firms is lack of resources and expertise to cope with complex health and safety issues. In the TUC's view, health and safety legislation should not be regarded as a burden but an essential means of helping workers and employers to overcome hazards at work and prevent accidents, injuries and damage to health.

26 The Government's proposals to raise the exemption limit on small firms from 5 to 20 employees from preparing even a simple written plan on safety policies mean that up to a quarter of the workforce could be placed at risk as a result. The TUC has urged all employer organisations to join trade unions in opposing this move. Instead, new and imaginative policies are needed which recognise that a wider approach is needed than the traditional one of basing strategic thinking on health and safety issues around the large enterprise. The TUC is planning a major campaign on health and safety in 1988/9 and will be giving special attention to the question of health and safety in small firms and the trade union contribution to reducing accidents and ill health in this area.

#### Accounting standards

27 The Government's approach also seems to be trying to undermine efforts to improve sub-standard accounting procedures. According to recent press reports, the Auditing Practices Committee has recommended that auditors no longer issue audit reports based on directors assurances rather than on an opinion of the company accounts. This is estimated to be the case in about a quarter of small firms. Moreover, the accountancy bodies are also trying to monitor more effectively the standard of work of their members, in line with Government concerns about the quality of audits. It is unfortunate the Government's proposals on these important issues - to remove small firms from the audit requirement altogether - should have been circulated on such a restricted basis. It is quite inconsistent with previous practice, when the TUC among others submitted a Memorandum to a widely circulated consultative document "Accounting and Audit Requirements for Small Firms" in 1985.

#### Finance for Small Firms

28 The question of finance for small businesses had been addressed by the Committee to Review the Functioning of Financial Institutions, set up in 1977.

The Committee - more widely known as the Wilson Committee - reported in 1979, and concluded: "the deficiencies in the availability of equity finance for small businesses are putting undesirable constraints on their rate of creation and growth". The Government introduced, in 1981, the Loan Guarantee Scheme (LGS) intended to help banks supply medium term finance to small independent businesses who would not otherwise secure capital

29 The recent NEDO report from the Committee on Finance for Industry (CFI) noted that LGS did not meet the need for straight equity finance and resulted in very high rates of interest in part because borrowers had to pay a premium to cover default losses. There was also a strong suspicion that banks were using LGS to reduce their existing lending to risky customers. Premium income, however, failed to cover losses and, as a result, in mid-1984 the terms were tightened further resulting in a dramatic decline in demand.

30 The Government subsequently introduced the Business Start Up Scheme in 1983, which in turn was developed into the Business Expansion Scheme (BES). The declared aim of BES was to provide smaller firms with extra finance by giving a tax-incentive to individuals to invest in the riskier unquoted independent company sector of the market, although tax relief could also be obtained by channelling money through less risky "Approved Funds". The Government also introduced the Enterprise Allowance Scheme (EAS), which provides an allowance to unemployed people who want to set up their own business. There is a strong suspicion that much of the money channelled through BES has gone on speculative investments with comparatively little going in long term capital for productive investment. It does not appear to have solved the market weakness identified by Wilson.

31 Further research by the CFI has also revealed that long-term funds for start ups are not readily available from private sector institutions. It found that central and local government in fact play a greater role in the financing of startups. It also found the costs of raising equity are proportionately higher the smaller the amount raised; front-end costs were 50 per cent higher, as a percentage of funds raised, for amounts of around £50,000 compared with amounts over £100,000. It concluded that this was a source of considerable disadvantage to small firms. It recommended that further progress was needed on filling the gap in supplying smaller amounts for early stage finance and regionally based needs. A CFI review of the electronics sector confirmed the unwillingness of institutions to consider investment below £100-150,000. The TUC believes that these problems could be

addressed by the extension of the local economic initiatives outlined below and by re-examination of the CFI proposals for a new financial intermediary. Consideration could be given to an extension of the current activities of 3is. This work could draw on the successful experience of other economies, such as Japan and France, in providing lower cost, long-term finance.

#### Regional and inner city dimension

32 Small firm policy has also had an important regional and inner city dimension. The regional dimension has been partly as a source of offsetting employment losses in traditional large scale capital-intensive industries, and partly as a means of countering the development of branch plant economies. The inner city dimension has been because of growing concern that the small firms previously under-pinning the urban economy were either closing down or moving to other locations, leading not only to loss of jobs but also weakening the entrepreneurial base.

#### Regional employment growth

33 The distribution of employment growth since 1983 gives added importance to these dimensions of small firm policy. Between mid 1983 and mid 1987 total employment (employees in employment plus the self-employed, GB unadjusted) grew by nearly 1.4 million, but nearly 90 per cent of the increase took place in the South and Midlands. It is likely that the major conurbations fared even worse. However, it is particularly important to have realistic expectations of the contribution small firm policy can make to regional and inner city regeneration. There are no up to date figures published on the regional breakdown of enterprises on the BSO register but DTI figures suggest there is relatively little regional variations in the increase in enterprises on the register, albeit the South East has grown faster than most other regions in the period 1980-85. Employment creation on a significant scale in the high unemployment regions clearly requires far more than an active small firms policy.

#### Local economic initiatives

34 As noted above, the main exceptions to the policy of no general favourable treatment of small firms has been in terms of regional policy, and within the regional policy framework increasing attention has been focussed on the inner cities. Of particular importance has been the development of "local

economic initiatives", including the establishment of local authority Enterprise Boards, development of worker co-operatives, and joint public-private initiatives based on local community partnerships such as the work of Business in the Community.

35 The value of these initiatives is threefold. Firstly, they cover a wide range of enterprise development, from new start ups to the critical "medium-sized" small firm sectors. Secondly, being locally based they can quickly identify strengths and weaknesses, not only in particular businesses but also in local and regional markets. Thirdly, they provide an opportunity for trade unions and business to make a practical contribution to the rebuilding of local economies, a role unfortunately restricted at the national level.

36 Recent Government approaches can be criticised in taking a narrow view of small business development, not only in over-concentrating on start ups but in also ignoring the local authority contribution both through local Enterprise Boards and more general Section 137 assistance to local industry and commerce. The Enterprise Board contribution is particularly important as most Boards are concentrating on the "larger" small firms which can be expected to make a significant contribution to future employment growth.

#### Worker co-operatives

37 The role of worker co-operatives also appears to have been overlooked. Indeed, national policy has not been favourable to co-operative development, with cut-backs in the funding of national agencies - such as the Co-operative Development Agency (CDA) and the Industrial Common Ownership Movement (ICOM). Yet there is considerable interest in developing co-operatives, for example, the Wales Co-operative Development Centre which was set up after an initiative by the Wales TUC. The TUC has drawn up guidelines to encourage trade union support for worker co-operatives.

#### Ethnic minority business

38 An increasingly important aspect of small firms policy is on assisting ethnic minority businesses. For example, the Black Business Centre in Birmingham can only obtain Government funds if the private sector matches, but so far the private sector appears unwilling to provide significant investment funds. Larger companies have a particularly important role through their

purchasing and other relevant policies to assist ethnic minority business, and to promote equal opportunity policies more generally.

### Conclusions

39 Firstly, the contribution small firms make to economic and employment growth is important and likely to grow, but has often been exaggerated. There does not seem a strong case for any general discrimination towards small firms in Government policy.

40 Secondly, small firms policy is too narrowly defined and seems at times to be over-concentrated on issues - such as deregulation - which are of far less importance than questions of finance or demand.

41 Thirdly, the main focus of small firms policy should not be on business start ups or the new firm, but on more mature firms with some potential to expand. In short, policy should be more concerned with why most firms stop growing rather than trying to boost business formation rates.

42 Fourthly, for an increasingly important policy area it is striking how little is known for certain about small firms from official statistics. This is a major weakness which needs to be remedied. Policy measures need to be flexible and avoid across the board definitions of small firms which may be inappropriate for particular industrial sectors.

43 Fifthly, the regional and inner city dimension to small firm policy is of particular importance. However, far more than an active small firms policy will be required to generate significant employment opportunities in the North, and in cities in all regions. Moreover, the policy approach needs to embrace the full range of local economic initiatives, including the work of local authorities and the contribution of trade unions and employers. Of particular importance in the cities are measures to promote ethnic minority business, and increased willingness by Government to provide funds where private sector institutions appear reluctant. Also important is the development of worker co-operatives.

44 Finally, the existing schemes to promote finance for small firms are unsatisfactory and fail to address the problem identified by the Wilson Committee. A new form of financial intermediary is required.

Trades Union Congress

April 15 1988

## ANNEX A: DEFINITIONS OF SMALL FIRMS

The different statistical definitions adopted in 1971 by the Bolton Committee of Inquiry (eg in manufacturing 200 employees or less) are still used as guidelines.

	Statistical definition adopted by Bolton (turnover at 1963 prices)	Revised definition to allow for inflation* (turnover at Mar 87 prices)
Industry		
Manufacturing	200 employees or less	200 employees or less
Retailing	Turnover £50,000 or less	Turnover £368,000 or less
Wholesale Trades	Turnover £200,000 or less	Turnover £1,470,000 or less
Construction	25 employees or less	25 employees or less
Mining/ quarrying	25 employees or less	25 employees or less
Motor trades	Turnover £100,000 or less	Turnover £735,000 or less
Miscellaneous services	Turnover £50,000 or less	Turnover £368,000 or less
Road transport	5 vehicles or less	5 vehicles or less
Catering	All except multiples and brewery managed public houses	All except multiples and brewery managed public houses

Note: \* Estimated by applying the change in the general index of retail prices between the average for 1963 and March 1987, and rounding to the nearest £1,000. The RPI is more appropriate for adjusting the turnover of some industries than for others.

Source: Graham Bannock and Partners Ltd

April 15 1988



NEDC(88)16  
15 April 1988

SMALL FIRMS

Memorandum by the TUC

Introduction

1 Small firms are an important part of the British economy. Moreover, their contribution to national output and employment is likely to grow in the future. However, exaggerated claims have been made about the potential role of the small and particularly the new firm sector and the alleged burdens imposed on business by Government regulations. Small firms need to grow but regulation is needed to ensure that as small firms grow they become more efficient as well as meeting their social responsibilities. This Memorandum looks at the evidence and sets out some policy issues.

Main conclusions

2 The main conclusions of the attached Memorandum are as follows:

- (i) The contribution small firms make to economic and employment growth is important and likely to grow, but has often been exaggerated. There is not a strong case for any general discrimination towards small firms in Government policy.
- (ii) Small firm policy is too narrowly defined and seems at times to be over-concentrated on issues - such as deregulation - which are of far less importance than questions of finance or demand.



- (iii) The main focus of small firm policy should not be on business start ups or the new firm, but on more mature firms with some potential to expand. In short, policy should be more concerned with why most firms stop growing.
- (iv) For an increasingly important policy area it is striking how little is known for certain about small firms from official statistics. This is a major weakness which needs to be remedied. Policy measures need to apply flexible definitions of small firms taking account of sectoral differences.
- (v) The regional and inner city dimension to small firm policy is of particular importance, however, far more than an active small firm policy will be required to generate significant employment opportunities in the North, and in cities in all regions. Moreover, the policy approach needs to embrace the full range of local economic initiatives, including the work of local authorities and the contribution of trade unions and employers. Of particular importance in the cities are measures to promote ethnic minority business, and increased willingness by Government to provide funds where private sector institutions appear reluctant. Also important is the development of worker co-operatives.
- (vi) The existing schemes to promote finance into small firms are unsatisfactory, and fail to address the problem identified by the Wilson Committee. A new form of financial intermediary is required.

#### Conclusions and Suggested Action

3 The Council are invited to comment on the above conclusions and the attached Memorandum.

Trades Union Congress

April 15 1988

## SMALL FIRMS

### Memorandum by the TUC

#### Introduction

1 Small firms are an important part of the British economy. Moreover, their contribution to national output and employment is likely to grow in the future. However, exaggerated claims have been made about the potential role of the small and particularly the new firm sector, and the alleged burdens imposed on business by Government regulations. Moreover, the small firm sector is heavily dependent on large firms - particularly in manufacturing - for their continued survival. Small firms need to grow but regulation is needed to ensure that as small firms grow they become more efficient as well as meeting social responsibilities. This Memorandum looks at the evidence and sets out some policy issues.

#### Bolton Committee

2 The only comprehensive official examination of the new and small firm sector remains the report of the Bolton Committee, published in 1971. This is surprising given the increased importance attached to small firms policy from the mid 1970s onwards, and particularly since 1979. Moreover, the underlying position has changed markedly since Bolton. A major concern behind the inquiry was that the small firm sector in the 1950s and 1960s was declining and apparently at a faster rate than in other, more successful, industrial economies. However, in the 1970s and 1980s the reverse would appear to be true, with the small firm sector growing - in numbers, output and employment.

### Official statistics

3 Improvements have been made in official statistics on small firms, but there remain serious inadequacies. It is still not possible to be certain how many small firms there are, how many people work in them, and their exact contribution to national output. Academic studies have failed to show conclusively one way or the other how important small firms really are to economic and industrial success, thus leaving the field open to champions and detractors alike of small firms to make selective use of the findings. Moreover, even if good statistics existed, there is no up to date and commonly agreed set of definitions of small firms, whether by turnover or employment. Finally, confusion is frequent between enterprises and establishments, and between new and small firms (in the latter case, not all small firms are new).

4 The main official source of small firm statistics are those provided by the Business Statistics Office (BSO), in turn derived from data supplied by HM Customs and Excise from VAT registers. The statistics are not comprehensive, for example, excluding many firms whose turnover is too small to require registration or whose main product is exempted from VAT, and there are other reasons for being cautious in their use, particularly when looking at trends over time. Nonetheless, for all their weaknesses, they remain the only broad-based official source of information on enterprises in Britain in the 1980s.

### Small firms in the 1980s

5 The BSO registers show that in 1987 there were nearly 1.6 million legal units registered for VAT (including some firms who registered voluntarily even though not legally obliged to do so). About 10 per cent were in manufacturing; 11 per cent were in agriculture; and 14 per cent were in construction. The remaining 65 per cent were in the service industries.

6 Since 1980 the net increase (ie registrations less deregistrations) in the number of VAT registered enterprises was 13 per cent. The net number of enterprises in the financial property and professional services and in the "other services" sectors has increased by 40 per cent and 47 per cent respectively. Indeed, the net growth in businesses in wholesale, finance services and other services accounts for 70 per cent of the total increase

since 1980 and 86 per cent of the increase since 1983. In contrast, the net increase in manufacturing enterprises has been just over 2 per cent since 1983. This is shown in Table 1 below.

7 The vast majority of firms registered for VAT are, by any definition, small. Nearly two thirds had a turnover of below £100,000 and over 80 per cent had a turnover of below £250,000. Both would comfortably fall within the Bolton Committee's definitions of small firms in the non-manufacturing industries (see Annex A), and 90 per cent of enterprises on the BSO register are in the non-manufacturing sector. The BSO register is essentially a register of small firms in the non-manufacturing sectors of the economy.

8 Research by the DTI (published in "British Business") has also shown that the VAT registers are subject to great volatility. For example, between 1980 and 1985 it is estimated that there were over one million registrations and nearly 0.9 million deregistrations. Moreover, it is likely that a high proportion of deregistrations were comparatively new firms. Further research by the DTI suggests, for example, that between 1974 and 1982 about 40 per cent of businesses registering during this period had failed by 1982, and that 70 per cent of such failures occur in the first three years. These figures must be treated cautiously however, as VAT deregistrations are not the same as a firm going out of business; and evidence from the DTI suggests that at least part of the high level of turnover may be related to ownership changes and changes in main product. Nonetheless, the evidence suggests a high level of volatility, particularly among comparatively young firms.

Table 1: Net Business formation by sector 1980-87

	<u>1980-83</u>	<u>1983-87</u>	<u>1980-87</u>
	(%)	(%)	(%)
Manufacturing	+ 8.1	+ 2.2	+ 10.3
Construction	+ 8.3	+ 4.3	+ 13.0
Wholesale	+15.6	+ 6.5	+ 23.1
Financial	+11.7	+25.1	+ 39.7
Other Services	+18.1	+24.1	+ 46.6
All Other sectors	+ 1.8	n.c	+ 1.8
Total	+ 6.7	+ 5.7	+12.8

Notes: all other sectors include agriculture, mining, transport, postal services, retailing, catering, and motor trades. Wholesale includes dealing. Financial includes property and professional services. Other services includes business and central office services.

Source: BSO Business Monitor, PA1003, Table 1, 1987

Small firms and economic success

9 As mentioned earlier, one of the concerns that prompted the Bolton inquiry was that Britain's small firm sector was declining faster than that of our major rivals and this in part was one reason for Britain's relative economic decline. This argument usually focuses on the role of small firms in supporting the large firm sector, for example, as sub-contractors; but also that the small firm is often seen as providing entrepreneurial skills and being more innovative. However, as noted earlier, it is the small firm which is more likely to depend on the strength of the large firm sector than vice versa. Moreover, it is not entirely clear what the direction of causality is between economic success and small firm formation: for example, the 1988 DTI White Paper on industrial policy implies that current rates of net enterprise formation are a consequence of national economic success. However, at the aggregate level there appears little to suggest a clear link between

increasing numbers of enterprises and economic growth, either as a cause or a consequence. The net annual increase in businesses - cited in the 1988 White Paper - has not increased significantly since 1981, although economic growth has been high. This is shown in Table 2 below. Indeed, the net average annual increase since 1981 is rather similar to net business formation in 1978 and 1979.

10 It could be argued that simply taking the aggregate figures are misleading, as they cannot take account of qualitative improvements in the business stock - such as better management or entrepreneurial flair, or improvements in design and quality. Those could lead to a more competitive and stronger small firm sector without necessarily being reflected in an acceleration in the rate of net business formation. However, any improvements should lead to improved survival rates, and hence to a higher rate of net business formation and this is not the case to date. It could also be argued that the aggregate figures mask important changes at the bottom end of the scale, and it is true that the official figures are particularly weak with very "small" small firms. However, as pointed out earlier, the BSO register is overwhelmingly a small firm register: closures of very large enterprises in, say, manufacturing would have relatively little impact on the overall figures because such enterprises form a tiny part of the total enterprises registered by BSO.

Table 2: Net Business formation and economic growth

<u>Year</u>	<u>Net Business formation</u>	<u>Growth (GDP)</u>
	<u>Annual %</u>	<u>Annual %</u>
1981	+ 4.2	- 1.2
1982	+ 0.5	+ 1.5
1983	+ 1.9	+ 3.4
1984	+ 1.6	+ 2.4
1985	+ 1.1	+ 3.7
1986	+ 1.3	+ 3.0
1987	+ 1.6	+ 4.5

Note: "business formation" is net increase in businesses on VAT register over previous year; growth is average estimate of GDP in 1980 prices.

Sources: BSO Business Monitor PA1003, Table 1, 1987;  
CSO Economic Trends Supplement, 1988;  
Financial Statement 1988-89

11 Whatever the link between small firm formation and economic success, it is therefore clearly not a simple one. Indeed, Bolton concluded that the decline in the small firm sector in the 1950s and 1960s "does not constitute proof of fundamental weaknesses in the sector or of a basic disequilibrium in the economic system". Bolton pointed out that it was often unavoidable but often desirable economic forces affecting markets, distribution systems and the nature of processes and production which affected the size of the small firm sector. Indeed, in certain industries it is likely that such forces are leading to fewer and not more small firms - for example, in retailing, where the number of VAT registered businesses fell between 1983 and 1987. Moreover, as indicated earlier, financial services and business services have been the mainstay of recent increases in enterprises registered for VAT. The changes observed in the BSO enterprise registers may reflect particular industrial structural shifts within the economy and within certain industries rather than an across the board increase in "enterprise".

## Small firms in employment creation

12 The interest in small firms is, however, perhaps greatest in terms of their contribution to job creation. However, the debate has often suffered from confusion between "net" job creation (the difference between job losses and gains) and "gross" job creation (job gains only). Most studies in the US and the UK suggest that "small" firms (definitions vary) in the late 1970s and early 1980s have been net employment generators, while large firms have been net employment losers. However, there is little agreement about the actual figures.

## Self-employment

13 The growth in self-employment in the 1980s can be seen as further evidence of a growth in enterprise and small firms. Indeed, self-employment has grown rapidly, from 1.8m in 1979 to an estimated 2.2 million in 1983 to 2.8 million in 1987 (all figures are for Great Britain). However, in construction at least, much of the increase in self-employment appears to have been at the expense of direct employment, and is associated more with tax avoidance rather than new firm formation in any meaningful sense.

14 The increase in the self-employed is concentrated in a narrow band of industrial sectors. Between mid-1983 and mid-1987 self-employment increased by 640,000, but 38 per cent was accounted for by business services, banking and finance and "other services" and another 21 per cent by construction. However, as with the increase in employees in employment, it must be remembered that much of this increase has been in part-time self-employment. According to recent DE estimates, 28 per cent of the increase in self-employment since March 1983 has been part-time, and this increased to 37 per cent between September 1986 and September 1987.

15 The increase in self-employment has not been confined to Britain. A comparative study by the OECD showed that self-employment as a proportion of civilian non-agricultural employment had increased in all major OECD economies since 1979, with the exception of Japan. The increase in Britain has been particularly marked, but this is in part because employee employment fell more sharply than in other OECD economies in this period. However, there seems no obvious connection between changes in self-employment and economic success. For example, in 1984 the proportion of non-agricultural self-employment in civilian employment was higher in Britain than in Canada, Germany and the



United States, lower than Japan and Italy, and about the same as France.

16 Nevertheless, given the general background of rising self-employment within the OECD as a whole, the conclusion of the OECD's comparative study on the contribution of self-employment to job creation - published in September 1986 - is worth quoting at length. How far it is a fair picture of self employment in Britain is open to debate, but at the least it should give pause for thought. The OECD said:

"Most self-employment businesses remain very small, employing fewer than four persons. In this sense, the role of self-employment in job creation is limited. It seems that only a few rapidly growing self-employment firms become incorporated. The evidence also suggests that most new self-employed employ no one but themselves... The self-employed tend to work longer hours for lower earnings than do their wage and salary counterparts, and the proportion of the self-employed with relatively low earnings has been growing".

### Productivity

17 The above assessment raises an important question, namely to what extent is the growth in small business and self-employment in the 1980s associated with the low pay-low productivity sector of the economy. The 1988 Budget Statement shows that for manufacturing, productivity growth in the 1980s is close to that achieved in the 1960s. However, growth in the rest of the non-oil economy has been barely half and this in turn has dragged down productivity growth for the economy as a whole. It is also clear that the growth of small firms and self-employment in the 1980s is taking place in the non-manufacturing sector. There is a concern that the two developments are related. In other words, that the existing growth in small business and self-employment is adding to the low pay-low productivity sector of the economy. There are also closely related concerns that as a consequence industry's training effort is being weakened.

18 It is worth pointing out that the most striking productivity gains - in large plants in manufacturing in particular - have been made in sectors and industries where trade unions are well represented. Against this, the low productivity areas of the economy - which may include most of the small firm sector - are those in which a relatively low proportion of workers are

organised in trade unions. It is unfortunate, to say the least, that the impression is given that the reverse is the case. Trade unions are in fact an essential part of any strategy in raising productivity in small firms, particularly in the service industries.

19 The OECD study makes a further important point, namely that it is a relatively small number of small firms who develop and grow, and start to take on significant numbers of employees. Research in the UK seems not only to back this up, but to suggest that compared with the United States the UK "small" firm stops growing much sooner than its US counterpart. An article by Gallagher and Doyle of the University of Newcastle in "British Business" (October 1986) concluded: "small firms in Britain are running out of steam at only 20 employees whereas in the US the figure is near 100". This point is taken up in the next section, particularly in the light of the assertion in the 1986 White Paper "Building Businesses, Not Barriers" that "new business start ups are the essential source of jobs for the future".

#### POLICY ISSUES

20 The main thrust of Bolton's recommendations was that there was no case for general discrimination in favour of small firms, but there was a need to make sure small firms were not unfairly discriminated against. This has been broadly the approach of Government policy since, with particular concern about the provision of finance to small firms. However, the main case for general policy measures is that small firms make a disproportionately important contribution to economic success, or to job generation.

21 As the earlier analysis in this Memorandum suggests, any link - either cause or consequence - between national economic growth and net business formation is not a simple one. Nor does there seem an obvious link between increases in self-employment and relative economic success. The role of small firms and self-employment in employment growth is important, but many claims appear exaggerated. Moreover, the evidence suggests that what growth has been taking place since 1983 has been increasingly concentrated in a narrow range of industries and sectors. This suggests industrial structural changes within the economy and within industries may be far more important factors than general change within the economy resulting in an across the board increase in "enterprise". There does not seem to be a strong case for abandoning the Bolton Committee's approach of no general discrimination towards small firms.

22 However, even if it was agreed that general measures of assistance were desirable there is still no agreed measure of what constitutes a small firm. Indeed, as Bolton suggested, it would be more realistic to use a range of measures suited to particular industrial circumstances. For example, a small firm in manufacturing - defined by Bolton as employing fewer than 200 - would be a medium to large sized firm in construction and many service industries. Policy measures in the UK have tended to use 25 employees as the cut-off point, which may be too small in manufacturing and indeed too small more generally. The EC Commission, for example, applies a more generous definition of small and medium sized firms of 500 employees.

23 The relatively narrow industrial base for net business formation in recent years suggests such an approach is required. There also appears to be a tendency in recent years for small firms policy to concentrate on the smallest of "small firms", and the new business start up. Of course, there are important policy measures which can be taken to help new businesses survive, such as advice and training. And, as the analysis presented earlier suggests, the key characteristic of this part of the small firm sector is one of great volatility and high failure rates in the early years. Net business formation rates have shown steady growth over the past fifteen years, and the basic concern about new firm formation no longer seems as strong. It may be far more cost-effective to concentrate resources on "established" firms (failure rates appear to drop significantly after three years); and on growing firms, particularly those in the "medium" to "large" small firm categories. The more relevant policy question in the late 1980s may be why expanding small firms stop growing, rather than how can the business start up rate be increased.

### Regulations

24 The Government has been particularly concerned to remove what are said to be "burdens on business", in the form of regulations and requirements. There is no doubt these often enrage businessmen, and particularly owners of small firms: and the TUC fully accepts that outmoded procedures should be changed, and that the need for particular requirements kept under review. However, it is questionable whether this is really an important determinant of firm development. The Government's own report, "Burden on Business" published in 1985 concluded: "There is no evidence that regulatory burdens borne by business in our main international competitors are significantly higher than in the United Kingdom". Moreover, the report also said:

"Most small businesses are managing to cope with Government requirements, about which only a minority are openly critical. And most small businesses see problems with finance, sales and so on as more serious than problems with compliance costs".

Looking at the more detailed results, even for those small firms who thought business was bad only 15 per cent mentioned "Government" - in all its forms, including foreign trade policy, interest rates and grant availability. Nearly 30 per cent mentioned the business climate. Moreover, for those firms for whom business was good, about 10 per cent of responses mentioned the Government - while individual effort and demand featured in 33 per cent and 23 per cent of responses respectively. The "burden" most frequently identified was VAT and even then not by a majority of firms (39 per cent). The report said on VAT: "in relation to a firm's total business problems, VAT is not of first importance".

#### Health and Safety

25 Moreover, in some areas regulations are essential. This is particularly true in relation to health and safety in small firms. It is a matter of deep concern that the accidents at work rate in small firms appears to be on the increase in recent years. The TUC has strongly supported initiatives to try to combat this, for example, by the small firms working party of the Health and Safety Executive (HSE) and the Health and Safety Commission's Industry Advisory Committee. A clear conclusion of this work is that small firms in particular may need additional help to ensure health and safety requirements are properly understood and complied with, but this also requires the agencies charged with enforcing this work to be properly resourced. At present the HSE is at least 25% below strength and the TUC is continuing to campaign for its expansion. The Executive's own report in 1983 on Manufacturing and Service Industries said of small firms: "the majority are not alert to hazards to which their employees are exposed and are not well briefed on health and safety legislation and practice". The introduction to the 1984 report by HM Chief Inspector of Factories said many small firms "are completely ignorant about what the law requires". A 1985 report made similar points concentrating particularly on the accident rate of the construction industry. The TUC first set out proposals for a new approach to health and safety in small firms in evidence to the Secretary of State for Employment's

working party on the impact of health and safety requirements on business in 1986. More recently, the 1987 TUC statement "Health and Safety at Work: the Way Forward" makes the point that the real burden facing small firms is lack of resources and expertise to cope with complex health and safety issues. In the TUC's view, health and safety legislation should not be regarded as a burden but an essential means of helping workers and employers to overcome hazards at work and prevent accidents, injuries and damage to health.

26 The Government's proposals to raise the exemption limit on small firms from 5 to 20 employees from preparing even a simple written plan on safety policies mean that up to a quarter of the workforce could be placed at risk as a result. The TUC has urged all employer organisations to join trade unions in opposing this move. Instead, new and imaginative policies are needed which recognise that a wider approach is needed than the traditional one of basing strategic thinking on health and safety issues around the large enterprise. The TUC is planning a major campaign on health and safety in 1988/9 and will be giving special attention to the question of health and safety in small firms and the trade union contribution to reducing accidents and ill health in this area.

#### Accounting standards

27 The Government's approach also seems to be trying to undermine efforts to improve sub-standard accounting procedures. According to recent press reports, the Auditing Practices Committee has recommended that auditors no longer issue audit reports based on directors assurances rather than on an opinion of the company accounts. This is estimated to be the case in about a quarter of small firms. Moreover, the accountancy bodies are also trying to monitor more effectively the standard of work of their members, in line with Government concerns about the quality of audits. It is unfortunate the Government's proposals on these important issues - to remove small firms from the audit requirement altogether - should have been circulated on such a restricted basis. It is quite inconsistent with previous practice, when the TUC among others submitted a Memorandum to a widely circulated consultative document "Accounting and Audit Requirements for Small Firms" in 1985.

#### Finance for Small Firms

28 The question of finance for small businesses had been addressed by the Committee to Review the Functioning of Financial Institutions, set up in 1977.

The Committee - more widely known as the Wilson Committee - reported in 1979, and concluded: "the deficiencies in the availability of equity finance for small businesses are putting undesirable constraints on their rate of creation and growth". The Government introduced, in 1981, the Loan Guarantee Scheme (LGS) intended to help banks supply medium term finance to small independent businesses who would not otherwise secure capital

29 The recent NEDO report from the Committee on Finance for Industry (CFI) noted that LGS did not meet the need for straight equity finance and resulted in very high rates of interest in part because borrowers had to pay a premium to cover default losses. There was also a strong suspicion that banks were using LGS to reduce their existing lending to risky customers. Premium income, however, failed to cover losses and, as a result, in mid-1984 the terms were tightened further resulting in a dramatic decline in demand.

30 The Government subsequently introduced the Business Start Up Scheme in 1983, which in turn was developed into the Business Expansion Scheme (BES). The declared aim of BES was to provide smaller firms with extra finance by giving a tax-incentive to individuals to invest in the riskier unquoted independent company sector of the market, although tax relief could also be obtained by channelling money through less risky "Approved Funds". The Government also introduced the Enterprise Allowance Scheme (EAS), which provides an allowance to unemployed people who want to set up their own business. There is a strong suspicion that much of the money channelled through BES has gone on speculative investments with comparatively little going in long term capital for productive investment. It does not appear to have solved the market weakness identified by Wilson.

31 Further research by the CFI has also revealed that long-term funds for start ups are not readily available from private sector institutions. It found that central and local government in fact play a greater role in the financing of startups. It also found the costs of raising equity are proportionately higher the smaller the amount raised; front-end costs were 50 per cent higher, as a percentage of funds raised, for amounts of around £50,000 compared with amounts over £100,000. It concluded that this was a source of considerable disadvantage to small firms. It recommended that further progress was needed on filling the gap in supplying smaller amounts for early stage finance and regionally based needs. A CFI review of the electronics sector confirmed the unwillingness of institutions to consider investment below £100-150,000. The TUC believes that these problems could be

addressed by the extension of the local economic initiatives outlined below and by re-examination of the CFI proposals for a new financial intermediary. Consideration could be given to an extension of the current activities of 3is. This work could draw on the successful experience of other economies, such as Japan and France, in providing lower cost, long-term finance.

#### Regional and inner city dimension

32 Small firm policy has also had an important regional and inner city dimension. The regional dimension has been partly as a source of offsetting employment losses in traditional large scale capital-intensive industries, and partly as a means of countering the development of branch plant economies. The inner city dimension has been because of growing concern that the small firms previously under-pinning the urban economy were either closing down or moving to other locations, leading not only to loss of jobs but also weakening the entrepreneurial base.

#### Regional employment growth

33 The distribution of employment growth since 1983 gives added importance to these dimensions of small firm policy. Between mid 1983 and mid 1987 total employment (employees in employment plus the self-employed, GB unadjusted) grew by nearly 1.4 million, but nearly 90 per cent of the increase took place in the South and Midlands. It is likely that the major conurbations fared even worse. However, it is particularly important to have realistic expectations of the contribution small firm policy can make to regional and inner city regeneration. There are no up to date figures published on the regional breakdown of enterprises on the BSO register but DTI figures suggest there is relatively little regional variations in the increase in enterprises on the register, albeit the South East has grown faster than most other regions in the period 1980-85. Employment creation on a significant scale in the high unemployment regions clearly requires far more than an active small firms policy.

#### Local economic initiatives

34 As noted above, the main exceptions to the policy of no general favourable treatment of small firms has been in terms of regional policy, and within the regional policy framework increasing attention has been focussed on the inner cities. Of particular importance has been the development of "local

economic initiatives", including the establishment of local authority Enterprise Boards, development of worker co-operatives, and joint public-private initiatives based on local community partnerships such as the work of Business in the Community.

35 The value of these initiatives is threefold. Firstly, they cover a wide range of enterprise development, from new start ups to the critical "medium-sized" small firm sectors. Secondly, being locally based they can quickly identify strengths and weaknesses, not only in particular businesses but also in local and regional markets. Thirdly, they provide an opportunity for trade unions and business to make a practical contribution to the rebuilding of local economies, a role unfortunately restricted at the national level.

36 Recent Government approaches can be criticised in taking a narrow view of small business development, not only in over-concentrating on start ups but in also ignoring the local authority contribution both through local Enterprise Boards and more general Section 137 assistance to local industry and commerce. The Enterprise Board contribution is particularly important as most Boards are concentrating on the "larger" small firms which can be expected to make a significant contribution to future employment growth.

#### Worker co-operatives

37 The role of worker co-operatives also appears to have been overlooked. Indeed, national policy has not been favourable to co-operative development, with cut-backs in the funding of national agencies - such as the Co-operative Development Agency (CDA) and the Industrial Common Ownership Movement (ICOM). Yet there is considerable interest in developing co-operatives, for example, the Wales Co-operative Development Centre which was set up after an initiative by the Wales TUC. The TUC has drawn up guidelines to encourage trade union support for worker co-operatives.

#### Ethnic minority business

38 An increasingly important aspect of small firms policy is on assisting ethnic minority businesses. For example, the Black Business Centre in Birmingham can only obtain Government funds if the private sector matches, but so far the private sector appears unwilling to provide significant investment funds. Larger companies have a particularly important role through their



purchasing and other relevant policies to assist ethnic minority business, and to promote equal opportunity policies more generally.

### Conclusions

39 Firstly, the contribution small firms make to economic and employment growth is important and likely to grow, but has often been exaggerated. There does not seem a strong case for any general discrimination towards small firms in Government policy.

40 Secondly, small firms policy is too narrowly defined and seems at times to be over-concentrated on issues - such as deregulation - which are of far less importance than questions of finance or demand.

41 Thirdly, the main focus of small firms policy should not be on business start ups or the new firm, but on more mature firms with some potential to expand. In short, policy should be more concerned with why most firms stop growing rather than trying to boost business formation rates.

42 Fourthly, for an increasingly important policy area it is striking how little is known for certain about small firms from official statistics. This is a major weakness which needs to be remedied. Policy measures need to be flexible and avoid across the board definitions of small firms which may be inappropriate for particular industrial sectors.

43 Fifthly, the regional and inner city dimension to small firm policy is of particular importance. However, far more than an active small firms policy will be required to generate significant employment opportunities in the North, and in cities in all regions. Moreover, the policy approach needs to embrace the full range of local economic initiatives, including the work of local authorities and the contribution of trade unions and employers. Of particular importance in the cities are measures to promote ethnic minority business, and increased willingness by Government to provide funds where private sector institutions appear reluctant. Also important is the development of worker co-operatives.

44 Finally, the existing schemes to promote finance for small firms are unsatisfactory and fail to address the problem identified by the Wilson Committee. A new form of financial intermediary is required.

Trades Union Congress

April 15 1988

## ANNEX A: DEFINITIONS OF SMALL FIRMS

The different statistical definitions adopted in 1971 by the Bolton Committee of Inquiry (eg in manufacturing 200 employees or less) are still used as guidelines.

	Statistical definition adopted by Bolton (turnover at 1963 prices)	Revised definition to allow for inflation* (turnover at Mar 87 prices)
Industry		
Manufacturing	200 employees or less	200 employees or less
Retailing	Turnover £50,000 or less	Turnover £368,000 or less
Wholesale Trades	Turnover £200,000 or less	Turnover £1,470,000 or less
Construction	25 employees or less	25 employees or less
Mining/ quarrying	25 employees or less	25 employees or less
Motor trades	Turnover £100,000 or less	Turnover £735,000 or less
Miscellaneous services	Turnover £50,000 or less	Turnover £368,000 or less
Road transport	5 vehicles or less	5 vehicles or less
Catering	All except multiples and brewery managed public houses	All except multiples and brewery managed public houses

Note: \* Estimated by applying the change in the general index of retail prices between the average for 1963 and March 1987, and rounding to the nearest £1,000. The RPI is more appropriate for adjusting the turnover of some industries than for others.

Source: Graham Bannock and Partners Ltd

April 15 1988



NEDC(88)10  
15 April 1988

SKILLS AND SKILL SHORTAGES

Memorandum by the Trades Union Congress

1 This paper sets out the TUC's recognition of the crucial role of skills in generating economic success; surveys the increasing problems of skill shortages and maps out a long term skill strategy in the interests both of workers and the economy as a whole.

2 The TUC's memorandum on Industrial Policy Issues to the Council in October 1987 identified the lack of investment in skills as one of the principal weaknesses of British industry. This applies particularly in the high technology, research intensive sectors of industry, which are the key to rapid growth but in which the UK is not keeping pace with our major competitors. Recent research at Warwick University has confirmed the TUC's view that lower wages in the UK compared with overseas competitors have provided firms with a short term route to price competitiveness but have reduced the incentive to invest in training and new productive processes, encouraging a low pay/low productivity economy. The memorandum on Innovation Policy to the Council in March 1987 pointed to the specific importance of a highly skilled and motivated workforce in creating the right conditions for innovation and R&D.

3 The development of skills therefore requires greater investment in the provision of training, but it is also about the way work is organised. If firms are to obtain the full benefit of an expansion of skills, workers and their trade union representatives must be involved in and negotiate over the way change is introduced and skills are deployed. This is an important element in the work programme of newly-constituted NEDO Sector Groups.

Economic Success

4 The key role of an adequate supply of skills as a pre-requisite of economic success and competitiveness has become widely recognised and accepted. Report after report has underlined the long-standing trade union argument that skills are vital to the economic health of the nation. 'Competence and Competition' concluded of West Germany, the USA and Japan, that "all three countries see education and work competence as a key to their economic success."

5 This argument reflects the trend towards freely exchangeable capital equipment and processes. As enterprises become more international, and as the capital they employ becomes more easily transferrable between countries, a major economic difference between countries becomes the skills of their workforces, and the quality of their product (whether in manufacturing or services).

6 Studies have also shown that UK workers at all levels appear significantly under-trained compared with our international competitors. The National Institute of Economic and Social Research has indicated that in the retail industry 75% of the West German workforce has served an apprenticeship, compared with 5% in Britain. In addition, 70% of Germany engineers have recognised qualifications compared with 40% of British engineers.

7 The situation is not necessarily improving with time. The number of adults receiving formal training fell from 7% to under 4% between 1974 and 1984, and the numbers in apprenticeships declined steeply in that decade, and far faster than the decline in employment in the few sectors where apprenticeships, or organised initial training, were to be found.

Skill Shortages

8 It is one measure of the UK's failure to train that, despite record levels of youth and adult long-term unemployment (still historically high), skill shortages have existed throughout the recession, and are now increasing at a rate which gives serious cause for concern. Although such shortages would not be expected to be at the level they were before mass unemployment, skill shortages remain a major problem in certain sectors and regions.

9 One of the most recent pieces of evidence on this problem is the MSC's most recent Skills Monitoring Report. This reveals that the 1987 CBI/MSC Special Survey of Skill Shortages in Manufacturing Industry found 37% of respondents reporting that skill shortages were constraining output, compared with 19% in October 1986.

10 The most critical skill shortages reported are in professional engineering and machining, in textiles, electrical and instrument engineering and mechanical engineering. But there are also shortages in printing, computing, among managers, engineering craftsmen, and especially in construction, where the percentage of firms reporting difficulties in recruiting bricklayers and carpenters is into the upper sixties.

11 Skill shortages in services are less well reported, although there is regular evidence of shortages in such areas as nursing and key teaching subjects, and of severe retention problems in tourism (prompting the Tourism Training Initiative in which the TUC is involved). In teaching, the shortage of trained workers can develop into a vicious circle - without trained trainers, we cannot develop other skills. The problem in services is more likely to affect not output quantity, but the quality of service provided - something which is rarely monitored, but regularly experienced by consumers.

12 The causes of such skill shortages vary from one to another, and they do not in all cases solely result from insufficient training. In nursing, for instance, low wages have a significant impact, and there is a case for improving terms and conditions in a number of areas, and for enhancing both subsequent wages and remuneration while undergoing training as an incentive to those in low-skill jobs to train for higher-skill vacancies. Even that, however, would not be a sufficient solution to the problem, which exists (albeit in varying degrees) at all levels of skill.

13 A further problem, affecting a number of craft skills, is the lack of secure employment. This discourages entry into training, and leads those skilled in such fields to leave for jobs with greater employment security.

14 In addition, some skill shortages result mainly from a geographical mis-match of the skills and jobs available. But some shortages exist in all regions, and it is therefore likely that geographical variations merely exacerbate an underlying problem.

15 That problem is an overall lack of training. And the situation is likely to get worse, rather than better. If the economy is growing, the demand for skills will increase. This is especially a problem in the light of the demographic changes in the 16-19 year old age group (where the number will decline by 25% between now and 1995).

### Responsibilities

16 A number of interests need to contribute to solving the skills problem faced by the UK. The Government, employers, trade unions and public sector education and training institutions are the major actors. They need to act together if we are to succeed.

17 The need for action by Government is overwhelming. In its general control over public education, and through its funding for the Manpower Services Commission, as well as its legislative role, the Government can have a major impact on the level of skills in the workforce. This is based on two key powers of Government - provision of funding and the creation of legislative rights.

18 In terms of funding, the Government has a duty to provide a broad-based, socially and economically relevant education to all those under 16, and all those over 16 who can and wish to benefit from further and higher education. Our competitor nations have far higher rates of staying on at school or moving into vocational education or training at that age. The Government has a duty to ensure that initial training (where not provided by employers) and training for the unemployed, is funded at such a level that it works, and also to ensure that there exists a national network of vocational education and training institutions (colleges and skillcentres) able to cater for the training needs of the country.

19 In terms of legislation, the Government has a duty to ensure that working people, students and the unemployed have a right to education and training, that they have equal access to it, that it should be properly funded and that it should be to high standards.

20 In short, the Government's role is to ensure everyone gets good training, and that the resources are there to underpin that right.

21 The role of employers revolves around the funding and delivery of training for employees. All enterprises should be concerned about the need to train their workforce, and this should involve providing adequate time-off and funding. The best employers, of course, already do this, and the MSC's first National Training Awards demonstrated the good work that some enterprises (public and private) are doing. But far more needs to be done.

22 Trade unions, also, have a role in training. Unions need to encourage their members to seek and undertake training, and must therefore ensure, with employers, that the demand for training is met, and that such training is, in organisation, content and quality, relevant to their members needs.

23 One final major interest in this field is the trainer, whether in a public sector college or skillcentre. Such trainers have an immense amount of experience in the field of training, and should be provided with a role in advising on how to meet training needs, as well as the support to be able to meet those needs.

24 In summary, the TUC believes that all four major actors in training have a mutual interest and that there is substantial ground for joint action. That is why the TUC considers the Manpower Services Commission, with its tripartite structure, is so important, and why the TUC has and will continue to oppose the Government's wish to damage the Commission's good work by increasing the number of employers on the Commission and its advisory bodies when there is no evidence that employers are under-represented on such bodies. Instead of expanding the composition of such bodies, the Government should be expanding the resources available to them to monitor and deliver better quality training.

#### Target Groups

25 As the early paragraphs of this paper sets out, skills are needed everywhere and by everyone. But the TUC would accept that different groups need different help. This section sets out some proposals for improving the help that is currently available.

26 One of the major deficiencies in this country's vocational education and training system is in the area of retraining and continuing education and training for employees. Working people need far greater opportunities to update their skills, retrain in circumstances of changing jobs or changing technology, and in order that their careers can develop. The issue of work quality is a central one: better trained workers can improve the quality of their product, whether this involves reducing waste or errors, or enhancing their service to consumers. And in addition, better trained workers are more able to identify and remedy faults, and come up with better ways of working. All these areas are, of course, not only to do with increased skills, but also enhanced motivation, and the two are very closely linked. The vital link is that working people should be involved in determining the training they receive, and the TUC therefore strongly supports the creation of joint committees of managers and workers, the development of training plans and the conducting of training audits, on the basis of which individual workers should be encouraged and assisted to seek extra training relevant to their needs. Part of this strategy will be an extension of open learning, and also the provision of paid educational leave in line with ILO recommendations. The TUC would be keen to see Government action in this direction, and also to work with employers organisations to develop joint action.

27 The importance of training for employees should not, however, obscure the need to train unemployed people. The TUC has made it consistently clear that the major problem facing the unemployed is the lack of jobs, and we do not believe that training can create jobs. Nevertheless, unemployed people do need training, in preparation for their re-entry to the labour market and to assist that re-entry. The MSC has done a great deal in the past decade to provide for unemployed people, but it falls far short of the need. The new programme for the adult unemployed is currently being considered by the TUC, but the TUC has already identified the issue of resources as a problem. The funding allowed for the new programme will provide in the main short courses, which although they could meet some of the needs in the economy, can only make a very limited contribution to higher skills.



28 Another point which needs to be recognised in relation to training, whether for adults or youth, is that all such training must be voluntary. Compulsory training is bad training, unlikely to benefit the individuals forced onto courses, and likely to hinder trainers and other trainees in their courses. The TUC believes that this is widely understood by those involved in training, such as employers and trainers - and it is a cardinal principle of the MSC that its training must be voluntary.

29 Women have historically been under-trained for employment - and where training has been provided for them, it has often been restricted to traditionally female areas of employment. This is not only wrong in principle, it is, as bodies like the Engineering Industry Training Board have pointed out, an unjustifiable waste of potential skills.

30 The MSC, local authorities and initiatives such as Women Into Science and Engineering, have begun to address the problem, but often on a very small scale. Training for women needs to overcome a number of obstacles central to which is the shortage of real opportunities for women in non-traditional areas. Other obstacles include discrimination by employers; social background which often makes women less confident about pursuing non-traditional courses; the problems of re-entry into work and childcare and other domestic responsibilities. The Government has a role to play in enforcing anti-discrimination and promoting positive action measures such as contract compliance, as well as in providing for childcare. Remedies exist in both these areas (albeit not fully developed), but more imaginative methods need to be found to overcome social pressures. Women's current skills need to be more fully recognised and rewarded, and the scale of provision of women-only or reserved-place schemes needs to be enlarged.

31 Turning to initial training for school leavers, the prime measure, the Youth Training Scheme (YTS) is now well-established, and has enjoyed TUC support since its inception. YTS is now in a position to be consolidated and substantially improved. The major issues for the development of YTS are to ensure that it covers more employed young people (both by enlarging the number of current YTS places carrying employee status and by bringing more school leavers' jobs presently without a structured training element within YTS), and improving the quality of training, with a greater degree of directed training and an extension of the levels and breadth of skill imparted. But other issues also need addressing: the training allowance is far too low and discrimination (sexual and racial) needs to be more effectively combatted.

32 There are, however, other methods for training the 16-19 age group. The Technical and Vocational Education Initiative needs to be better integrated with other youth initiatives, especially the second half of its four year curriculum, and young people need a greater incentive to stay on beyond 16, such as Education Maintenance Allowances. In the field of further education, the TUC is opposed to the proposed withdrawal of benefit entitlement for 16 and 17 year olds which will have the effect of preventing young people from studying while unemployed.

33 Finally on young people, the TUC supports a major expansion of apprenticeships, especially in manufacturing. The record of apprenticeships has been the creation of generations of highly-skilled and internationally respected labour, and some of the best examples of YTS courses are to be found where they form a foundation for apprenticeships. Their decline, especially in engineering, has left the industry short of skills and with the prospect of increasing shortages.

34 The TUC would also welcome measures to expand the supply of graduate labour. The Engineering Council, and the MSC's Skills Monitoring Report, have pointed to shortages of graduate engineers. One possible solution would be to expand access to higher education, both for those young people who have not in the past considered it an appropriate route, and also for those adults who have gained their qualifications through vocational rather than academic routes. Such an extension of access would demand a mixture of paid educational leave and an enhanced student grant, and would certainly not be possible with any loans-based system, which the TUC would oppose.

35 Finally, the TUC also welcomes an increasing emphasis on management training and development, both for our members who are themselves managers, and also for those who manage our members, as well as for greater economic success for enterprises. Reports like Professor Handy's have indicated the need for this, and the TUC would welcome further moves to increase the skills of British managers.

## Towards Solutions

36 Apart from the specific proposals made above, the TUC would also urge overall reform of three broad areas of the vocational education and training system: qualifications, funding, and joint action by unions and employers.

37 On qualifications, the TUC supports the work being done by the National Council for Vocational Qualifications in establishing a coherent and accessible structure of qualifications which are comparable, transferrable and allow for progression. The Council evidently has a great deal to do in producing that structure for 1991, but the TUC welcomes its approach so far in ensuring that qualifications should be employment-led rather than narrowly specific to individual employer requirements, and in recognising the interests of unions, employers and trainers in drawing up its criteria for qualifications. The TUC believes that the Government should ensure that the NCVQ continues to have adequate support in its work.

38 The TUC is also involved in the MSC's current study of the funding of industrial training. However important the questions of content, quality and qualifications, funding is still a major issue, and it is clear that a substantial obstacle to developing the British training system is the lack of funds available. It is the view of the TUC that the Government's abolition of seventeen Industrial Training Boards in 1981, and the shift that marked towards voluntary training arrangements, was a step backwards. This view has recently been endorsed by the MSC's research into the operation of Non-Statutory Training Organisations. The TUC considers that the problems of poaching, coping with newly emerging skills, and the lack of resources for training, will only be solved by a statutory system of collective employer funding. Without prejudging the results of the MSC study, however, the TUC is keen to explore a range of possible methods of implementing that system, including fiscal measures, levies and grants, or non-financial arrangements such as a right for employees to a certain amount of training.

39 Lastly, the TUC is committed to the extension of the consensual approach to decisions about training which characterises the Manpower Services Commission's current operations. The TUC would wish to see this approach adopted more generally at the level of the enterprise, through joint action between managements and unions, in workplace training committees, and in the

development of enterprise training plans and audits. The TUC would urge the Government to encourage this approach but individual steps can and should be taken by joint agreement between employers and unions.

#### Conclusion

40 The TUC is committed to increasing the levels of skill in the economy as a key to continued and increased growth, and in order to create a better working life. We are willing to work constructively with others who share that commitment.

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Trades Union Congress  
Congress House  
Great Russell Street  
London WC1B 3LS



Briefing behind, but  
Ch/ I have spared you the  
papers. Would you like  
to see anything on  
this menu?

NOT FOR PUBLICATION

National Economic  
Development Council

NEDC(88)  
2nd Meeting

Meeting to be held at the  
National Economic Development Office  
on Tuesday 26 April 1988 at 10.00 am  
Luncheon will be available in the Office.

upw 22/4

no thanks -  
Prattas

A G E N D A

1 SKILLS

- Skills for the Future: Memorandum by the Secretary of State for Employment and the Chairman of the Manpower Services Commission (NEDC(88)9 already circulated);
- Skills and Skill Shortages: Memorandum by the TUC: (NEDC(88)10 circulated herewith);
- Skill Shortages and Employer Action: Memorandum by the CBI (NEDC(88)11 already circulated);
- The Supply of Skills: Some Questions: Paper by the Director General (NEDC(88)12 circulated herewith, Annex to follow).

2 SECTORAL REPORT: COTTON AND ALLIED TEXTILES SECTOR GROUP

- Serving the Customer: Memorandum by Mr S D Hollander CBE, Chairman of the Cotton and Allied Textiles Sector Group (NEDC(88)13 already circulated).

3 SMALL FIRMS

- Encouraging the Small Firms Sector: Memorandum by the Department of Employment (NEDC(88)14 already circulated);
- Encouraging Enterprise: The Role of the Smaller Firms: Memorandum by the CBI (NEDC(88)15 already circulated);
- Memorandum by the TUC (NEDC(88)16 to follow);
- The Growth of Small Firms in the UK: Memorandum by the Director General (NEDC(88)17 already circulated);

\*4 NEDO PLAN AND BUDGET FOR 1988/89

- Note by the Director General (NEDC(88)18 already circulated).

5 RELEASE OF PAPERS

6 ANY OTHER BUSINESS

- \* This item is put forward for formal noting: if this is not acceptable it will be withdrawn and made the subject of further consultation.

National Economic Development Office  
Millbank Tower, Millbank, SW1P 4QX

15 April 1988

THIS PAPER IS NOT  
FOR PUBLICATION

I have  
skills  
near by

mp

*Handwritten initials in a red circle*

*Handwritten signature*

FROM: P WYNN OWEN  
DATE: 20 April 1988

- 1. MR MONCK
- 2. PS/CHIEF SECRETARY

cc APS/Chancellor  
PS/Sir P Middleton  
Mr Burgner  
Mr MacAuslan  
Mr Flanagan

*Handwritten notes in a red box:*  
asked to substitute  
EST for 11.15  
I have spoken to  
EST, who will  
substitute for  
EST @ 11.15 am

ATTENDANCE AT 26 APRIL NEDC

You said the Chief Secretary had spoken to the Chancellor this morning about having to leave NEDC around 11.15am for an E(ST) meeting at 11.30am next Tuesday. You asked for a draft letter for the Chief Secretary to send to Mr Fowler warning him in advance.

2. The Chief Secretary is likely to be leaving the meeting sometime around the end of item 1. I understand Mr Fowler's office have already expressed concern to the Chancellor's office about likely Ministerial attendance in the light of E(ST). You may also feel that the absence of any Treasury Minister after item 1 would risk the TUC making mischief - eg on their proposal for a "new financial intermediary", or on financing for small firms, under item 3, or possibly even on the "below the line" paper on the NEDO grant-in-aid. We will, of course, cover such points in briefing for Mr Fowler, but he might feel exposed without a Treasury Minister present and perhaps inclined to promise further papers or discussions on Treasury matters to get round any problems. If you are able to arrange for another Treasury Minister to substitute for the Chief Secretary from 11.15am, you might mention it in this letter.

*(they rang up this pm)*

3. I attach a draft.

*Handwritten signature: Philip Wynn Owen*

P WYNN OWEN

DRAFT LETTER FROM CHIEF SECRETARY TO:

Rt Hon Norman Fowler MP  
Secretary of State for Employment  
Department of Employment  
Caxton House  
Tothill Street  
SW1H 9NF

NEDC, 26 APRIL

I am afraid I will have to leave the NEDC meeting you are chairing next Tuesday at around 11.15am, due to a major meeting of E(ST), at which I must be present. This has been arranged for 11.30am, and, though we have attempted to have that meeting shifted, I gather the Cabinet Office feels there are good reasons for leaving it as it stands.

2. I nonetheless look forward to seeing you for the first part of the meeting. [A.N. Other Treasury Minister has kindly agreed to substitute for me thereafter].

[J M]