The Ten Percenters

Fourth Report
Fast Growing SMEs in Great Britain
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Foreword

by Peter Morgan, Partner, Deloitte & Touche

This is the fourth report on 'Ten Percenters' jointly contributed by Professor David Storey of Warwick University's Centre for Small and Medium Sized Enterprises and Deloitte & Touche.

In the first three reports, Professor Storey examined middle market companies - with a turnover of between £5m and £100m - which have grown rapidly since the early 1990s. Since such firms constitute about one in ten of all companies in this size range, they are referred to as 'Ten Percenters'.

The first three reports were all based on data extracted in February 1996. Professor Storey drew various conclusions based on statistical analysis and qualitative research into these companies, including telephone and face-to-face interviews. This provided fascinating observations of the markets in which these companies operate. Professor Storey also observed that a remarkable number of Ten Percenters were not 'well-managed' in that their management techniques did not conform with the accepted text book norm.

To take our growth companies research to its next stage, we have tracked the performance of the Ten Percenters by reference to a further five-year period of information extracted in February 1998 - exactly two years after our original data. Professor Storey has carried out statistical analysis of the data on which his further observations are based. The results provide a further insight into the performance of high growth companies which are key to the UK economy and in particular, employment growth.

Two years on, the results show that 29 per cent of companies have achieved 'Star' status by virtue of again achieving a compound growth in turnover of at least 30 per cent per annum in this later five-year period. However, perhaps more interesting, cumulatively just under 50 per cent of companies achieved a growth rate of at least 20 per cent and a total of 60 per cent achieved at least a ten per cent growth rate - again compounded over five years. These are still outstanding performances which we should not allow to be eclipsed by the Stars.

Perhaps Professor Storey's key observation is that these fast growing businesses experience considerable year to year volatility along with rapid and probably unpredictable changes in demand. He concludes that the skills needed to manage these companies are analogous to those possessed by a surfer and what needs to be written is the surfer's guide to management. I hope someone rises to the challenge!

The next stage of our research will be based on further interviews with the Stars helping us to offer a further understanding of this unique group of UK companies.
**Observations and key statistics**

**Observations**

Our third report probed the factors underlying the exceptional performance of the Ten Percenters. We developed the analogy of a boat moving swiftly down the river. For this to happen there are two strategies: one is to have a capable crew and the other is to have the boat backed by a strong current.

We found that, whilst there was almost total uniformity amongst Ten Percenters in being located in growing niche markets – the elements of the current in the boating analogy – there was a much greater diversity in the internal organisation of these firms. In short, the crew appear to be organised and managed in a variety of ways. By the standards of the management textbook, a remarkable number of Ten Percenters do not appear ‘well managed’.

- The key finding in our analysis of Ten Percenters two years on is that very few middle market companies experience smooth, yet rapid, year on year growth. A much more frequent pattern is massive spurts, followed by fallbacks – some of which are substantial. There is considerable year to year volatility.

- The reason for these huge oscillations is probably the often short-lived surges of demand which can disappear almost as quickly as they arrive. The managerial skill is to be able to harness and benefit from these, often short-term, movements in demand.

- Two other ‘water-based’ analogies may be appropriate. Apart from the relatively few Ten Percenters occupying a dominant position in a market niche most middle market companies lack market power; they cannot set a course by driving through rough waters. The less successful ones are like corks bobbing about in a rough sea – they are pushed and buffeted and as likely to go back as forward.

- The skills which these successful businesses need can be considered analogous to those of a surfer. They recognise there will be surges in demand. Their skill is not to be thrown by a surge coming from an unexpected direction but instead be able to exploit and benefit from the surge, however temporary this may be. They need to constantly scan the sea for signs of the next wave and then plan to take maximum advantage of opportunities it presents. They certainly do not attempt to ‘plot a course’ which ignores the certainty that a giant wave will arrive.

- The analogy highlights the emphasis which fast growers place upon ‘flexibility’. The business has to be totally responsive to market-place changes. Since managers of businesses cannot forecast accurately what will happen next (where the next surge will come from), they have to be braced to respond to it in a highly ‘flexible’ manner.
We can now see why so many of the characteristics of Ten Percenters emerge, and why these are so contrary to the textbook management appropriate for larger enterprises.

For example, we saw that in the third report Ten Percenters had a management style which was more autocratic than team based. Teams require consensus or near consensus and that is time-consuming. The captain does not consult the crew when the wave is coming.

We also saw Ten Percenters were more characterised by informality than formality. Again procedural issues are time-consuming and inappropriate when the 'wave' is about to burst.

The lack of emphasis on training and development in middle market companies which grew rapidly are also understandable in this context. Investing in people is for the long term, whereas demand surges may be comparatively short-term. Only training which is clearly going to lead to considerable extra flexibility is likely to be attractive to such enterprises.

We conclude that it is difficult to link conventional good textbook management to exceptional performance amongst middle market companies. This is not because the companies themselves are badly managed. Far from it. Instead, the problem is that the textbook in many respects is inappropriate for such enterprises.

The textbook is devised and written for managers of supertankers who are capable of plotting a course and sticking to it through a rough sea. The skills required of the supertanker captain are fundamentally different from those of the surfer. What now needs to be written is the surfer's guide to management.

Very few middle market companies experience smooth, yet rapid, year on year growth.
KEY STATISTICS

- 29% of our 1996 Ten Percenters achieved a 30% or more compound growth in their sales when measured over the latest five-year period. We have referred to these companies as Stars.

- Stars are found across all industry sectors but are more concentrated in:
  - Computer and related services
  - Restaurants, hotels and catering
  - Electrical equipment
  - Retail

- 34% of London's 1996 Ten Percenters are Stars compared with 24% in northern England, Scotland and Wales. Only 16% of Scotland's Ten Percenters became Stars.

- Stars are characterised by high profit margins. 38% of 1996 Ten Percenters with profit margins exceeding 10% of sales were Stars compared with 22% which had profit margins of 2% or less.

- 25% of the 1996 Ten Percenters failed to meet our definition of middle market companies - 9% because they were acquired, 4% because their turnover declined below £5m, 5% were untraceable (and probably ceased trading) and 7% where up-to-date financial records were unavailable.

- Of the remaining 46% of 1996 Ten Percenters the majority continued to achieve substantial growth rates over the five-year period. 38% of these companies achieved rates between 20 and 29.9% and a cumulative total of 67% of these companies achieved growth rates between 10% and 29.9%. These are still impressive performances, even if not qualifying for Star status.
1. CONTEXT

This is the fourth in a series of reports about the UK's Mittelstand - Britain's middle market companies. The reports all focus upon the comparatively small proportion of this group of firms which are growing rapidly in terms of sales. For our purpose the middle market is defined as:

- **Middle** Limited companies
- **Market** with sales of between £5m and £100m
- **Definition** which are independent, i.e. not subsidiaries

**Ten Percenter definition**

Our particular interest is in that section of the middle market which is growing rapidly - defined as being equivalent to at least a 30 per cent compound per annum sales growth over generally a five-year period. (Please see technical note in the appendix for further information.)

Our initial report in 1996 found that virtually ten per cent of eligible middle market companies achieved these fast growth rates. Hence we refer to such firms as 'Ten Percenters'.

**Our work so far**

i) Report one in 1996, identified the basic characteristics of the Ten Percenter population. It examined the published accounts of 7,203 middle market companies between 1990/1 and 1995/6 and found that 708 (ten per cent) had achieved 30 per cent per annum sales growth. The report presented the characteristics of these 708 companies in terms of their sector, age, size and geography.

ii) Report two in 1997, reported on telephone interviews with a sample of Ten Percenters.

iii) Report three in 1998, reported the results of in-depth interviews with senior personnel in 46 of these businesses.

**Our findings so far**

- Ten Percenters are found in almost all sectors and all parts of the UK, but are more heavily concentrated in London and in services
- they tend to be younger, rather than established, companies
- they occupy market niches and are highly skilled in identifying and developing these niches
- almost without exception they are found in marketplaces or niches which are expanding rapidly
- they tend to be internationally orientated
many do not follow the management textbooks, but their performance was clearly highly effective for their business over the period concerned.

we used a boating analogy to describe these businesses. We observed that our interest was in identifying the fast moving boats, and that their captains could employ two strategies: one was to locate the boat in a fast moving current (the market) and the second was to have a powerful co-ordinated crew (the management textbook).

we observed, perhaps controversially, that Ten Percenters placed more emphasis on locating the boat in the current than in ensuring the crew were co-ordinated and pulling in the same direction.

Responses to this finding

These, possibly controversial, findings generated considerable interest and so not surprisingly, were questioned. We were viewed as saying that ‘textbook management’ did not matter to Ten Percenters.

Our critics (politely) replied, also using a boating analogy: they said ‘Textbook management may not matter when the river is calm and the current is in your favour, but the longer the boat continues the more likely it is that it will hit the rapids. Good management will help you either to circumvent the rapids or manoeuvre your way round through them.’

Expressed more formally the critics said: ‘Four to five years is not long enough to isolate really excellent performance. It would be interesting to know what happened to these Ten Percenters over an even longer period – such as another two years.’

Our response

This report responds to this point. It examines what did happen, two years on, to those businesses which we defined as Ten Percenters in report one. During the last five years did they continue to be fast growers or did their growth rates slow down? Alternatively, were they acquired or did they cease trading?

‘Four to five years is not long enough to isolate really excellent performance. It would be interesting to know what happened to these Ten Percenters over an even longer period – such as another two years.’
2. WHAT HAPPENS TO THE 1996 TEN PERCENTERS BY 1998?

A. OVERALL

We examine what has happened two years on to middle market companies which grew their sales at, or faster than, an average of 30 per cent per annum compound over the 1990/1 to 1995/6 period; the Ten Percenters.

This is best understood in conjunction with Figure 1. It shows at the top all the Ten Percenters which we identified in our 1996 report. It then shows, at the second level, ways in which these firms developed over the next two years. They became:

(i) Stars
(ii) Decelerators
(iii) Departures

(i) Stars

These are middle market companies which, during the 1990/1 to 1995/6 period, grew their sales at, or faster than, an average of 30 per cent per annum compound and, also achieved this over the last five years 1992/3 to 1997/8.

Figure 1 shows that 29 per cent of the 1996 Ten Percenters were Stars.

(ii) Decelerators

These are middle market companies which, during the 1990/1 to 1995/6 period, grew their sales at, or faster than, an average of 30 per cent per annum. However, in the 1992/3 to 1997/8 period, sales grew less rapidly so that, during this later five years, they did not achieve 30 per cent per annum.

Figure 1 shows that, of the 1996 fast growers, 46 per cent were Decelerators.
(iii) Departures

These are middle market companies which, during the 1990/1 to 1995/6 period, grew their sales at, or faster than, an average of 30 per cent per annum, but in the following two years their status or circumstances have changed such that they no longer meet our middle market definition.

These constitute 25 per cent of 1996 Ten Percenters.

B. MORE DETAILED ANALYSIS

Figure 1 shows further analysis of the Stars and the Departures. Row three of the diagram shows that the Stars include some Superstars amongst their number.

Superstars are companies which, not only have at least 30 per cent per annum sales growth over the five years until 1996, but which continue to achieve at least 30 per cent per annum growth in the subsequent two years. The extent to which these are unusual or 'special' is reflected in the key finding that only 16 per cent of the original group of Ten Percenters are Superstars. We will examine these companies in more detail in a future report.

A second category of Stars are 'Shooting Stars'. These are companies which, although they did not achieve a growth rate of 30 per cent per annum in their most recent two years, exhibited such rapid growth in the first three years of the five-year period that, when the five years are taken as a whole, did achieve 30 per cent per annum. In this sense their early momentum carried them over the line, even though they slowed towards the end.

Figure 1 analyses the Departures between those which are acquired, those which were untraceable or ceased to trade and those which no longer fit our middle market definition.

Nine per cent of Ten Percenters over the 1990/1 to 1995/6 period were acquired in the subsequent two years and thus now contravene our definition of a middle market company as one which is not a subsidiary of another business.

Five per cent of companies were untraceable in 1998 and are likely to have ceased trading.

Four per cent of Ten Percenters no longer qualify as middle market companies. They were still trading but contravene our middle market definition as their turnover falls below the £5 million minimum threshold.

Seven per cent of the Departures are companies that had no new financial records (this could be due to late filing) or records that ended abruptly.
How are Stars different?

3. How are Stars different?

The above has provided the big picture about what happened to the Ten Percenters. But our interest is primarily in the Stars – those companies which continued to grow rapidly two years after they were identified as Ten Percenters. We want to know whether they differ from the others, and if so how.

We therefore review whether the three broad groupings of firms (Stars, Decelerators and Departures), differ in terms of the following characteristics:

- sector
- size
- profitability
- age
- region

(i) Stars

Stars which comprise 29 per cent of Ten Percenters, are found in all sectors. Sectors showing higher proportions of Stars are:

- restaurants, hotels and catering (60%)
- computer and related services (45%)
- electrical equipment (45%)
- retail (44%)

Stars are more heavily concentrated in London than in any other part of the UK:

- 34% of London’s Ten Percenters were Stars, compared with only 24% in northern England, and Wales
- In Scotland, the rates were particularly low, with only 16% being Stars

Those Ten Percenters which, in 1996, were generating high profit margins were much more likely to be Stars during the following two years:

- 38% of those Ten Percenters, which in 1996 had profit margins exceeding 10%, were Stars
- this compares with only 22% of those with profit margins of 2% or less becoming Stars

We find little evidence that age of company influences whether it is a Star:

- of those Ten Percenters incorporated before 1960, 27% are Stars, compared with 29% for the Ten Percenters as a whole

Finally, we do not find that the size of the company, defined as number of employees in 1996, is associated with Star status.
(ii) Decelerators

Earlier Figure 1 showed that virtually half (46 per cent) of Ten Percenters in 1996 still met the middle market definition in 1998 but, in the most recent five years, their growth rates had slipped to an average which was below 30 per cent per annum. These firms are called Decelerators.

The actual annual average rates of sales growth which Decelerators achieved over the last five years are shown in Table 1. In Table 2 the growth rates achieved by the Stars are shown for comparison.

The key point is that, although the Decelerators are not Stars, the performance of the majority is still extremely impressive. For example, 38 per cent achieve an average annual growth in sales greater than 20 per cent per annum over the last five years. A further 29 per cent achieve growth in sales of between ten per cent and 20 per cent per annum over that period. Although these rates of growth do not qualify these companies for Star status, they are still outstanding and justify such firms being viewed, by the standards of the UK middle market, as exceptional performers.

Nevertheless, compared with Stars, their performance is more modest. The exceptional nature of these Stars is clearly seen in Table 2. It shows:

- that eleven of the 1996 Ten Percenters, on average at least doubled their turnover each year over the last five years
- that a total of sixty-eight companies achieved average compound sales growth of 50% or more per year during that time

Since there were about 7,200 middle market companies identified in 1990/1 it appears that the chances of a company achieving these above rates of growth is more than one in six hundred-and-fifty, and one in a hundred respectively. These are exceptional performances.

(iii) Departures

Of the 1996 Ten Percenters, Figure 1 shows 25 per cent are Departures. These comprise companies which are acquired, those with turnover falling below £5m, those who do not have a complete set of financial records or that were untraceable and probably ceased trading.

Although the Decelerators are not Stars, the performance of the majority is still extremely impressive
We find that Departures are fairly evenly distributed across sectors, although there are:

- comparatively lower rates in manufacturing (20%)
- comparatively higher rates in computer and business services (29%)
- comparatively higher rates in construction and property (35%)

We find little evidence that the age of the company influences its likelihood of being a Departure. However, we do note it is younger rather than older companies that are more likely to be acquired:

- 7% of companies incorporated before 1979 were acquired, compared with 12% of those incorporated after 1985

The proportion of 1996 Ten Percenters which are now Departures only varies very slightly between regions. Again, however, there are some slight differences between the regions in rates of acquisition:

- 1996 Ten Percenters located in London are more likely to be acquired than those located in northern England, Scotland or Wales

Profit margins in 1996 were a major influence on whether or not businesses ‘departed’:

- 41% of Ten Percenters with negative profit margins in 1996 were Departures compared with 22% of those reporting profit margins of more than 10%

A clear difference is apparent amongst the Departures between those which cease trading and those which are acquired. The former have low profit rates, whereas those which are acquired exhibit much more variable profits.

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Table 1: Annualised compound rates of growth over the last five years

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<th>DECELERATORS</th>
<th>Number</th>
<th>%</th>
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<td>Zero</td>
<td></td>
<td>17</td>
<td>7</td>
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<tr>
<td>&lt;5</td>
<td></td>
<td>19</td>
<td>8</td>
</tr>
<tr>
<td>5 – 9.9</td>
<td></td>
<td>27</td>
<td>11</td>
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<td>10 – 19.9</td>
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<td>20 – 29.9</td>
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<td>97</td>
<td>38</td>
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<td>18</td>
<td>7</td>
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<td>TOTAL</td>
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Table 2:

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<th>% Growth</th>
<th>STARS</th>
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<td>30 – 39.9</td>
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<td>40 – 49.9</td>
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<td>39</td>
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<td>50 – 74.9</td>
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<td>75 – 99.9</td>
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<td>100+</td>
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<tr>
<td>TOTAL</td>
<td></td>
<td>160</td>
<td>100</td>
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n.a. = incomplete information
Appendix

TECHNICAL NOTE

In the first (1996) study a Ten Percenter was defined as:

- An independent company with annual turnover in the latest year of between £5m and £100m
- A company which grew its sales at a compound growth of 30% per annum over the previous five years

The 'base year' for most companies was either 1990 or 1991 which meant that the latest year was 1994 or 1995.

However in a handful of cases only four years of information was available but these firms were included in the analysis.

In the current (1998) study the One Source database was used again, and it is possible to identify sales growth rates in the latest five-year period (i.e. to 1996 or 1997).

This means we can track the 1996 group distinguishing:

i) A Star is defined as a Ten Percenter which in the most recent five years, until 1996/7, achieved 30% per cent per annum average compound growth.

- A Superstar is a Ten Percenter which grew at 30% per annum in the last two years and also (by definition) in the previous five.

- A Shooting Star is one which grew at 30% in the last five years, but not in the last two years. However, its growth in the first three years was sufficient to ensure that, taken over the five years as a whole, it achieved 30% per annum average compound growth.

ii) Decelerators
Those companies which survive but which, during the latest five years, do not achieve the 30 per cent per annum average compound growth.
Contacts

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