The Insight Report

Tomorrow's champions: finding the small business engines for economic growth

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Contents

1. Executive summary

- Experian's analysis shows that high growth businesses represent less than 10 per cent of the UK's SME population and play a key role in underpinning the stability of the economy.

- This small number of 'champion' businesses account for two thirds of all employment created by existing SMEs and effectively replace the jobs lost by the 40 per cent of the SME population that decline or cease trading altogether.

- Experian's research shows that there are far more SME businesses with the potential to become champions in the UK, but never go on to achieve champion status. Identifying potential champions ahead of time means that they can be targeted with the right support and helped to drive the economy.

- Simply targeting sectors identified as having high growth potential, will not create the level of growth the economy needs. There are champions in every sector and the level of job creation varies in each.

- Some of the UK's least resilient regions – such as the North East – have the highest proportion of potential champions. Finding them and supporting them to grow could help create new jobs in those regions.

- Targeted public sector support can play a vital role in helping businesses address the barriers to growth that they are currently facing.

- There are multiple barriers to growth and in order to address and encourage businesses to grow, Experian has identified six areas for focused business support:
  - » encouraging new relevant start ups
  - » improving business skills
  - » enabling customer acquisition
  - » encouraging export
  - » access to finance
  - » providing intensive support for high growth firms.

- By delving deeper into Experian's analysis, for the first time government, financial institutions and business groups can target their support effectively, not only by pinpointing where the most struggling businesses are located, but by also identifying where the businesses with the greatest potential for rapid growth are located.

2. Introduction

Charlotte Hogg, Managing Director, Experian UK & Ireland

In this Insight Report, we are focused on growth in the private sector and particularly employment growth. What drives small businesses to become 'champions'? Can we identify them? What can Government, banks and the companies themselves do to increase the numbers of champions?

Intriguingly, our data would suggest that some well held beliefs may not be accurate; or are only a piece of the puzzle. For example, it isn't about sector. We have seen and will see champions in agriculture as we see champions in high tech.

It isn't about region; all regions can have them, and the impact in the North and Midlands can be more critical than in the South where unemployment is lower. It isn't all about start ups; although they play a role in the years spent setting up by driving employment growth, the majority stabilise or even fail within three years.

So what indicates a business' potential? Again, this confirms in some ways traditional banking beliefs. It absolutely matters who leads the business, and their experience, and it matters whether that business is linked with other high growth companies, and whether or not they have an international focus. Size matters, as does age.

What does this mean for governments, financing institutions and companies themselves? For governments, it will be key to ensure that the new Local Enterprise Partnerships and Regional Growth Fund don't over emphasise the high tech or green sectors because champions can exist in all sectors.

For banks, lending decisions are often about risk as much as growth potential. Factoring in growth potential as well as credit quality using calculated probabilities may help to refine lending models. And the companies themselves can play a role. Ensure their credit quality is good, as champions have no worse credit than any others. Ensure cash flow is solid (customers need to be good credit quality and pay on time) because growth is going to require working capital support.

We remain optimistic about the business base of the UK and its potential to generate employment growth. We believe that there are opportunities to better identify and support that relatively small number of companies that can generate millions of new jobs. And we believe the benefits of a more systematic approach will be legion.

3. Unlocking the door to economic recovery

Gareth Rumsey, Research Director, pH, an Experian company.

All eyes are on the private sector to help drive the economic recovery and with small and medium sized enterprises (SMEs) making up 99 per cent of the commercial world[1], the bulk of the burden seemingly lies with them.

In order to support these businesses, the Government recently announced plans to encourage entrepreneurs and help SMEs flourish. Measures include improving access to finance, opening up Government procurement to smaller businesses and establishing a network of 'growth hubs' to provide specialist support to businesses with high-growth potential.

Encouraging these businesses to take the risks associated with growth at a time when most are focusing their attention on surviving will be a challenge. However, a bigger challenge lies in locating those most likely to grow and help drive the economic recovery.

The vital ten percent

Groundbreaking new analysis by Experian, requiring in-depth analysis of complex data on the UK's business population going back to the start of 2000, reveals that there is consistently a small percentage of the SME population – less than 10 per cent – that help to underpin the stability of the whole economic system.

This small number of firms – but a hugely significant minority – has a giant impact on job creation by consistently growing at 20 per cent or more a year over each three year period analysed by Experian. These firms are described as 'champions' by Experian and, according to its research, these small companies combined are responsible for around two thirds of all the jobs created in the SME world (not including start-ups).

Given the need for growth, it becomes ever more important that champions thrive, and that their numbers increase. Success in this area will be vital to employment growth.

[1] SMEs provide over 33 per cent UK GDP and over 50 per cent of UK employment

Small companies with a huge impact

Experian's analysis of 10 years' worth of business data, looking specifically at private sector SME businesses, was undertaken in several consecutive three year periods (Figure 1). Analysis of 2003 to 2006, the last benign economic period before the downturn, revealed that the 10 percent of champion small businesses generated around 1.6 million jobs.

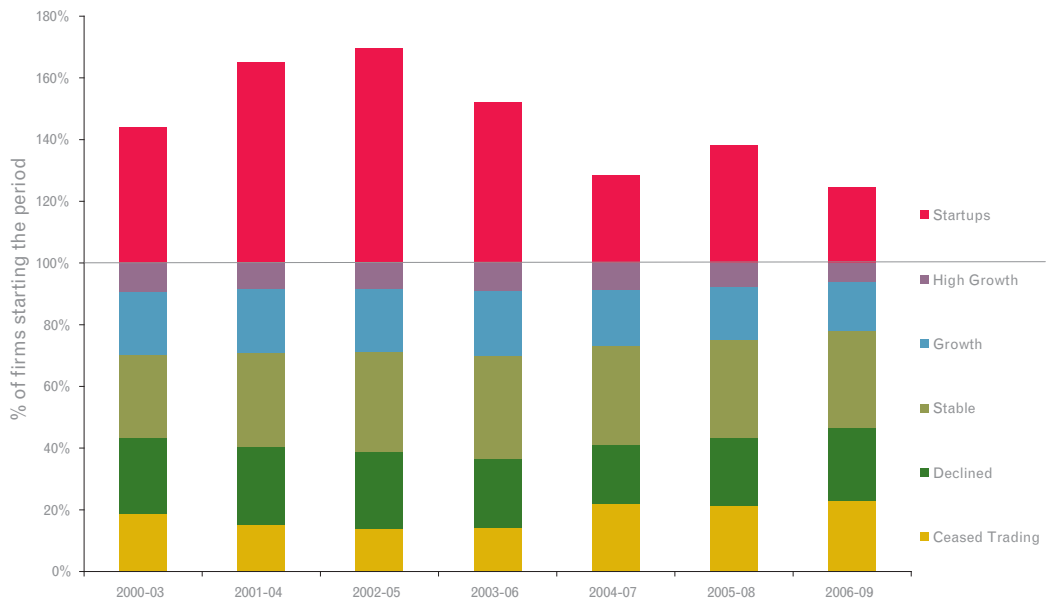
Of the remaining SME business population (excluding start-ups):

- 20 per cent grew steadily, albeit at a much slower level than the champions
- 30 per cent remained stable
- 40 per cent either decline or cease trading therefore losing jobs.

Collectively, these three groups lost around 1.75 million jobs during this period.

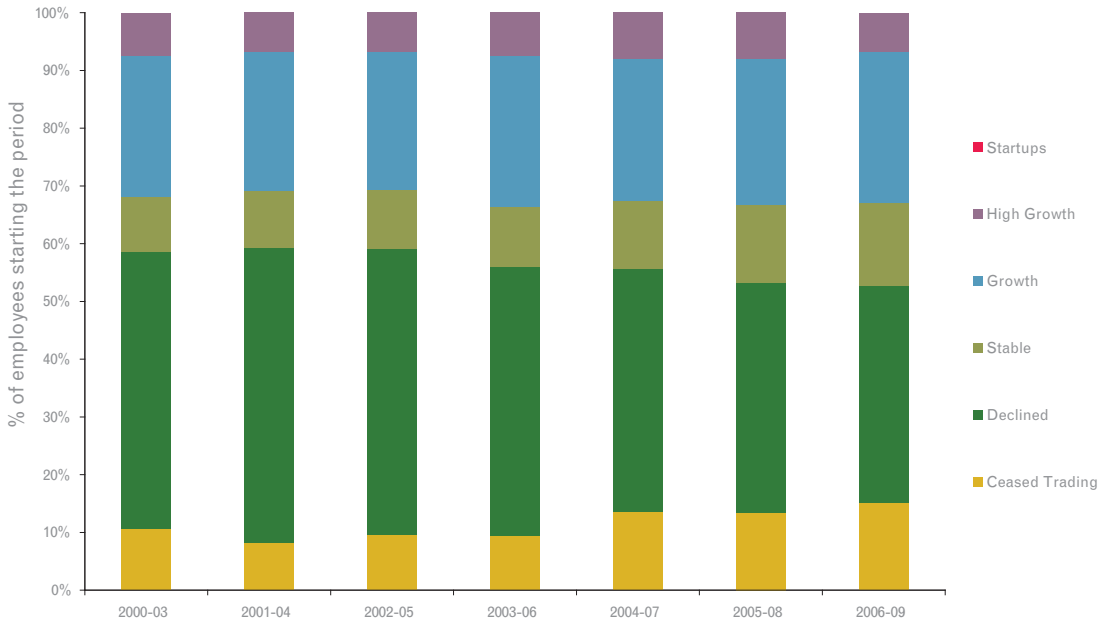
Crucially, champions account for 10 per cent of all jobs in the SME world at the start of any three years period and grow to account for 22 per cent of all employment (see figure 2 and 3). If it had not been for the 1.6 million jobs created by that 10 per cent of champion businesses, the net loss in employment between 2003 and 2006 would have been significantly worse.

Figure 1: Population split - high growth vs decline



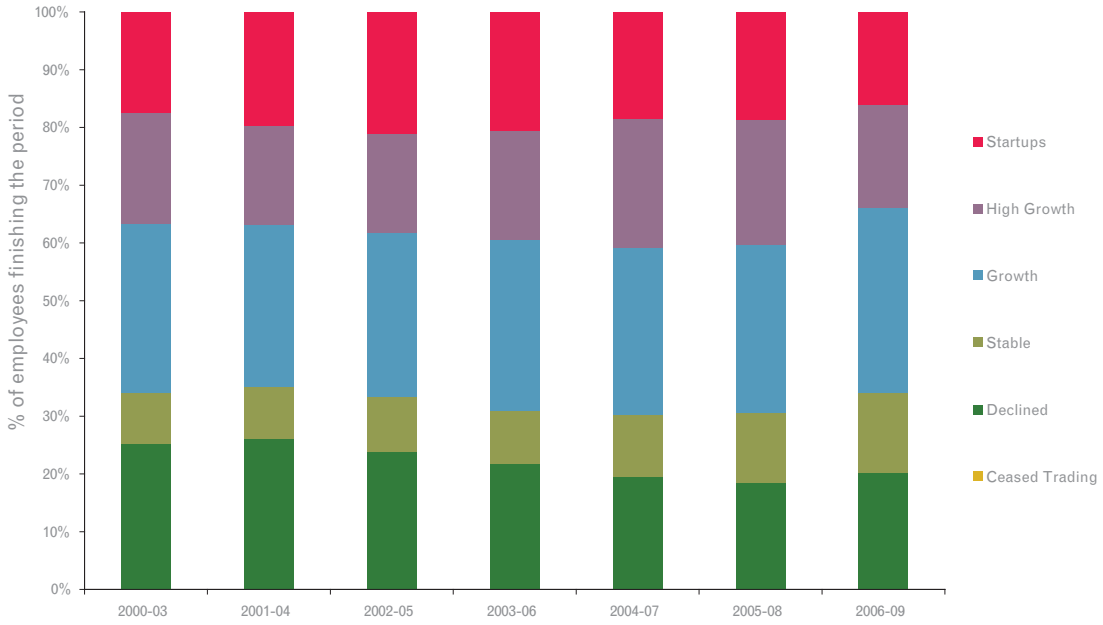
Source: Experian

Figure 2: Percent of those employed at the start of any 3 year period.



Source: Experian

Figure 3: Percent of those employed at the end of any 3 year period.



Source: Experian

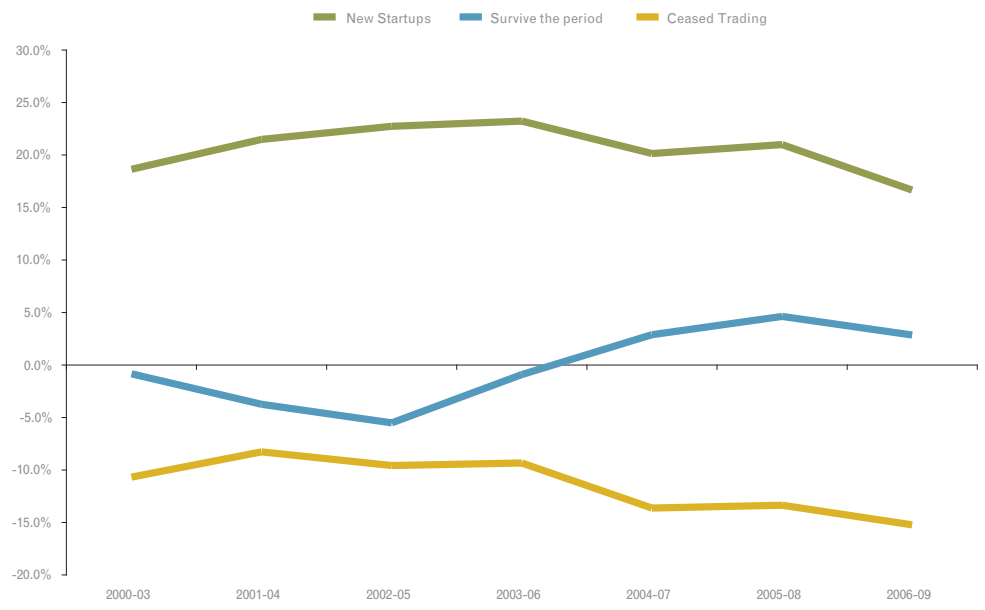
Start-up analysis

When it comes to focusing on growth, much attention is paid to start-up businesses. For every 100 businesses that exist at the start of any three year period, an additional 25 to 70 businesses will start up, generating significant growth in employment within the SME population as shown in Figure 4. Experian's analysis of businesses between 2003 and 2006 found that over 2.7 million jobs were created by companies 'born' during this period.

Once established, however, the majority of these new firms fall into the 'stable and able' category – they survived and remained roughly the same size. Between 10 and 20 per cent shrank, while a further 10 per cent ceased trading altogether, resulting in the loss of the jobs they had created only a short time before.

While start-ups are important to help kick start the road to recovery, Experian's analysis shows that – critically – less than five per cent of these ever go on to become one of the champion firms that see consistent and rapid growth.

Figure 4: Job creation by business type



Source: Experian

What do champions look like?

Experian's analysis found that, while there are champions in every sector and region of the UK, there are several characteristics that champions have in common:

- young, small companies – those under 10 years old and with less than 50 employees – have the highest possible probability of becoming a champion.
- firms with directors showing entrepreneurial appetite and experience in other recent successful business ventures are more likely to achieve champion status
- chances are also increased if the firm is part of a wider corporate network in which sister companies have also experienced recent growth
- being involved in some form of international activity is another key characteristic associated with champions.

In addition:

- businesses more than 20 years old are the least likely to see high growth, having already gone through their growth stage
- organisations with more than 50 employees have only an average incidence of reaching champions status
- micro businesses, those with fewer than five employees, have a below average likelihood of becoming champions. This is because they often include lifestyle businesses with no real intention of growing substantially.

Champions in waiting that didn't make it

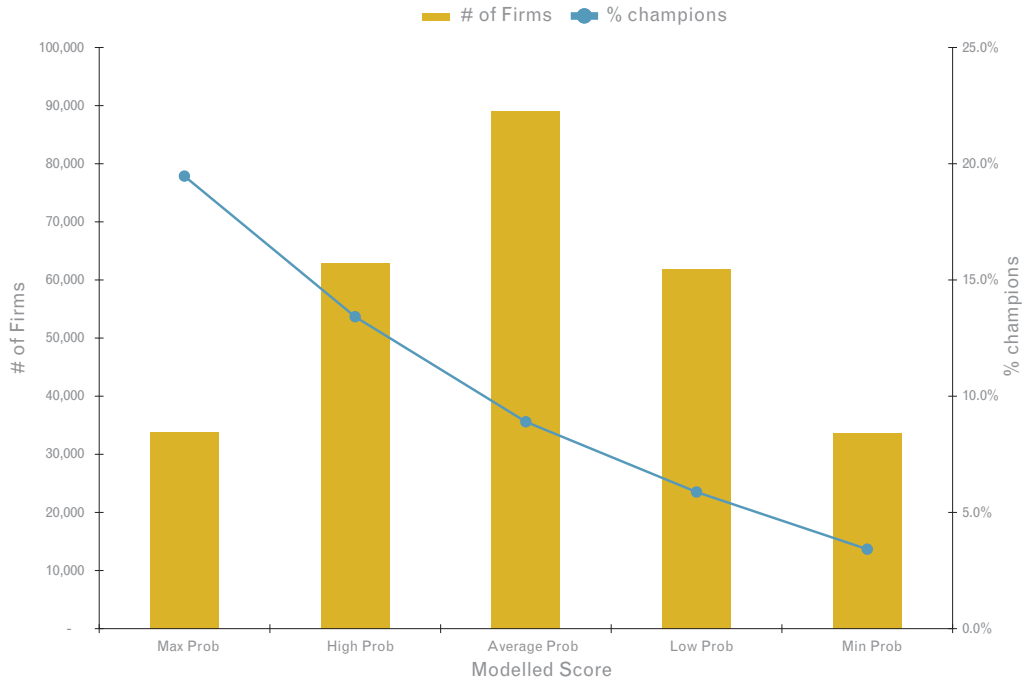
By examining the drivers behind the success of champions, Experian can estimate the probability of growth for SMEs in the private sector. Retrospective analysis reveals a far greater number of 'would-be champions' that did not realise their full potential.

Experian applied its growth model to information about the UK's business population between 2003 and 2006. Figure 5 shows several probability levels, ranging from maximum, where one would typically expect 20 per cent of the population to achieve champion status under normal circumstances, to minimum, where this proportion is reduced to just three per cent of firms.

Around 34,000 businesses had the highest possible potential to become champions, but fewer than one in five actually went on to achieve champion status. Despite 80 per cent of would-be champions missing the opportunity, the 6,500 champions that successfully emerged created over 260,000 jobs in the UK.

Experian's insight reveals that some of the businesses that missed their opportunity to reach champion status did still achieve some healthy growth. 26 per cent of firms that had the potential to become champions but did not achieve this status contributed nearly 44,000 jobs to the economy. Although still valuable to the economy, the potential to achieve far greater results was missed. The possible barriers to achieving champion status are examined later in this report.

Figure 5: Champions vs potential champions



Source: Experian

Around 34,000 businesses were identified by Experian as having the minimum probability of achieving champion status, and they saw total employment decline by 289,000 between 2003 and 2006. It is important to note that around 1,000 (three per cent) of these firms did still manage to achieve champion status, creating 143,000 jobs. Whether these businesses benefited from effective business support or received a helping hand with funding, they were able to overcome barriers to both survival and growth. This underlines the importance of finding these potential champions, and helping them overcome whatever barriers they face.

Sector analysis: finding budding champions

Experian's insight into the current SME business population has found that looking at sectors is one of the least powerful predictors of champion probability. This in turn casts questions on an industrial policy based on sector support.

The analysis shows that regardless of whether a sector is considered to be growing or declining, each has its share of potential champions, survivors and strugglers and the level of jobs generated varies as a result.

For example, Experian's analysis shows that within sectors perceived as struggling, such as Building and Construction, there are significant numbers of high potential champions that could create a considerable number of new jobs. With the right support, champions in these industries could help reverse the overall decline of the sector, and potentially generate a significant number of new jobs over the next three years.

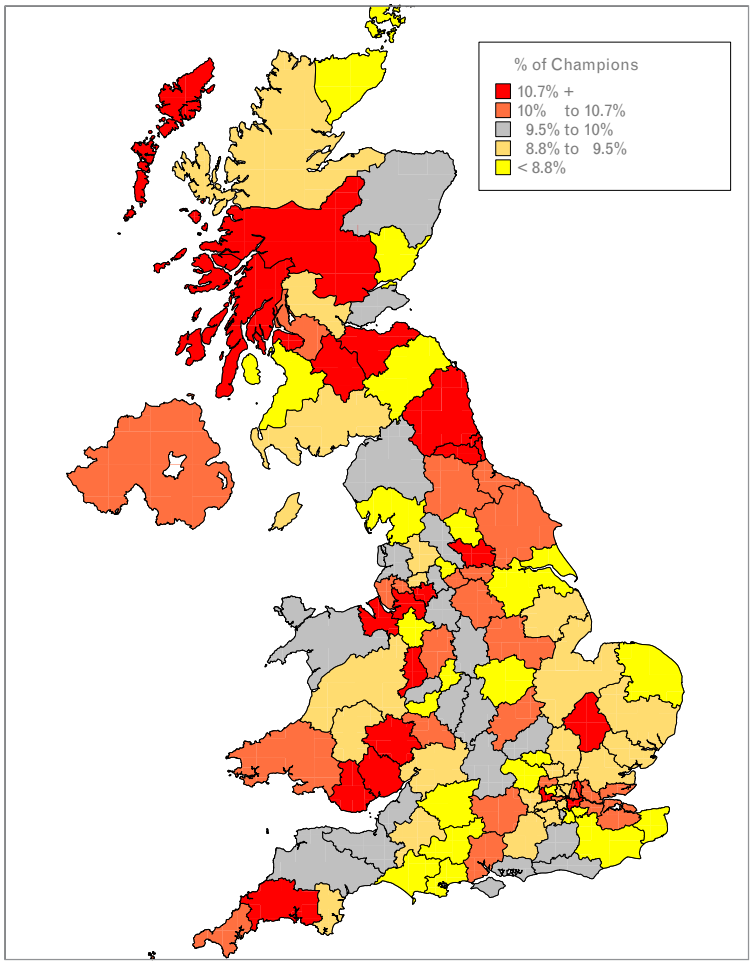
Finding these businesses, no matter what sector they are in, and giving them the support that will enable them to grow is vital. If the economy is to be stimulated so that it grows rather than remains stable, then the focus needs to be on finding and targeting the potential champions in all sectors. By applying forensically Experian's analysis of businesses that have the potential to grow quickly, this could be achieved.

Regional analysis: a break in the clouds?

Experian's analysis reveals an interesting North/South divide when it comes to the areas in the UK between 2003 and 2006 that had the highest concentration of champion businesses (see Figure 6). While East Anglia and the South of England have only an average or below average concentration of champion businesses, Scotland, the North East and Northern Ireland had higher concentrations.

These northern towns have traditionally had the lowest levels of employment and during a recession, when employment numbers fall further, many are pushed into starting up businesses or being more innovative in their current businesses in order generate more revenue. In the South, where levels of employment have generally been higher, there is less urgency to create work.

Figure 6: Breakdown of area and champions – 2003 to 2006



Source: Experian

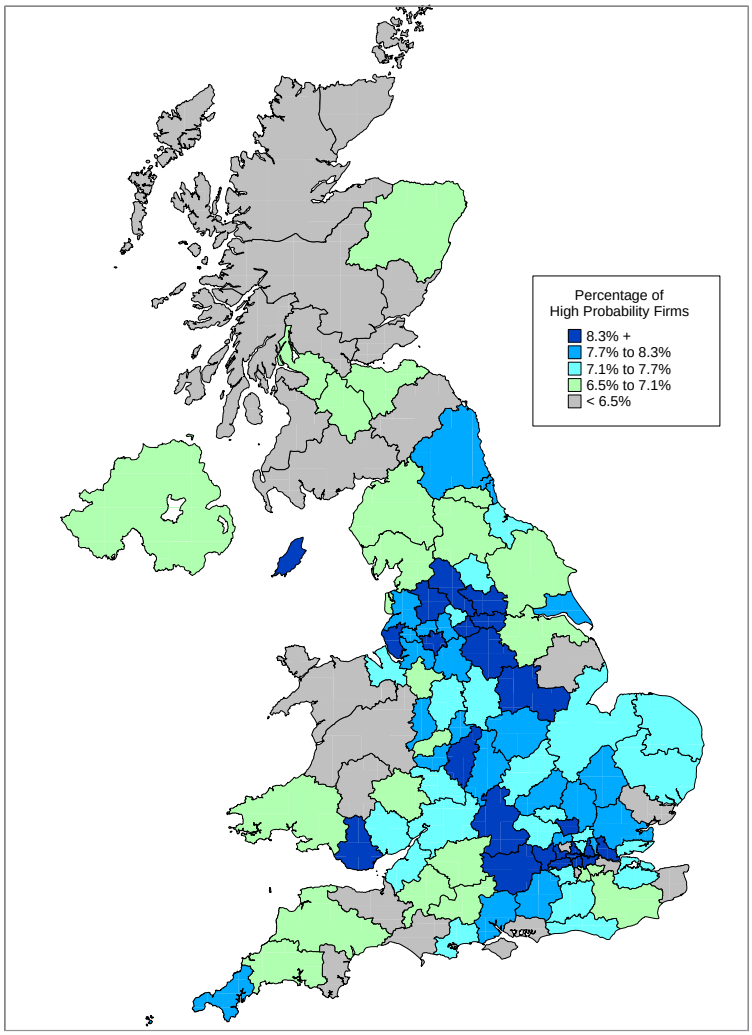
Forward looking analysis of the current business population (Figure 7) reveals how businesses with the greatest potential to become champions are situated across the UK and the picture is quite different.

The North East and Midlands have healthy levels of potential champions. These firms will be vital in turning around these regions, which have been hard hit by the economic downturn and are most vulnerable to a reduction in public sector employment. By using Experian's insight to find and target these potential champions with the support they need to grow, the regions would be able to generate a greater level of much needed employment.

The future looks less rosy for Scotland and Northern Ireland, which had a higher number of potential champions previously.

A key point to make concerning regional analysis is that champions not only create jobs, but they are highly likely to stimulate other businesses around them. Therefore, while some areas, such as Dumfries in Scotland may have a low level of high potential champions, stimulating the few that do have the potential to become champions will benefit further businesses in the surrounding regional economy.

Figure 7: Breakdown of area and potential champions – 2010



Source: Experian

Supporting the potential champions

There are many factors in play that cause well placed businesses to fail to achieve the rapid growth they are capable of. Not all SMEs aspire to grow. Many are lifestyle businesses, and once they have reached a size at which they can generate and maintain a satisfactory income for their owners, growth is no longer a strategic focus. Encouraging these businesses to prioritise growth at a time when many of their peers are doing all they can simply to survive is a challenge in itself.

The barrier that has had the greatest amount of attention is access to finance. A key point to make here is that, as a whole, the financial health of this small number of potential champions is often above average. Regardless of whether they go on to borrow or not, the risk of future failure among them is very low.

While a lack of funding for these specific businesses will not result in their future failure, Experian's research has found that funding can have a significant impact on their growth. However, there will still be some businesses within this population that are not financially sound, so lending decisions still need to be based on their credit worthiness.

Experian identified the businesses that appeared to have the greatest potential for rapid growth in 2003 and then examined whether they went on to borrow in the following three years and the impact it had on their businesses.

The analysis in this report found that 61,000 businesses with the potential for rapid high growth did not borrow any money, but still managed to create 173,000 new jobs, a 15 per cent increase. The 36,000 similar businesses that did borrow went on to generate 291,000 additional jobs, a 25 per cent increase in employment.

The message from banks and Government now is that funding is available to credit worthy SMEs, but the economic downturn has left many SMEs cautious of taking the risks associated with growth.

The danger now is that any demand for finance is likely to come from those that need working capital to re-stock, rather than from those firms planning to expand.

If there are few firms with sufficient confidence that they can achieve growth and even fewer willing to take the risk and seek finance to help them grow, it becomes a self-fulfilling prophecy.

Conclusion

While many in business adhere to the Pareto principle that 80 per cent of rewards come from 20 per cent of effort, Experian's research takes this a step further. Its analysis shows that new employment created by just 10 per cent of the SME population makes up for the jobs lost by the 40 per cent that either declines or ceases trading.

If the population of champion businesses can be grown above and beyond the usual 10 per cent of firms, then greater levels of job and wealth creation, as well as faster economic growth, can be achieved.

Experian's insight into private sector firms is the first step to finding those businesses best equipped to achieve champion status and rapid high growth ahead of time. By delving even deeper into the data, with forensic precision it is possible for individual businesses with the highest probability of becoming a champion to be pinpointed. Equally, those businesses most in need of support – who might not be champions or champions in the making – can also be targeted.

Once found, the challenge is then for Government, banks, venture capitalists and other finance and support providers to identify those businesses' specific barriers to growth and target them with the right support. Only then will this population stand the greatest chance of fulfilling its potential.

4. Creating an environment for business growth

Adam Swash, Head of Strategy and Research, Experian

The business support environment

Prior to the downturn, UK businesses operated in a fairly benign economic environment and, though questions were asked, business support was thought to have played a part in ensuring steady growth for the economy.

The UK has since seen several quarters of negative GDP growth and unemployment close to levels not seen since 1996. With the potential of a further 490,000 public sector job losses by 2015 and the knock on effect in the private sector, there is now an urgent need for more targeted business support to stimulate growth and get the unemployed back into work.

In recent years, the publicly-funded support arena for businesses has seen considerable re-structuring. The new coalition continued this trend by announcing the Regional Development Agencies (RDAs) and regional Business Links will cease to exist by March 2011, shortly after coming to power. In their place will be new Local Enterprise Partnerships (LEPs) - public/private partnerships tasked with coordinating growth in across England. Local business support in Scotland is currently under review, but recommendations may be for further changes to the current arrangements in which support is delivered by local authorities through the Business Gateway and Scottish Enterprise.

Furthermore, the Prime Minister has made it clear that there would be a 'forensic, relentless focus on growth' over the coming months, with innovation, job creation in the private sector and creating conditions in which entrepreneurialism would flourish being key targets.

To support this, the Government has created the Regional Growth Fund of £1.4 billion over the next three years to stimulate private sector led sustainable economic growth and employment in England. In addition, the Government is investing more than £200 million over the next four years in technology and innovation centres. Bringing together universities and businesses, these centres will drive growth in high-tech industries and help spread knowledge from researchers to entrepreneurs, making them aware of funding streams and providing access to skills and equipment. Regional growth hubs are also being established.

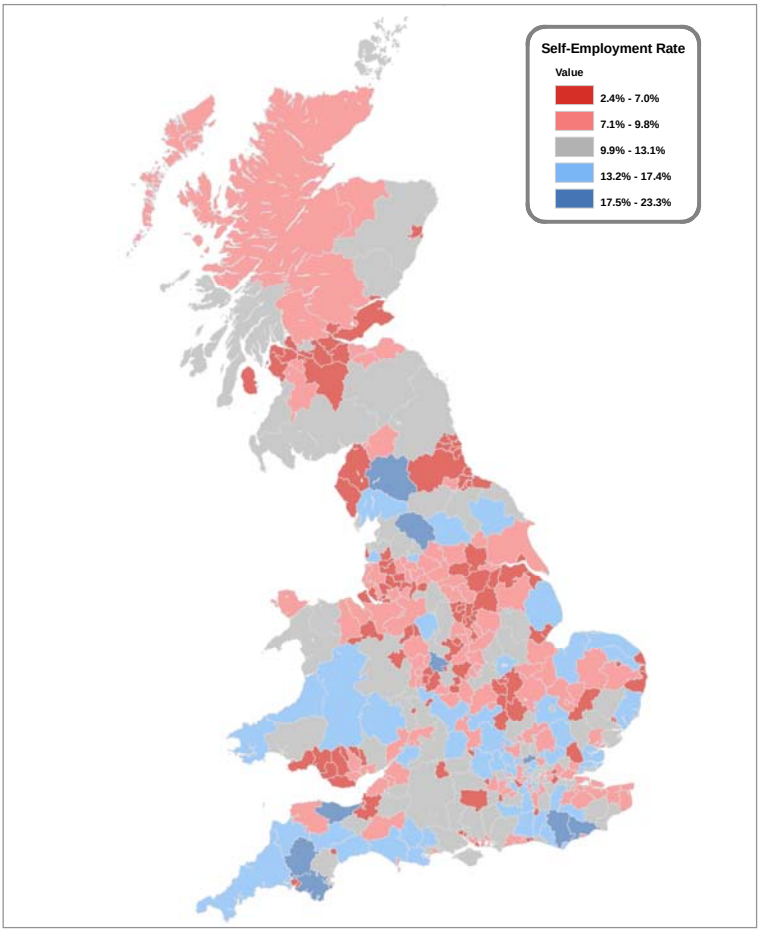
While these measures should have a positive impact on the business world, the challenge is ensuring they are targeted effectively to deliver sustainable economic growth. Many of the much vaunted high-tech high-growth industries may not offer suitable employment opportunities for the existing skills within the general population, including those exiting the public sector.

Creating growth

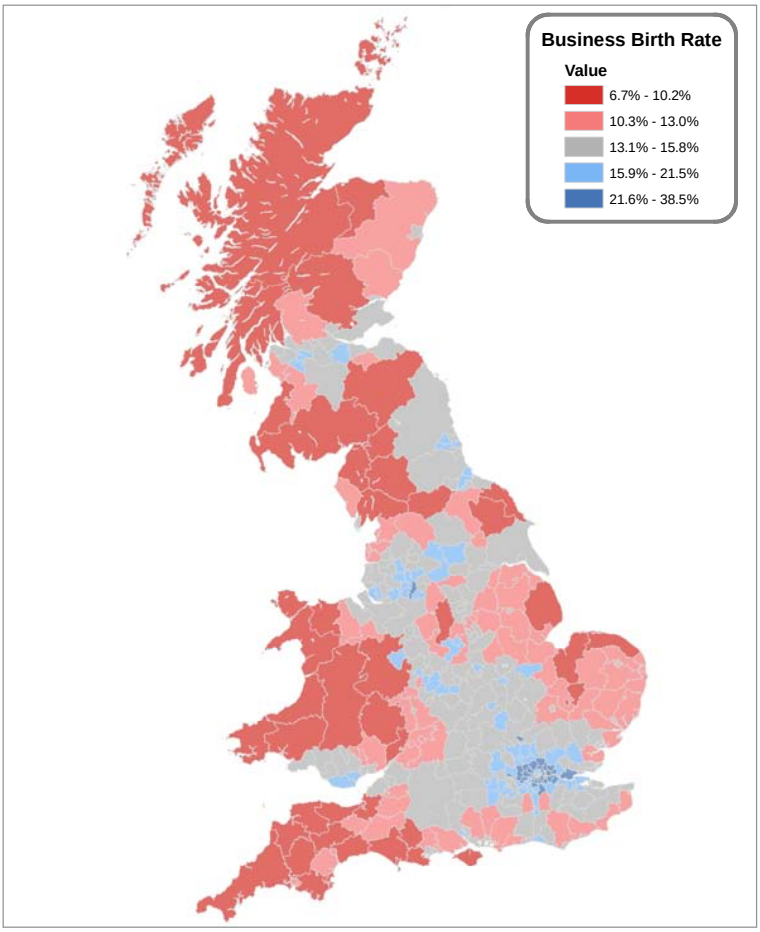
Public sector support plays a role in the business world, but in order to be far more effective than it currently is, it needs to be more targeted to address particular market failures. Thought needs to be given to the balance between private and public contribution and equitable payment by results formulae. The business support model which has existed until now will no longer be sufficient enough to stimulate the level of growth needed.

For example, as the Government attempts to establish centres dedicated to supporting entrepreneurs, Figure 8 shows the distribution of self-employment and new business start-ups based on Experian's analysis and gives an indication of where there is currently a strong entrepreneurial base to build on. It shows that their spread across the UK is far from even, so in order to find and support them, a more targeted approach is needed.

Figure 8: Maps of self-employment and new business start-ups



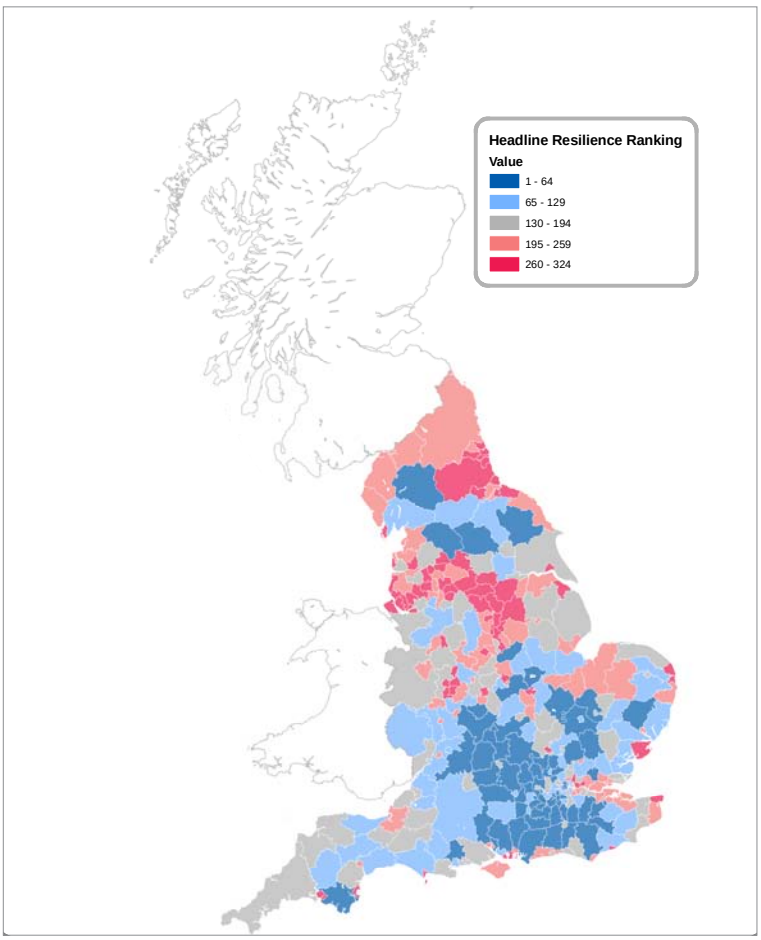
Source: Experian



Source: Experian

Furthermore, the impact of the coalition's austerity measures is likely to be varied in different parts of the country, with some of the UK's industrial heartlands, such as the North and parts of the West Midlands, impacted disproportionately highly. Nonetheless, the high prevalence of potential champion firms in these areas, identified in the previous article, gives a good base to capitalise on. Figure 9 illustrates some of the areas that might be least able to cope with major structural change.

Figure 9: Resilience map



Source: Experian

Public sector interventions will need to be tailored to local agendas, building on local strengths to meet LEP visions, while entrepreneurship can also be used as a lever to boost communities in deprived areas.

Based on Experian's analysis, there are six key areas that need to be developed in order to encourage SME formation, continue growth and nurture champions:

1. Encouraging new relevant start ups

Given the time lag between start up and champion status, for there to be a significant SME driven turn-around in the economy in this parliament, a start-up drive needs to commence now.

Much research has been conducted into both the types of people that are likely to start businesses and the typical issues they face using for example consumer segmentation tools such as Experian's Mosaic. Identifying and targeting these people with information on starting enterprises and the support available would be a critical boost.

Indeed, it is possible to go further than this and understand exactly the types of enterprises likely to be favoured by each segment and match this to local need. This type of targeting can encourage entrepreneurship to meet the local vision and also can be directed to help communities with low economic activity as well as an exit route for those leaving the public sector.

2. Improving business skills

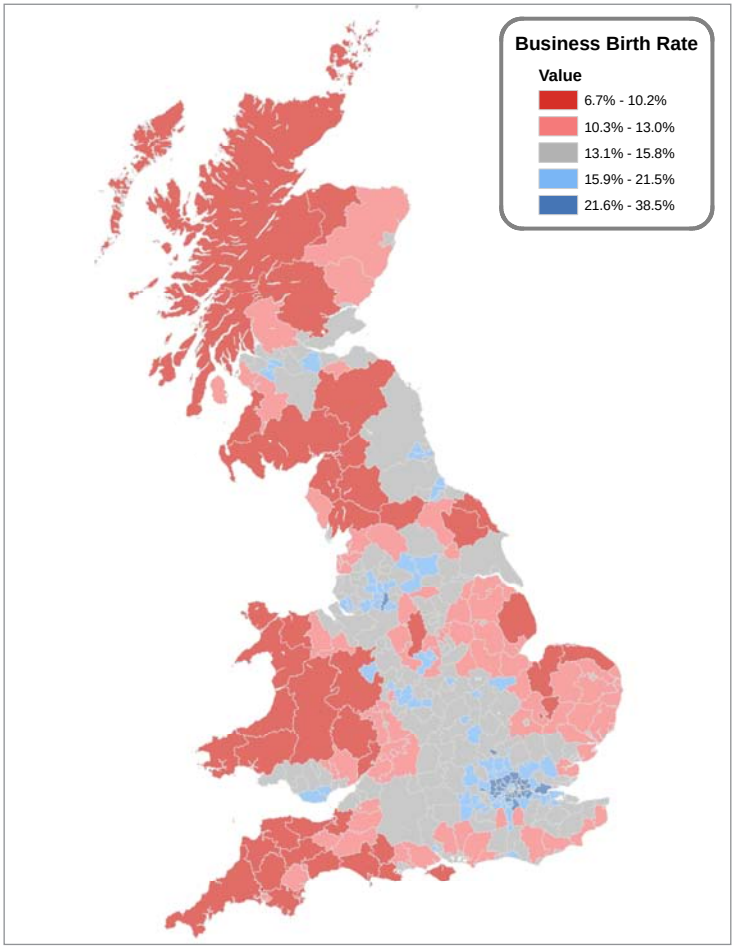
Experian's analysis (Figure 10) shows areas where business failure rates are far higher compared to business start up rates.

Having the right skills is crucial for any business hoping to succeed. These include strategic planning, marketing, sales, people management, finance and accounting, as well as general business administration capabilities.

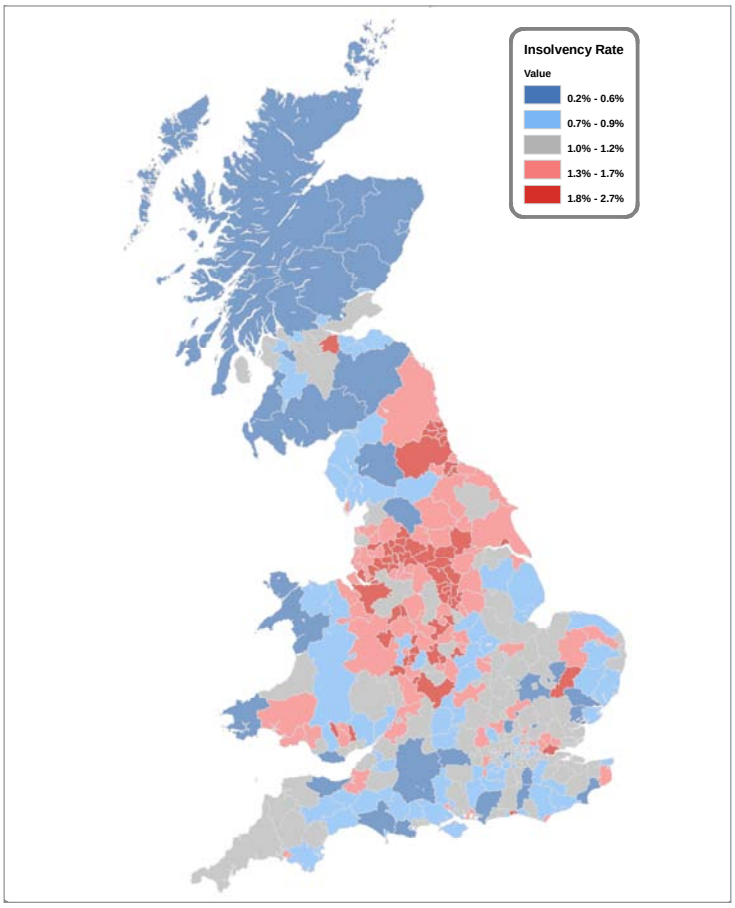
While some of these areas take years to perfect, one of the biggest reasons for business failure is poor cash-flow management. This is relatively simple to fix. A much more targeted programme of business education both on and offline – focused on those areas most in need – can help address some of these easy to fix business hygiene issues.

The discrepancy between business failure rates and start up rates (Figure 10) may also indicate where the recently announced mentoring scheme could show early dividends.

Figure 10: Business start-ups and insolvencies



Source: Experian



Source: Experian

It is pivotal that alongside the growth agenda, business education is also a focus area within the education sector, and in particular highlighted areas of the country are further targeted.

3. Customer acquisition

Experian's business research over the last 15 years has shown that alongside skills, lack of orders is a major non-finance issue. The area of customer acquisition and retention is an area where SMEs, without the resources and expertise of larger companies, also have room for improvement. There is a wealth of information around to help businesses target their customers. Furthermore, the increasing prevalence of the online world allows them to compete on an even playing field. Opening up access to this type of information in an easily digestible format, enabling them to build networks of similar prospects, will allow SMEs to grow their order books.

4. Encouraging export

Given a fairly benign prognosis for the UK economy over the next few years, export represents one of the largest areas for growth that we are likely to see. In Experian's model for identifying 'champions', international activity was a key variable. Targeting support from the UK or overseas trade delegations to those SMEs that do not currently export, but could potentially export will help lever in this revenue growth.

5. Access to finance

Accessing finance is a key concern for enterprises looking to fund growth. However, as with other areas of business support it is very complex. Banks, venture capitalists, peer-to-peer lenders, community finance associations and, of course, the well established 'bank of mum and dad' are all active in this area.

While there are many avenues down which businesses can seek funding, banks remain one of the primary commercial options to most organisations. Much has been said and written about the provision of finance to smaller firms of late, however, a greater financial education among SMEs themselves is crucial.

There are steps SMEs themselves can take to ensure they are in the best position for securing finance. For example, SME's should check that all the information held about them in their own credit reports is accurate and up-to-date, so that finance providers have all they need to help them make an informed decision to lend.

6. Intensive support for high growth companies

In all sectors and regions of the economy, as we have identified, there are champion businesses delivering sustained, high growth, and more companies with the potential to be part of the next wave of champions. Every additional one per cent of potential champions converted to deliver consistent high growth will have a considerable impact on the UK economy.

Conclusion

The ability to identify and monitor potential champions at the pre-growth phase, so that any barriers are removed through targeted business support and their growth potential realised, will be critical to achieving growth aspirations.

Experian's research has shown that, despite the fact they exist in all sections of the economy and regions of the UK, businesses with potential can be identified early.

The next step would be to delve deeper into the analysis within this report and pin point ahead of time exactly who and where those individual businesses best equipped to achieve champion status and deliver rapid high growth in the future are.

This information will be vitally important for any business support group. It means that relevant interventions can be targeted on a one-to-one basis to improve the rate of those converting from budding champions to fully-fledged champions.

5. What can SMEs learn from this analysis?

Simon Streat, Managing Director, SME, Experian

Small businesses do not have the luxury of waiting to find out what support is going to be available to them.

They are focused on the here and now – the order book, cash flow, job security for their employees and making the investment decisions that create the conditions for champion-like growth, if that is their ambition.

We know from extensive research with small businesses and from our own small business customer base that they face three key pain points – cash flow, access to finance and customer acquisition.

Managing cash flow and debt is the major headache for small businesses and late payment is cited as one of the biggest causes of this. With the UK's culture of late payment, small businesses are the ones that face the brunt of it.

In order to grow and exploit the opportunities to move ahead of competitors in today's tricky trading conditions, access to finance plays a key role. Another constant challenge faced by small businesses is the ability to find and retain profitable and reliable customers.

The good news amidst this roll call of grievances is that there are steps any small business can take relatively quickly to address these hurdles.

Taking cash flow first

In a challenging environment, a healthy, well-regulated cash flow is essential to long-term survival. The advantages are clear – gaps in cash flow can be spotted and reduced, small businesses can think about that new investment or expansion, and can begin to reduce debt and free up cash that is currently paying loan interest.

There are a number of measures small businesses can take to achieve this. They should start by aiming to recruit and retain customers who are good payers. They can do this by using a reputable credit reference agency to check their credit status, and by auditing customer records to identify customers who are good payers and have a good credit score.

It is key to set appropriate payment terms and credit limits. Small businesses should discuss and agree payment terms with customers and suppliers before accepting or placing an order with them. And where possible, try to negotiate payment terms with suppliers that allow them longer to pay than the terms on which they are paid by customers, leaving some breathing space.

Invoices should be issued immediately after products or services have been provided. It is really important too that order fulfilment, shipping and handling is efficient. The sooner small businesses can invoice for their products and services, the shorter their cash conversion period will be.

Finally, when it comes to larger invoices, SMEs should be sure to call the customer before the payment is due to make sure no queries are unresolved that will hold up the payment. This also demonstrates good service, and maintains relationships with the most important customers.

Second, accessing finance

Experian carried out research in June this year that showed two-thirds of small businesses do not think it is important to check their own credit scores.

The opposite holds true – businesses are in a climate where a healthy credit score is more critical than ever before. Suppliers of products, services and finance have tightened their criteria and it is now important for companies to actively manage and monitor their own business credit scores to be in the best possible position to secure credit, business loans, tenders or business services.

There are a number of steps small businesses can take to build a healthy commercial credit score. They include getting hold of a copy of their own report and ensuring it accurately reflects their circumstances – remembering that these are based on information from third party suppliers. Paying invoices on time and filing annual returns and financial accounts on time are also key.

Owners of small or newly formed businesses should also keep an eye on their own personal finances. In cases where the financial data of a business is scarce, consumer data is a valuable indicator of the business's likely commercial integrity.

Third, finding new customers

New business opportunities are always hard to come by. It can take a lot of hard work – and plenty of knock-backs – to generate the new sales opportunities small businesses need.

That is why many small businesses choose to buy lists of marketing leads to make their new business activity much more effective. New business lists enable small businesses to target, with real precision, the businesses and consumers they would like to do business with.

However, with a little more creativity, those lists could prove more valuable. It is not just size, turnover and location that affect their likelihood of becoming a customer. It is also down to their sector, age, and all kinds of variables including personality, attitudes and approach.

Increasingly, small businesses can select prospective customers by these criteria and also on the basis - in the case of businesses - of whether they will be good payers.

In summary, taking these steps will help small businesses deal with the fundamental challenges they face day to day. It will mean they run faster, smoother and more profitably and, ultimately, will cement their status as the sector that will lead the UK's economic recovery.

6. Methodology

Experian's research into the UK's fast growth champion businesses uses data from Companies House looking at businesses that have been trading since 2000 as well as field research conducted by directory based companies.

The research is focused on a universe of 1.5 million businesses where employment data was available. Non-limited businesses and large companies with more than 10,000 employees were not included.

Several consecutive three-year periods between 2000 and 2009 were examined. The characteristics of businesses that experienced high growth within any of the three year periods were identified and included in a model to help distinguish those that would go on to achieve high growth from the remainder.

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