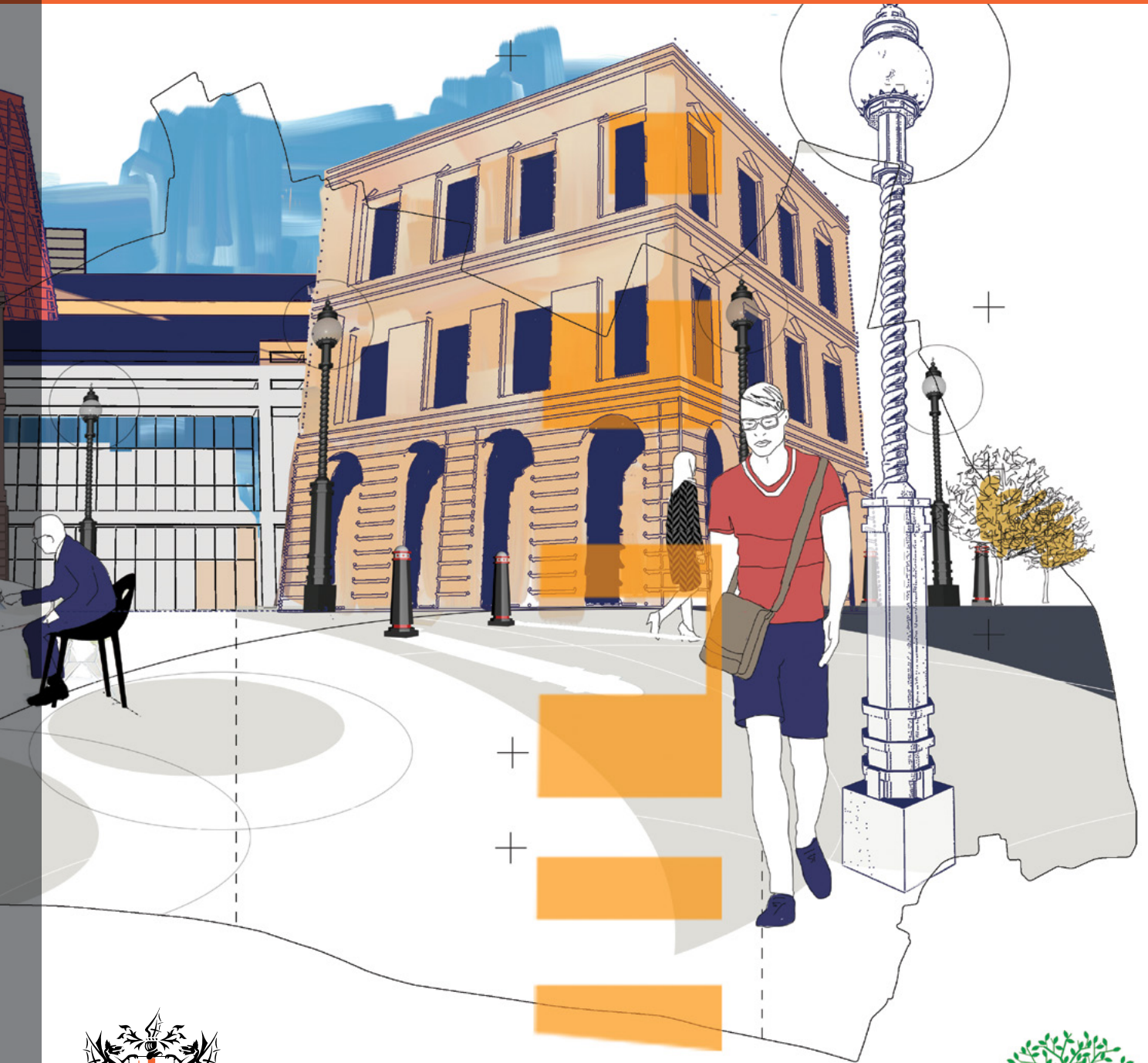


Clusters and Connectivity: The City as a Place for SMEs

RESEARCH REPORT

PUBLISHED BY THE CITY OF LONDON CORPORATION AND THE CITY PROPERTY ASSOCIATION



CPA
City Property Association



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March 2016

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Foreword

As the world's leading international finance and business centre, the City of London is renowned for being home to some of the largest financial and professional services firms. But it is also a thriving place for 16,000 firms with fewer than 250 employees (SMEs), who employ around half of the City's workforce.

The City is a dynamic environment for businesses, with productivity levels twice the London average, and strong employment growth in recent years – 60,000 new jobs since 2010. Each year, an average of 1,200 firms move to the City from other locations, and around 900 start-ups form here. This research investigates the factors that draw SMEs to the City, the benefits that a City location offers, and how the physical infrastructure – in particular the office stock – underpins this.

This report was jointly commissioned by the City of London Corporation and the City Property Association to further understanding of the opportunities that a location in the City offers, and the challenges emerging from increasing pressure on SME workspace. It complements our 2015 research, *Future Workstyles and Future Workplaces in the City of London*, which looked at how the requirements of large firms were changing.

The research findings show that the SMEs here – both new and established – strongly value the City's offer as a place to do business. In particular, many singled out the connectivity, both in terms of the links to other businesses and the dense transport network; the ease with which they could attract skilled staff was also highly rated. Whilst some agents reported a perception that the City Core was very corporate, firms appreciated the more varied

offer of the wider City and neighbouring areas, and the amenities available – retail and entertainment – were highly regarded.

The report also demonstrates the City's ability to adapt to new sectors and changing business requirements. The last few years have seen the strong growth of the Technology, Media and Telecoms (TMT) sector in the City, a 45% growth in these jobs since 2010. In addition to rating the business and transport connectivity highly, this sector felt particularly strongly that a City location helped to attract the right staff, and appreciated the building amenities here. Flexible workspaces and serviced offices have quadrupled over the last twenty years and continue to grow, providing a new type of space, from which many smaller SMEs have benefitted.

Yet this growth has not come without challenges. Vacancy rates in the City are at 3.9%, their lowest level since 2001, illustrating the pressures on space. This pressure is particularly marked for floorspace of 300-1000 sq m, often regarded as move-on space for growing firms.

We are therefore looking at measures that can safeguard the provision of attractive and cost-effective space for our varied and dynamic community of SMEs. This includes the potential use of protected heritage buildings for small office space, and working with developers to promote the inclusion of affordable space for start-ups in future large developments. The recommendations in this report will help to ensure that the vast array of businesses that make up such an important part of the economy here can continue to thrive.

Mark Boleat

Chairman of Policy and Resources
City of London
March 2016

Executive Summary

Companies that employ fewer than 250 workers form the vast majority of businesses in the Square Mile, and are crucial to its position as one of the country's most successful and diverse business centres. Though perceptions of the City often focus on its large corporations, it contains over 16,000 small- and medium-sized enterprises (SMEs), which form a unique business ecology. This report examines the benefits SMEs gain from being in the City and what more can be done to make it a place where they can thrive.

As part of the research, SMEs based in the City were surveyed and face to face interviews with representatives of the property supply chain were carried out. The findings suggest that SMEs are attracted to the City by several factors, including: its dense business cluster, which offers ready access to suppliers and clients; its historically rich urban environment and diverse office stock, and the sense of prestige attached to the location. The City is also well regarded for the competitive price of its office space.

The report finds that the City's population of SMEs spans a wide range of sectors. As well as obvious strengths in Finance and related industries, there is good representation in Professional Services; Insurance; Admin and Support; Wholesale, Retail and Consumer, as well as Technology, Media and Telecommunications (TMT).

The report also finds that SMEs are widely distributed across the Square Mile, and that they play a significant role in influencing the shape of the urban form. The City's financial core, where many of its large corporations are based, is the centre of gravity for SMEs in the sector, but many of those in other industries are scattered more widely.

Notably, many SMEs in the TMT sector are clustered in parts of the Square Mile adjacent to Shoreditch, Clerkenwell and Farringdon. This has led to parts of the City acquiring a look and feel similar to these tech hubs, characterised by small and serviced offices in historic, formerly industrial, buildings. Indeed, a particularly interesting finding of the report is that many respondents perceived the City to extend beyond its actual boundaries to encompass these areas immediately to the north.

In order to consolidate and build on its success as a location for SMEs, this report makes four main recommendations:

- o **The City must maintain its cost competitiveness.** Whilst the City's office stock is good value compared to other parts of Central London, the research indicates that the factor most likely to drive SMEs out of the City is increasing cost. If actions are taken to keep prices competitive, this would serve to encourage resident SMEs to remain and may bolster the City's attractiveness.
- o **There is a growing shortage of space between 300 and 1000 sq m that must be countered.** The increasing scarcity of this space may become a deterrent to SMEs that would otherwise have considered locating to the City. Boosting its availability would address this emerging challenge.
- o **The perception of the City must be addressed.** Impressions of the City as corporate and finance-dominated may deter some SMEs, in particular if they associate this with high cost. Promoting the area beyond the core where a more fluid landscape accommodates a diverse range of enterprises could improve the image of the City as a location for SMEs.
- o **Digital infrastructure must be improved.** The City's businesses depend on high quality, high speed connectivity but do not always receive a consistently good service. Efforts are underway to address this, and must be continued.

Introduction



1



1.1 Context

This report was jointly commissioned by the City of London Corporation (the City Corporation) and the City Property Association (CPA) to better understand and raise awareness of the City as a location for small and medium sized businesses (SMEs), who make up 98.6% of the businesses in the City (ONS, 2015). This research looks at the ecology of SMEs in the City and how it is changing: their working practices, locational requirements and the value they place on the City as a working environment. It highlights a range of implications for the City of London as a competitive location for SMEs in the light of how their needs and the wider business environment are changing.

This work sits alongside the *Future Workstyles and Future Workplaces* report, published by the City of London Corporation (Ramidus, 2015a), which examined how larger corporate office occupiers are responding to economic and technological changes. Together these reports offer a perspective on the changing nature of the City's economy and the corresponding future requirements of the City as a location and physical space.

1.2 The research

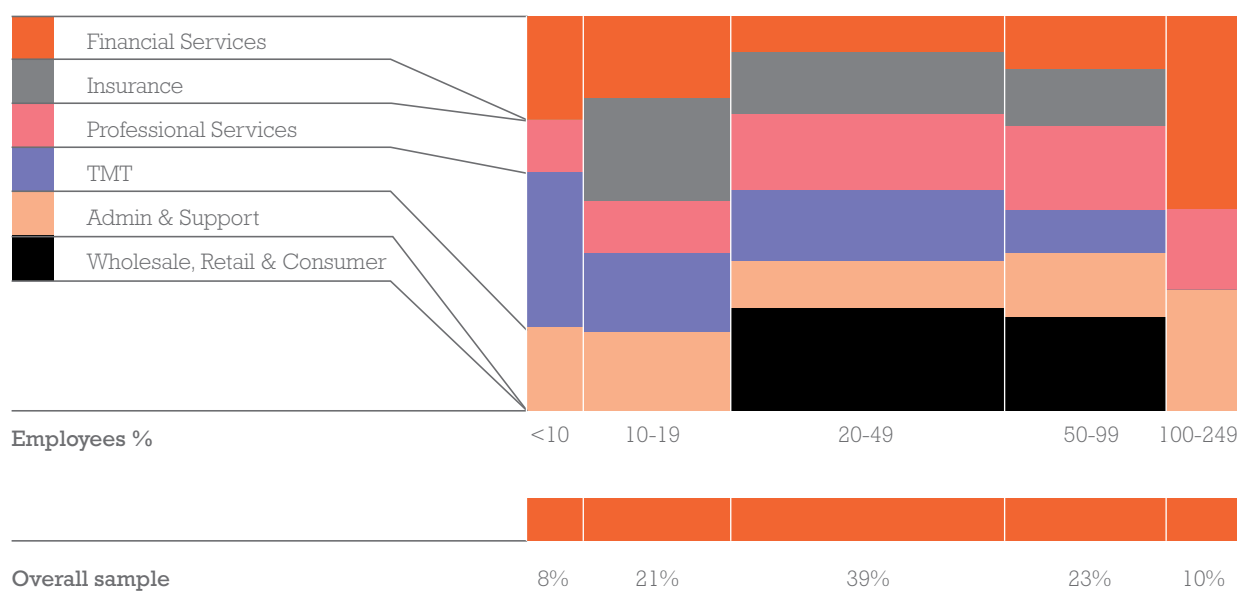
To better understand their location and premise requirements, 80 SMEs based in the City were surveyed. The questions were informed by a wider review of the literature around SMEs. The structure of the sample is shown in Figure 1.

SMEs are officially defined as firms employing fewer than 250 employees.¹ The sample covers a broad range of SMEs in terms of employee size and sector, although we recognise that firms classified within this band can span a diverse range of business types and sectors.

As many large firms also occupy small units as representative offices, regional offices, subsidiary offices, and project offices, we have chosen to include 'small- and medium-sized occupiers' within the survey. Given that one of our key interests in the research is to understand the impact of SMEs on the commercial property market,

¹ For more information, please visit the HMRC website at <http://www.hmrc.gov.uk/manuals/intmanual/intm412080.htm>

FIGURE 1
SME survey, firm size and business sector



Note: Firms with fewer than 10 employees in survey responses are examples of firms with between 10 and 249 employees in total, but fewer than 10 in that specific office. They could have other satellite offices in the City, elsewhere in London, or elsewhere in the UK.

we have chosen to exclude micro-businesses (i.e. firms with 0-9 employees in total) as they have less identifiable demand for space.

To get a wider perspective on market demand and supply, we conducted 16 face-to-face interviews with representatives of the City property supply chain, including owners, developers, commercial agents, designers and serviced office providers, to understand what attracts SMEs to the City and determine any changing trends in their premise and location requirements.

FIGURE 1

SME survey, firm size and business sector

A set of tables showing the characteristics of our sample of SMEs is included in Appendix Three. The key points are summarised below.

- The firms surveyed are distributed across all employment size bands within the SME spectrum. The most common size was 21-49 employees.
- Business sectors are represented across all employment sizes. Again the 21-49 size band is the most common, although Financial Services sector firms surveyed were slightly larger than the profile across the sample.
- Three quarters of the firms surveyed have been in the City for over 10 years. This was true for all sizes of firm, and also the case across most sectors.
- Most firms (73%) have experienced some increase in staff numbers in the past five years, with more than half growing by at least five staff members. The largest growth has occurred in firms with more than 100 employees.
- Across the sectors, the largest growth has been in financial firms, where although nearly a third had not grown, 20% have taken on more than 20 new employees.
- 75% of firms which have been in the City for less than five years have increased staff numbers by between five and 20.
- Over half of the respondents occupy between 200 and 1,000 sq m.
- Financial firms occupy the largest spaces, presumably due to being longer established, while the younger TMT sector occupy mostly smaller premises.
- Firms which have been in the City for less than five years all occupy space between 200 and 2,500 sq m. There is more variation in space amongst the older companies, with only firms present more than ten years occupying more than 2,500 sq m.

1.3

The body of this report is structured around a number of key themes:

Chapter 2 looks at why SMEs are important to the City of London

Chapter 3 addresses perceptions of the City as a location for business

Chapter 4 examines why SMEs are attracted to the City as a business location

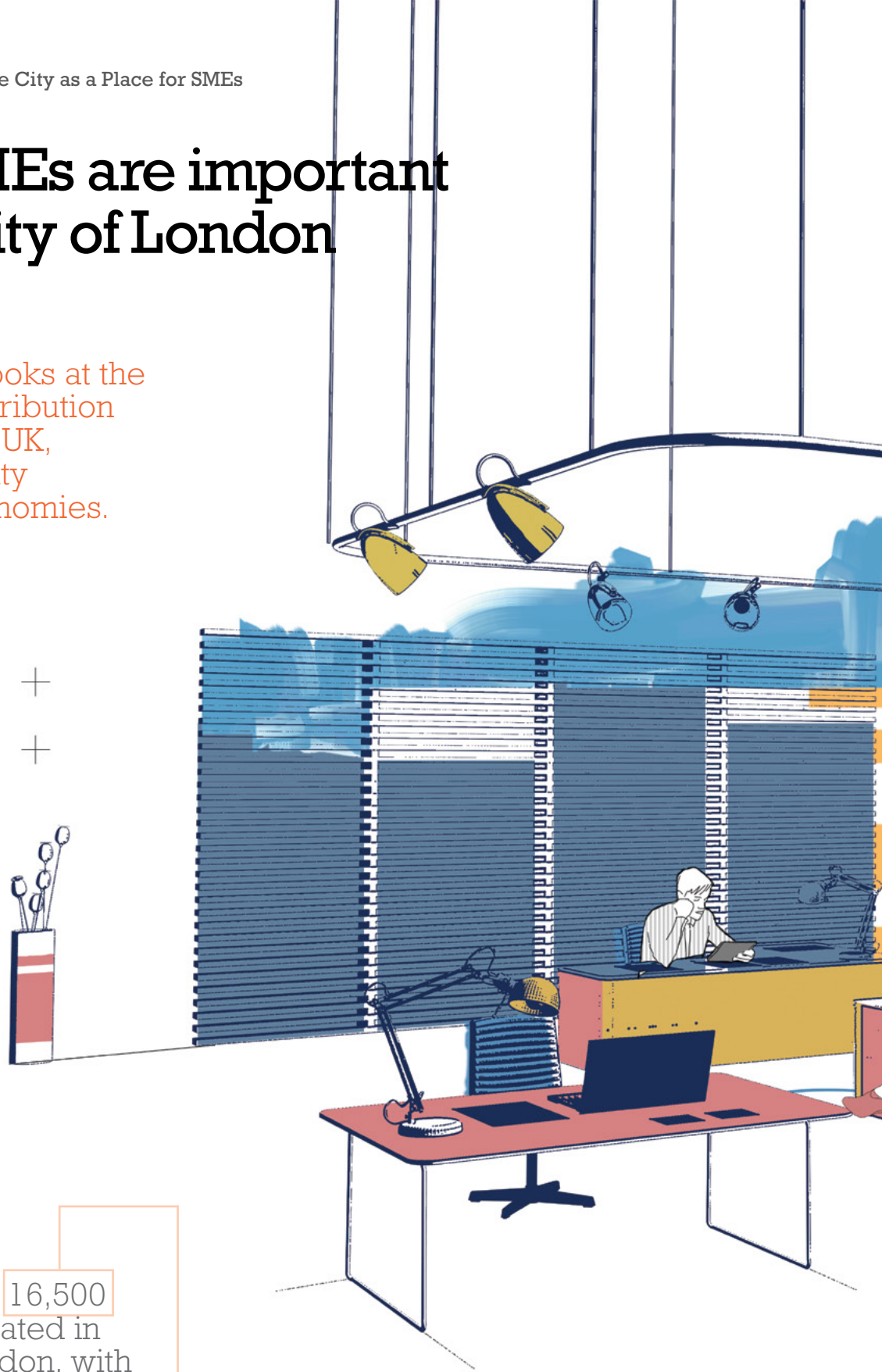
Chapter 5 analyses the property and premises requirements of SMEs in the City

Chapter 6 focuses on addressing SME needs in the City

Chapter 7 reviews the outcomes and policy implications of the research

Why SMEs are important to the City of London

This chapter looks at the value and contribution of SMEs to the UK, London and City of London economies.



There are over 16,500 businesses located in the City of London, with SMEs making up 98.6% of the total.

The number of workplaces in the City of London with fewer than 250 employees has been growing since 2008.

2



New start-ups have formed in the City at a rate of between around 800 and 1,000 per year, indicating the dynamism of the SME sector.

The provision of office space between 500-2,000 sq m increased significantly in the City from 1995-2010. However, office stock of less than 500 sq m declined over the same period of time.

SMEs make an important overall contribution to UK growth. There are 5.4 million SMEs in the UK, comprising 99% of all UK businesses (Department for Business, Innovation and Skills, 2015).

SMEs employ a total of 15.6 million people, equivalent to 60% of all private sector jobs, while the combined annual turnover of small and medium-sized businesses was £1.8 trillion (47% of all private sector turnover in the UK) (Federation of Small Businesses, 2015)

The picture across London is similar. Figure 2 shows the breakdown of companies by size band in London in 2013. SMEs account for just over half of all private sector jobs in London. In comparison, there are just under 1,900 firms with over 250 employees, with larger corporates accounting for 48% of all those employed in London.

FIGURE 2

Enterprise size band, London, 2013

Businesses based in the City of London, which sits in the heart of the capital and covers the area known as the Square Mile, make a particularly strong contribution to the UK economy. As the largest financial centre in the UK, the City of London was estimated

to contribute £45 billion to the economy in 2014, representing 3% of the UK's economic output (City of London, Centre for Cities & Cambridge Econometrics, 2015).

Substantial agglomeration over several decades has led to the City developing a strong and specialised financial, insurance and professional services cluster. Financial and Insurance sector firms make up 162,600 jobs, or 39% of employment, and contributed 61% of the City's GVA in 2014. The Professional Services sector accounts for 106,000 jobs (26% of employment), while the Technology, Media and Telecommunications sector (also known as 'TMT'), which has grown by 8% over the ten years to 2015, accounts for 34,500 jobs (8% of employment) (ONS, 2015).

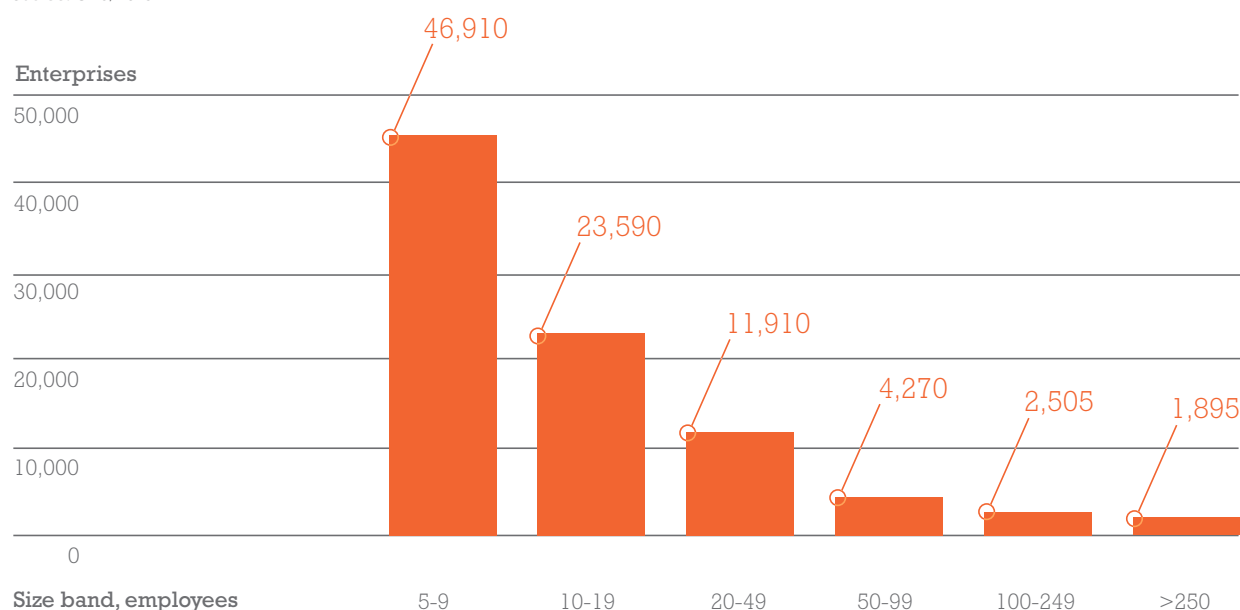
SMEs form a large proportion of businesses located within the Square Mile. Over 16,500 firms are located in the City of London, and 98.6% of these firms are SMEs (ONS, 2015).

This is not a homogenous group; SMEs in the City can range from anything between newly formed start-ups with little revenue to very wealthy established companies. Employment within smaller

FIGURE 2

Enterprise size band, London, 2013

Source: ONS, 2015



firms has also grown significantly in recent years, from 86,700 in 2005 to 118,100 in 2012 – a rise of 36% in seven years (see Appendix 3).

In terms of new start-ups locating in the City of London, data shows that between 800 to 1,000 start-ups arrived in the Square Mile annually between 2012 and 2014, with almost half consistently in Real Estate, Professional Services & Support Activities (see Appendix 3).

2.1 Distribution of small offices in the City of London

FIGURE 3

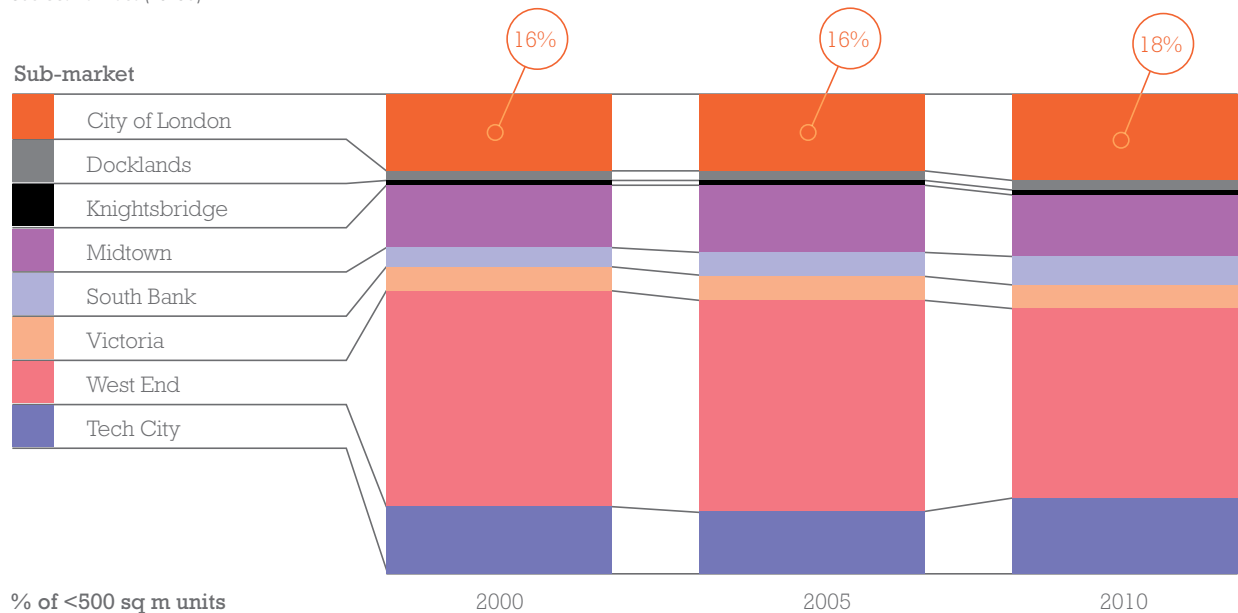
Distribution of small offices, by sub-market, 2000 to 2010

Figure 3 shows changes in the distribution of small offices across Central London between 2000 and 2010. The chart focuses on units of less than 500 sq m, suitable to accommodate SMEs with up to 45 employees (Bedford, Harris and King, 2013). The table shows that the West End accounts for the bulk of small stock, as might be expected given its very large SME population and preponderance of old building stock. The City's share of small office space increased marginally over the period

'The hub of the British insurance industry is here.'

FIGURE 3
Distribution of small offices, by sub-market, 2000 to 2010

Source: Ramidus (2015b)



to 18% of the total by 2010.

Figure 4 shows change in the number of units, between 1995 and 2010, across three size bands, up to 2,000 sq m – figures in brackets represent a decrease. Such office space would be suitable to accommodate larger SMEs with up to 180 employees. The table shows that across the period, the provision of office space in the larger two size bands increased significantly in the City, while the stock of smaller office space under 500 sq m conversely declined. This trend was repeated in other Central London areas, such as the West End and Victoria.

FIGURE 4

Change in number of small offices, by sub-market, 1995 to 2010

In more recent years, the supply of small units available to let in Central London fell by 33% between 2010 and 2014. Not only that, but small units also made up a diminishing share of space on the market, declining from 15% of total supply in 2010 to 11% by the end of 2014. In other words, the supply of space in small units declined at a faster rate than the rest of the market (Ramidus, 2015b). Looking at different Central Activity Zone

sub-markets, the City Core consistently had the largest supply of small units available to let over the five year period from 2009 to 2014 whereas on the City Fringe there was a sharp decline of 63% over the same period. In 2009 the City Fringe accounted for 20% of the supply of small units and by 2014 it had declined to just 10%. The performance of the City Core probably reflects both its attractiveness to small businesses and the on-going protection of heritage stock there (Ramidus, 2015b).

2.2

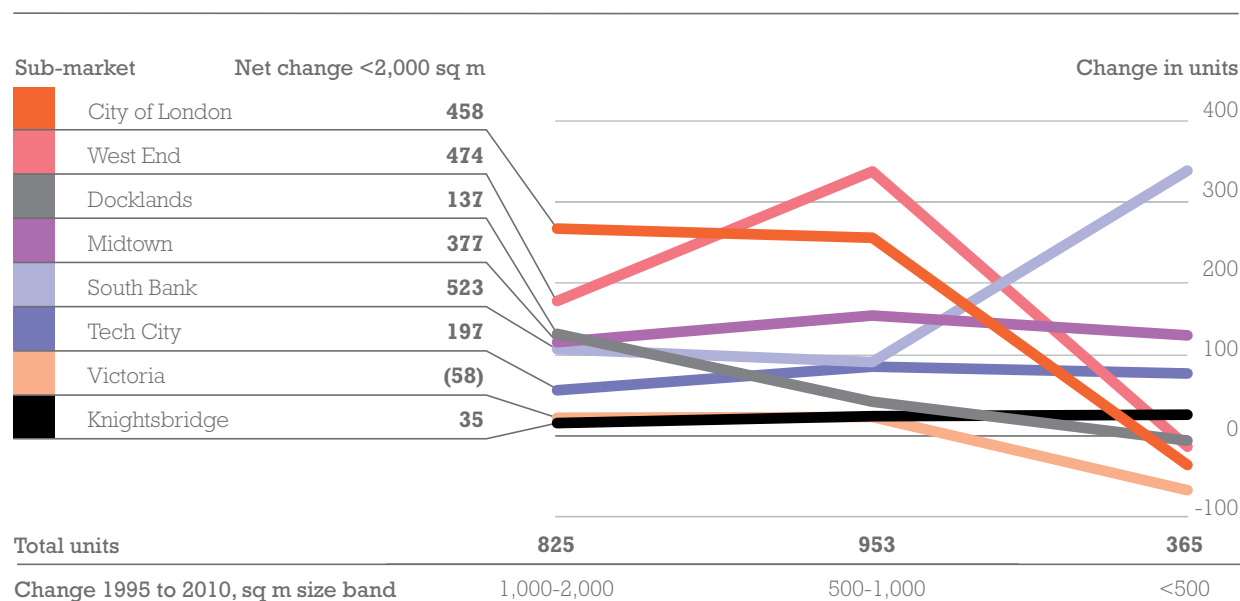
Future employment in the City of London

Employment in the City is expected to reach over 435,000 within ten years, up from around 415,000 today (ONS, 2015). The forecasts suggest that between 2015 and 2025, Finance and Insurance sector employment will grow by nearly 17,000 jobs. Growth in employment over the next ten years will likely have an implication on the provision of smaller office stock in the City of London, particularly given the rise in the number of start-ups and SMEs located in the Square Mile over recent years.

FIGURE 4

Change in number of small offices, by sub-market, 1995 to 2010

Source: Ramidus (2015b)



'It was wherever
people wanted it to be.
For some it was City,
for others, Clerkenwell,
or Midtown or
even Shoreditch.'



What is the 'City'?

This chapter assesses how SMEs perceive the City in terms of the area it covers and the type of firms based there.

Most SMEs surveyed perceive the 'City of London' as a larger spatial area than its official administrative boundary.

The core of the City is strongly associated with large corporate office blocks occupied by international businesses engaged in the financial sector.



3



The edges of the City merge with the markets beyond and are associated with an increasingly diverse occupier base.

Perceptions of the City Core as corporate and finance-dominated may deter SMEs from these locations, in particular if they associate this with high cost.

3.1 Where is the 'City'?

The area of London that is understood to be 'the City' varied by a surprising degree among the SMEs surveyed, and did not often coincide with the administrative boundary of the City of London Corporation.

FIGURE 5

Administrative boundary of the City of London

During interviews, locations that were used interchangeably with the City included: Aldgate East, Clerkenwell, Midtown, Shoreditch, South Bank and Whitechapel. One SME told us: "We have been able to save 30% on our rent by moving from Midtown to the City". In fact they had moved their business from Chancery Lane (which falls within the City of London boundary) to Finsbury Pavement (which is in Islington).

FIGURE 6

Areas associated with the City

In each compass direction, the City blends with its neighbouring markets beyond the border and, in every case, those markets are associated with far more diverse sectors than the central core. When commentators talk about the City having become acceptable to TMT, or creative, or digital, or ICT, they are more than likely to be talking about the parts of the City that merge seamlessly into any one of the five adjoining boroughs of Camden, Hackney, Islington, Southwark, and Tower Hamlets.

The City, for many, is perceived as being synonymous with big corporates in the banking and financial sector. Often, it is not even a physical place, it is a business sector. For SMEs engaged in mainstream City activities such as Finance, Insurance and Professional Services, a core location

FIGURE 5

Administrative boundary of the City of London



can bring benefits in terms of proximity to clients and collaborators. For those businesses engaged in other types of work, a City location can be difficult to contemplate.

3.2

Cost of being in the City

The reputation of the City Core as a location for large corporates has led to many SMEs perceiving the City to be too expensive for them. One agent underlined such SME perceptions of the City as a location for business: *"When I offer City Core buildings to SMEs from other parts of London their initial reaction is to say no, it's not for us, too corporate, not our place."* However, the agent added that those perceptions changed when such businesses saw what the City could offer: *"If I am able to persuade them they have nothing to lose by looking – it's only a*

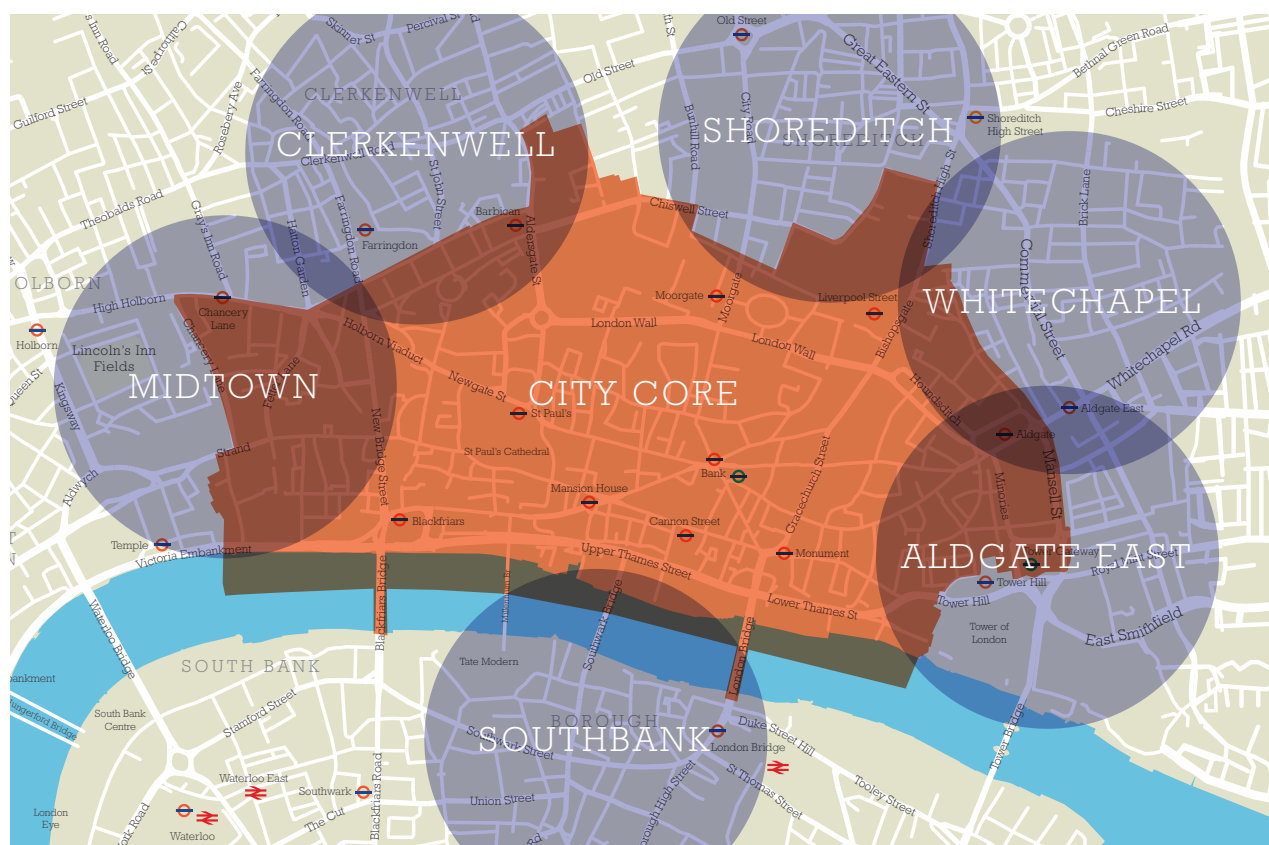
taxi ride away – when they see what they can get for their money their prejudices often melt away."

In many ways, the City is considered to offer 'good value' to businesses because the quality of office space available is superior to most other locations in Central London of an equivalent rent per sq ft. There is direct cost advantage to a business of being in the City, not just in rent but also in business rates, which are proportionately lower too, meaning that overall occupancy costs in the City are significantly lower than competing locations (see Figure 7).

Businesses in Central London generally have become more 'footloose' than in the past, with analysis indicating that rates of firm migration into and out of London are around twice what they were 10 years ago (TBR, 2014). For example, the

FIGURE 6

Areas associated with the City



cost advantage of the City compared to the West End has persuaded a significant number of businesses, not in the traditional 'City' sectors, that moving to a City location from other parts of London is acceptable. Evidence of this west-east shift is underlined by research from Cushman and Wakefield, who found that more than half (55%) of relocating West End offices migrated to one of the City or Docklands submarkets during 2014 (Cushman and Wakefield, 2015).

While businesses are currently able to secure good value for money for office space in the City, rents are on the rise as supply has contracted. This may affect the ability of more price sensitive SMEs, such as start-ups, to locate in the City in the future.

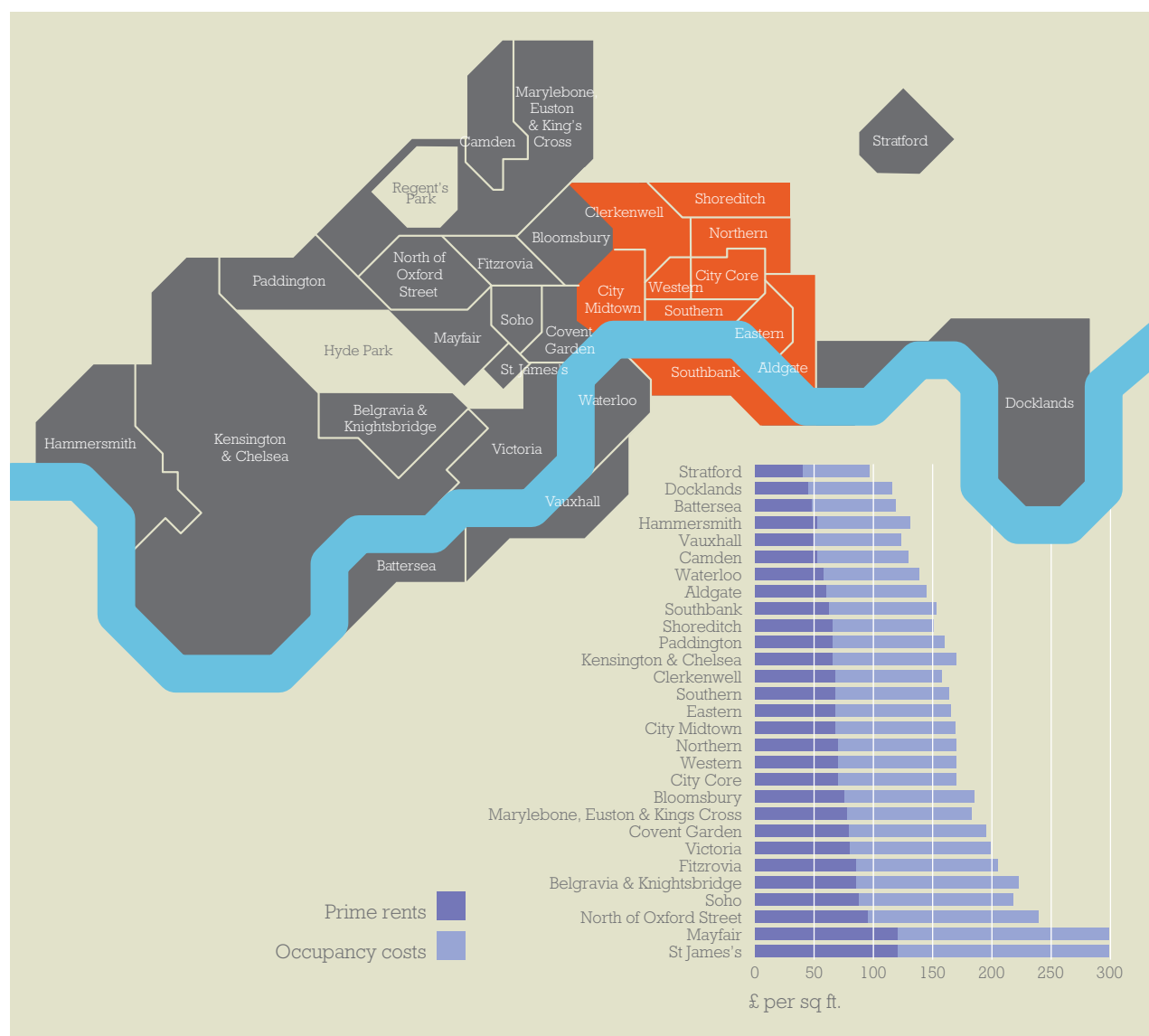
FIGURE 7

Rental conditions in Central London

FIGURE 7

Rental conditions in Central London

Source: JLL (2015): Central London Market Office Report Q4 2015.



'The City is very good for transport connections and being here places us close to big business.'

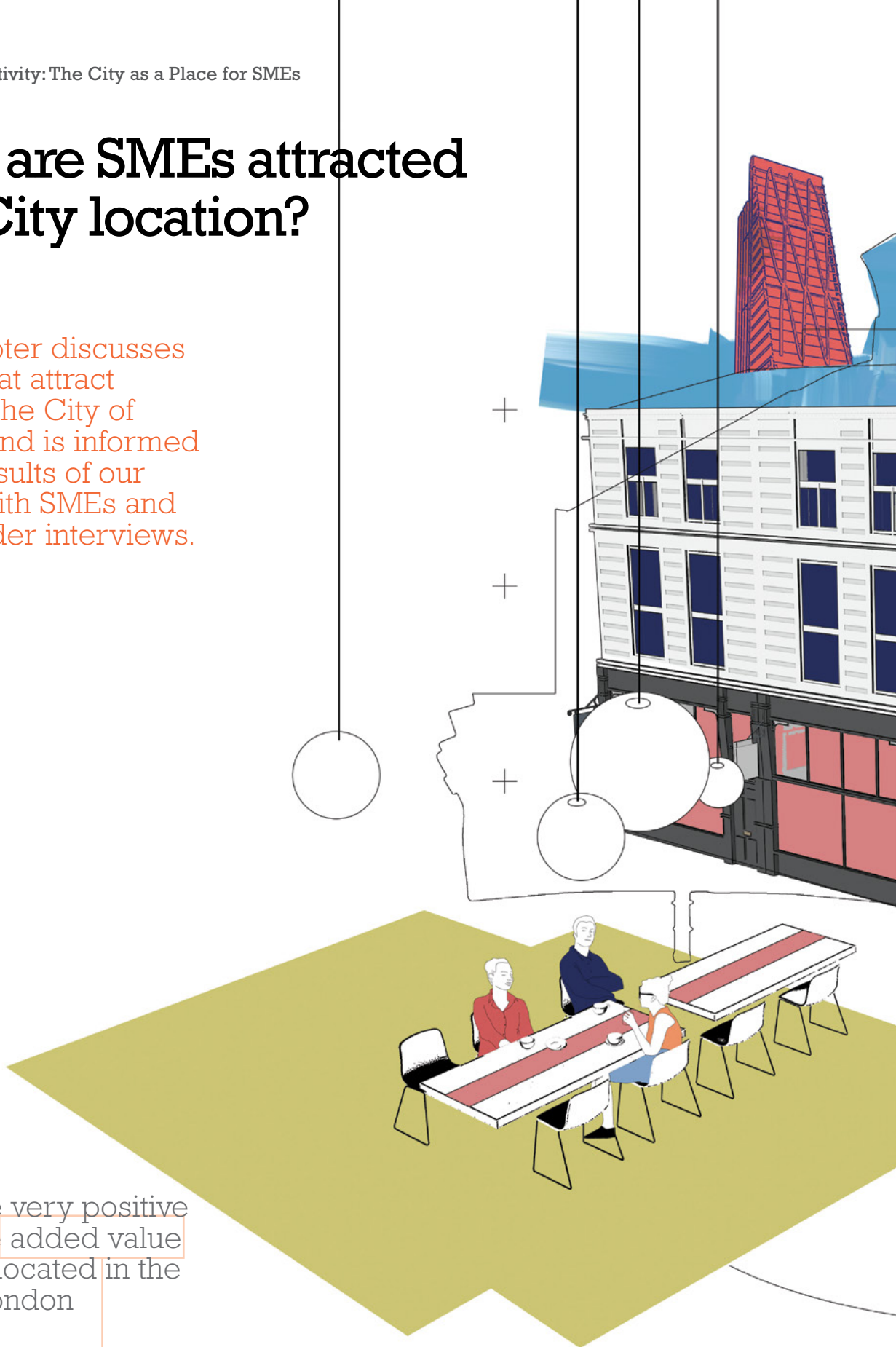


Why are SMEs attracted to a City location?

This chapter discusses factors that attract SMEs to the City of London and is informed by the results of our survey with SMEs and stakeholder interviews.

SMEs are very positive about the added value of being located in the City of London

Proximity to clients and customers was ranked as the number one benefit of being located in the City



4



The City's strong transport links and attractiveness to highly skilled staff were ranked highly

SMEs in the Insurance sector felt it was important to be based in the City more than any other sector surveyed

It is clear from our survey results that SMEs located in the City place a high value on being based here. As Figure 8 shows, SMEs in Financial Services; Insurance; Professional Services; and Admin and Support sectors value a City location more highly than SMEs in the Technology, Media and Telecommunications (TMT) sector, who were still strongly positive. In contrast, the Wholesale, Retail and Consumer sector was less positive.

FIGURE 8
How would you rate the City as a location for your business? (On a scale of 1 to 10, where 1 is very poor and 10 is excellent)

Survey respondents were also asked how important it is for their firm to be located in the City, as opposed to other locations. Figure 9 demonstrates that SMEs from the Insurance sector feel it is very important for their firm to be located in the City. One insurance firm commented, “the hub of the British insurance industry is here.” Only the Wholesale, Retail and Consumer sector did not value this as highly.

FIGURE 9
How important is it for your business to be based in the City? (On a scale of 1 to 10, where 1 is not at all, and 10 is vital)

Having established that SMEs generally place a high value on being located in the City, survey respondents were then asked specifically about what factors informed their decision to open a site in the Square Mile, as well as what they perceived to be the continued benefits of being based in the City.

4.1.
Proximity to clients and customers

Clearly one of the City's greatest strengths is its ‘business ecology’, in which firms are within easy reach of their suppliers, partners and customers. Indeed, proximity to clients and customers was ranked as the number one reason why SMEs chose a City location, with 36% of survey respondents singling out this factor. One SME stated: “Meeting people is key to our business, that’s why we’re here”. Another emphasised that their “location is in close proximity to our top clients”.

FIGURE 8
How would you rate the City as a location for your business?



FIGURE 9
How important is it for your business to be based in the City?



Figure 10 shows this factor is most important for SMEs in the Insurance, Professional Services, TMT and Admin & Support sectors.

FIGURE 10

What was your key reason for choosing the City?

The commercial benefits to SMEs of being near clients, customers and complementary businesses are what lead them to cluster together. Defined clusters are apparent for particular industries within the City boundaries, as shown in Figures 11 and 12, which represent firms moving into and out of the City over two years.

FIGURE 11 OVERLEAF

Firm Movements in the Insurance Sector in the City of London, 2012-14

FIGURE 12 OVERLEAF

Firm Movements in the Professional Services sector in the City of London, 2012-14

Being located within a business cluster has many advantages for firms of all sizes.

Being close to firms within a similar sector allows for “the exchange and diffusion of ideas driven by face-to-face interaction” (Centre for Cities, 2015) which has direct links to increasing productivity.

Furthermore, proximity to clients can be important to firms that provide highly specialised products and services “which require a lot of client interaction to develop” (Centre for Cities, 2015). Being in a cluster with other similar firms can also mean that there is a pool of local talent that can be more easily recruited.

There is evidence that SMEs within business clusters in the City support the growth of one another. For example, recent research found that 63% of firms in the City buy from others based in the City, while 68% of firms make sales to other businesses in the City (Bone Wells Urbecon, 2013). The survey shows that for over one third of SME respondents, over half of their annual trading income comes from sales to other City firms.

FIGURE 10

What was your key reason for choosing the City?



FIGURE 11

Firm Movements in the Insurance Sector in the City of London, 2012-14

Source: TBR (2016) forthcoming

Outward Inward



This map illustrates the clustering of Insurance firms in the east of the City.

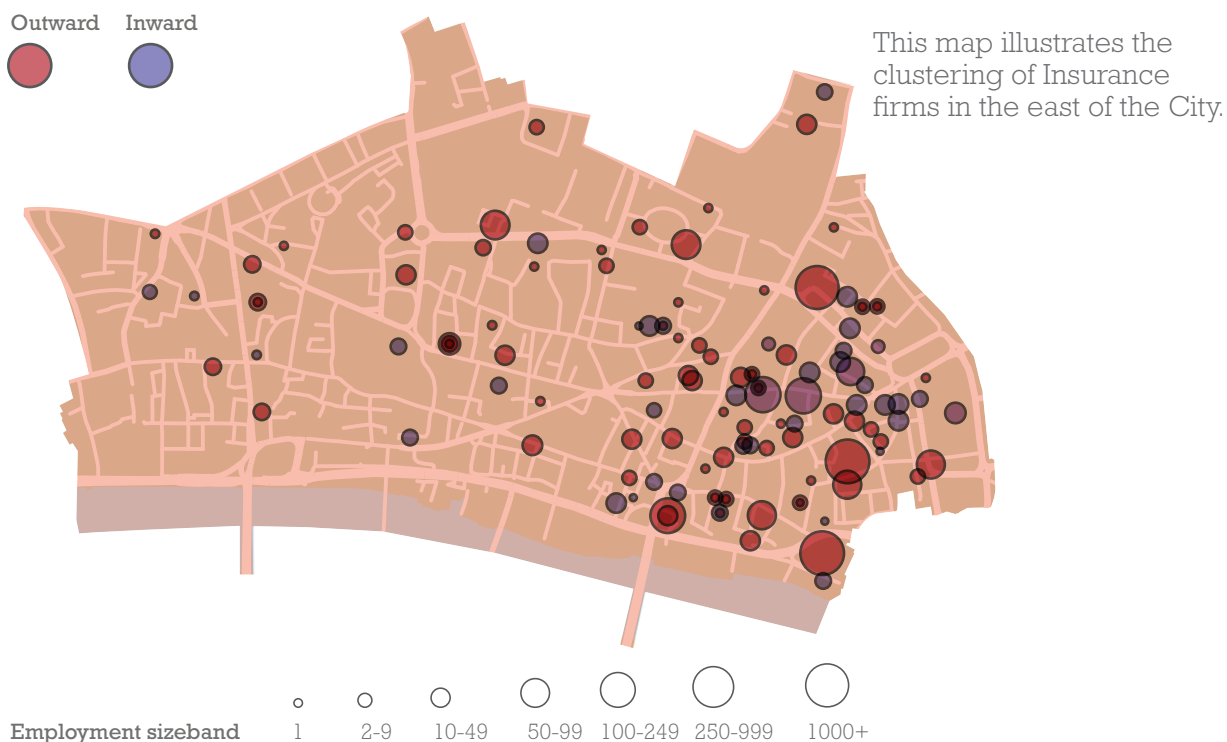


FIGURE 12

Firm Movements in the Professional Services sector in the City of London, 2012-14

Source: TBR (2016) forthcoming

Outward Inward



By contrast, Professional Services firms are distributed across the City, with a notable cluster around the western edge.

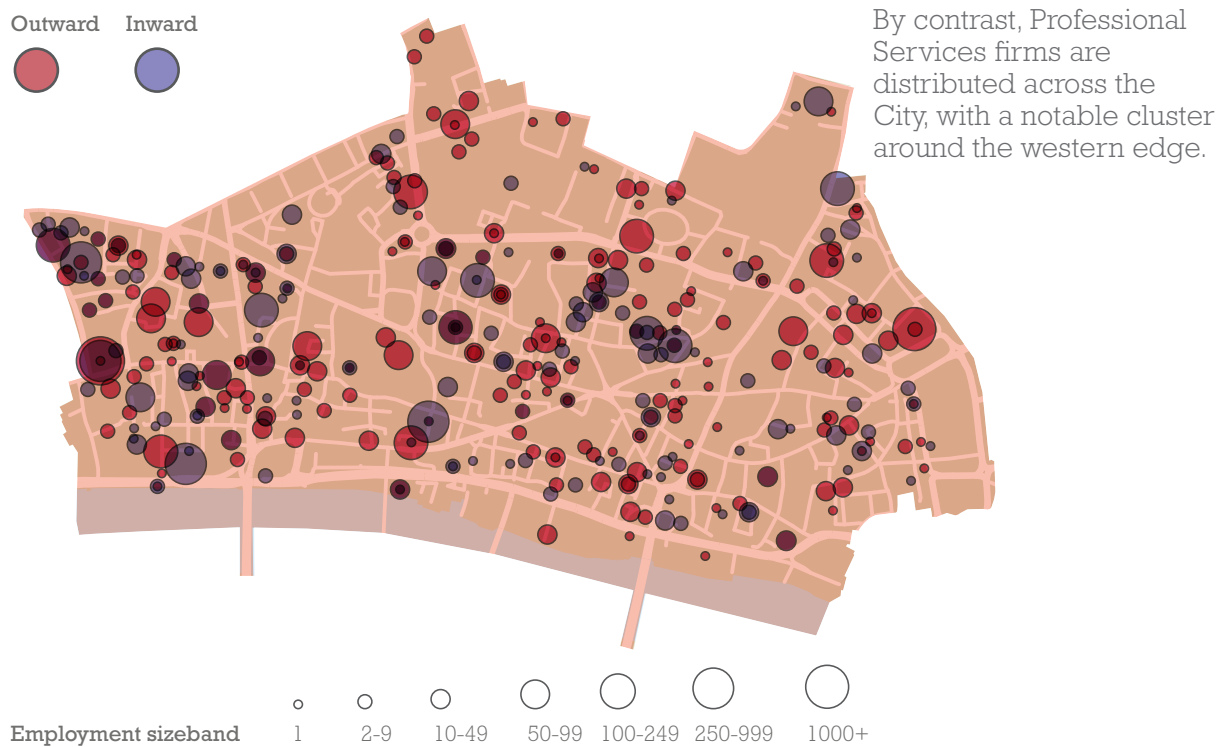
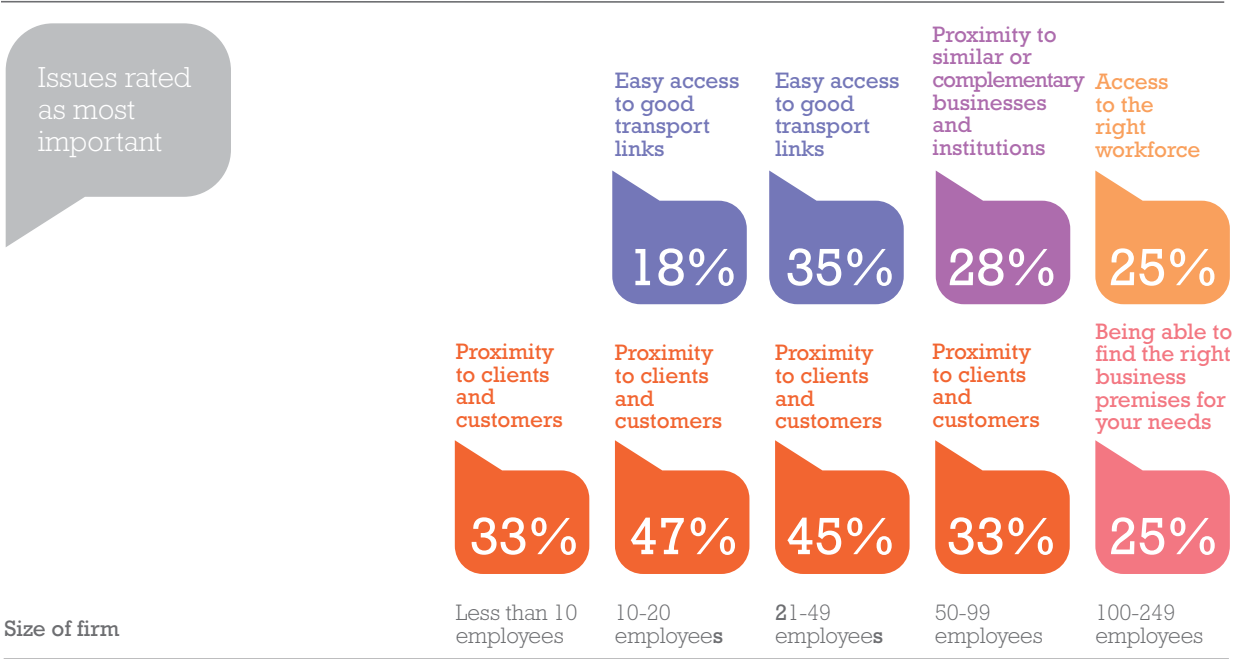


Figure 13 shows data collected during the survey with SMEs that support this conventional wisdom. Proximity to clients and customers is singled out as the most important factor to smaller SMEs with workforces of 99 employees or less. However, bigger firms with workforces of between 100-249 employees tend to place a higher priority on finding a suitable office space and being able to recruit skilled staff.

FIGURE 13
Most important locational factors by size of firm

‘When I offer City Core buildings to SMEs from other parts of London, their initial reaction is to say no, it’s not for us, too corporate, not our place... However, if I can persuade them they have nothing to lose by looking – it’s only a taxi ride – when they see what they can get for their money their prejudices often melt away.’

FIGURE 13
Most important locational factors by size of firm



4.2

Good transport links

Of the SMEs surveyed, 21% cited 'easy access to good transport links' as the most important factor in selecting a City location, making this the second most cited benefit of being in the City. Many SMEs agreed on the importance of access to transport, and commented on the ease of accessing the City, reporting that *"transport links are good"*. The City is currently well connected both in the density and number of tube stations and mainline rail termini and this is set to improve with the opening of the new Crossrail service in 2018. One SME survey respondent commented that *"the City is very good for transport connections and being here places us close to big business"*.

FIGURE 14

The City's transport links

Although public transportation is seen as a strength of the City offer, with approximately 85% of the workforce commuting this way, and a further 8.5% commuting by bicycle and on foot (City of London, 2012), those that choose to travel via private transportation have commented on the level of transport congestion in the City. There are efforts to encourage more people to commute into the City via cycle routes: for example 22 Bishopsgate, which is due to open in 2019 includes in its plans 2,300 bike parking spaces and 217 showers, along with facilities for bike hire, repairs and safety training.

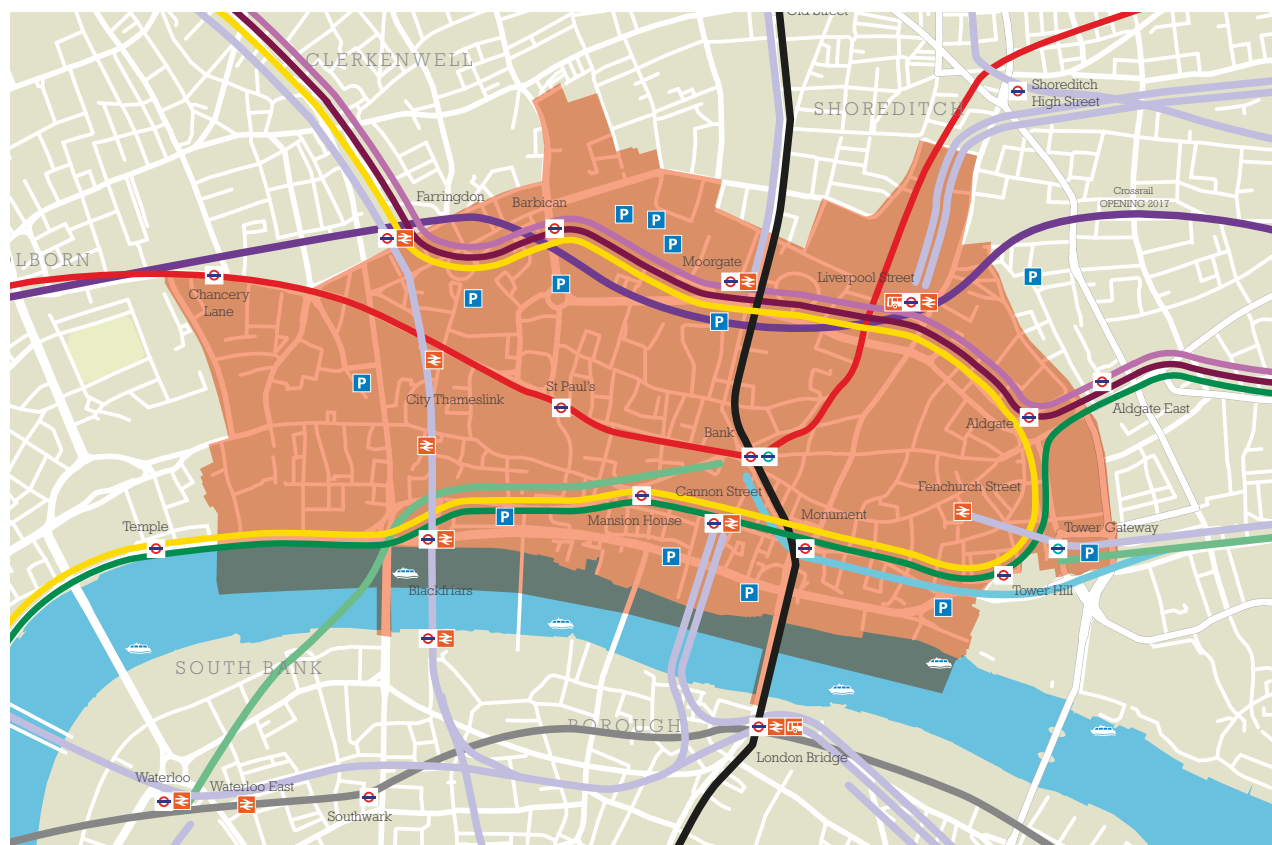
4.3

Ability to attract skilled staff

SMEs overwhelmingly agree that being located in the City has a positive effect on their ability to recruit appropriately skilled staff. Figure 15 demonstrates that this trend is

FIGURE 14

The City's transport links



true across all sectors but is particularly strong among SMEs surveyed from the TMT and Insurance sectors. This sentiment was weaker among respondents from Professional Services firms, perhaps reflecting the ready availability of certain remote services, such as IT support.

FIGURE 15

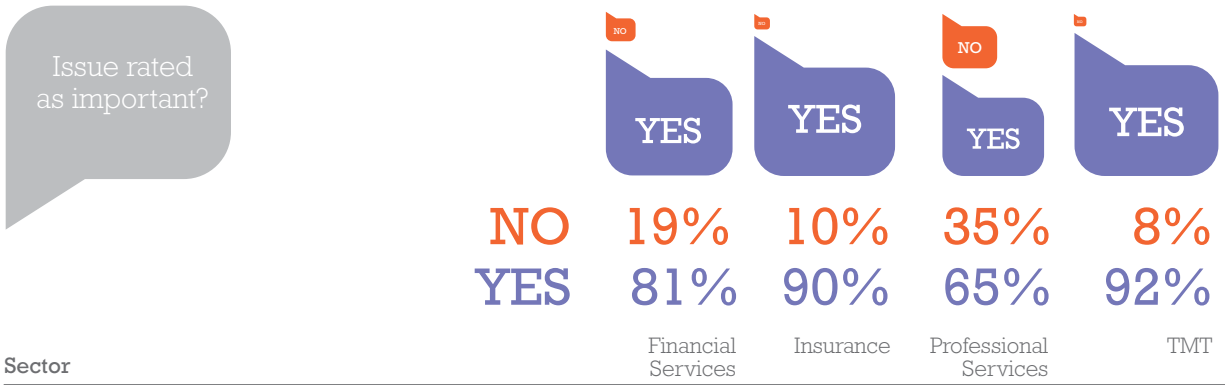
Do you think a City location affects whether you can attract the right staff?

With City businesses employing 414,600 workers (ONS, 2015) across a small and dense area, firms can easily access a large pool of potential recruits. Respondent comments also included that the prestige and reputation of the City helps to attract applicants, and that the location is accessible through good transport links.



FIGURE 15

Do you think a City location affects whether you can attract the right staff?



4.4

Prestige

The perceived prestige of a City location is one of the most important attractions of being located in the area. Due, in part, to the City's historical legacy and its on-going reputation as the one of the world's top financial centres and business hubs, the Square Mile has retained its image as an aspirational location. One insurance firm commented, *"it is important to have a flagship office at a premier site"*.

Bone Wells Urbecon's 2013 study found that one of the top reasons cited for businesses purchasing from firms in the City was the good reputation of firms based there.

4.5

The City's mix of building stock and heritage

One of the attractions highlighted by our interviewees was the City's blend of old and new, and large and small buildings, providing the raw material in its built environment to satisfy a broad spectrum of tastes, styles and needs.

A key insight from our interviews is that the City's public realm might be, to some extent, 'undiscovered': hidden beneath the dominant image of the City Core as large-scale, glass fronted corporate heartland. Interviewees referred to the passageways that wind between Cornhill and Gracechurch Street, Leadenhall Market and the small lanes close by, and the south eastern reaches of Eastcheap. Such areas have immense character and a stock of 'quirky' buildings, small scale and secondary buildings. For businesses not already occupying such buildings, these areas could lend themselves to a mixed community of small, medium and large occupiers from a range of business sectors.

4.6

Public realm and amenities

The range and quality of amenities and the public realm around a building have particular significance for smaller businesses that are not able to offer them internally. Placing emphasis on the importance of an attractive public realm and the range of amenities on offer is often a strategic consideration for SMEs that want to attract high-quality staff.

Leisure facilities and amenities were frequently mentioned in response to questions around ways in which the City has improved as a business location in recent years. SMEs respondents were generally positive when asked how the City compares with other locations in London. 34% of firms felt that the amenities were superior and only 19% of firms felt that the amenities were inferior (see Appendix 3).

Relatively new firms to the City – those who had spent less than 10 years in the City – were more positive than those who had been in the City ten years or more (albeit 78% of this latter group still rated the City as having comparable or better amenities than other London locations). With regards to retail space, some SME survey respondents noted the predominance of chain retailers as a disadvantage, although there have been efforts to address this in recent years.

Diversifying public realm and amenities in the City

Major work is currently underway in the Aldgate area which will see the completion of a new large public space in 2017.

To diversify the current retail offer in the City, there are planned retail improvements to Bloomberg Place and Poultry which will be exclusively populated by independent retailers, restaurateurs and 'pop-up' shops. Total retail floor space in the City of London has grown consistently, from 506,000 sq m in 2005 to 582,500 sq m in 2013 (City of London Corporation, 2013). The improvement to the retail offer will be complemented by plans to remove vehicles from Bank Junction (other than buses) due to be instigated in 2017. In addition, the City of London established its first Business Improvement District (BID) in 2015, the 'Cheapside Business Alliance'. This project aims to develop a strategy to support the development of Cheapside as an office and retail destination.

Interviewees highlighted a strong emphasis among SMEs on the context of their buildings – the surrounding public realm. SMEs ranked issues such as personal safety, environmental quality and retail more highly than base building specification. This mirrors one of the key findings of the *Future Workstyles and Future Workplaces in the City of London* report published in 2015.

4.7

Access to the City Fringe areas

Neighbouring boroughs directly adjoining the City that officially lie outside of the City of London's administrative boundary are not only an integral part of the City's business ecosystem, but are also considered an extension of the City itself. Indeed, the City is not an 'economic island' – the functional economic area referred to as 'the City' extends beyond the administrative boundary.

The areas adjacent to the City boundary are important in terms of providing appropriate space for SMEs, and are now collectively regarded as a market in their own right by many property agents and analysts. The City is dependent upon this area for providing space to accommodate many businesses that cannot find the right premises and the right price in the City Core.

FIGURE 16

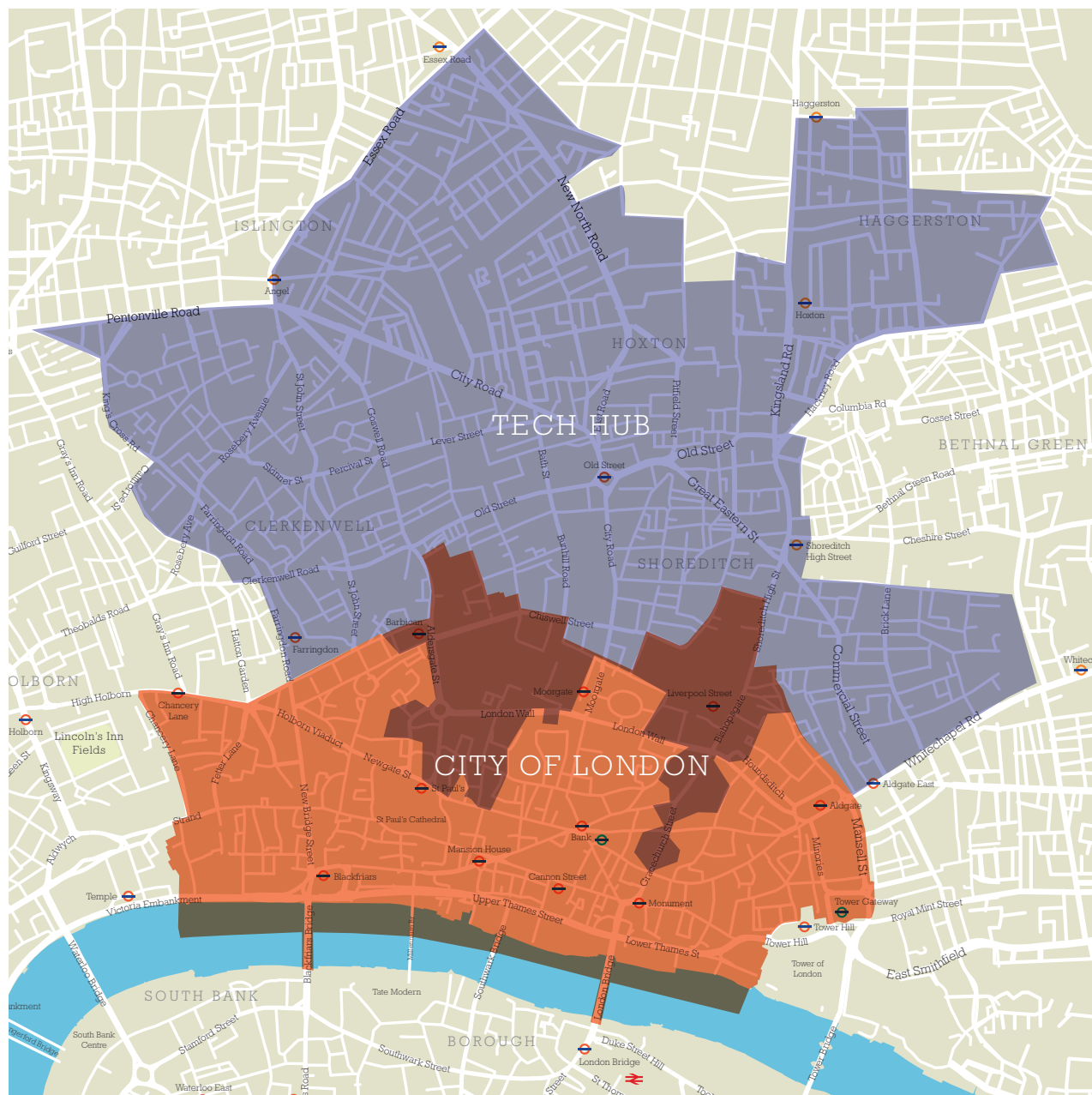
The Tech City hub overlaps with City boundaries

One example of this, as Figure 16 shows, is the Tech City hub which overlaps with the City of London administrative boundary, and is an integral element of the City's business ecology. Tech City's location on the fringe of the City facilitates business linkages, with tech companies gaining access to capital, and the City benefitting from a community that is creating products to support its operations. Recent research helps to illustrate this co-dependence, with many tech founders emerging from the City's big banks and management consultancies and "two of the biggest venture capital investments so far in 2015 from London-based FinTech businesses" (Nathan, 2015). The importance of business linkages between Tech City and the City was borne out in supply chain interviews with property investors. One of these explained: "As investors, we ask ourselves 'where is the growth coming from'? We see that growth is in TMT sector and it is happening nearby".

FIGURE 16

The Tech City hub overlaps with City boundaries

Source: TBR (2014) The Impact of Firm Migration on the City of London



Impact of the Tech City cluster

The Tech City cluster has grown significantly as a hub for small and medium-sized tech firms since the 2008-09 recession, where companies were attracted by the lower rents on offer. However, the success of the Tech City hub and increased demand for space in the Old Street vicinity – as well as the City Fringe area – has reduced the availability of low cost space that has previously catered for SMEs serving the City's corporate sector.

Data from Bilfinger GVA illustrate the impact of rising rents in Tech City. For example in Quarter 3 2013, prime rents in the City Core stood at £57.50 sq ft, while in Shoreditch they were discounted to £37.50 sq ft (Bilfinger GVA, 2013). By the end of 2015, City Core rents had risen to £67.50 sq ft, but Shoreditch rents had almost reached parity, at £65.00 sq ft (Bilfinger GVA, 2015).

Despite the recent arrival of a number of corporate organisations, Tech City is characterised by its attraction to SMEs. However, the significant rise in rental costs in the Tech City cluster could have major implications on SMEs that made use of cheaper office space on the City Fringe to work with customers based in the City Core. Indeed, the foundations of Tech City were the technology businesses occupying cheap spaces and selling software and services to Financial Services, Professional Services firms and Insurance companies. But Tech City is now a relatively expensive location with a diminishing amount of cheaper, secondary space from which SMEs can serve the City.

The success of Tech City is such that it has begun to influence business culture within the City, as tech businesses with products and services aimed at the financial sector seek to optimise their location advantage, which over time is likely to alter the look and feel of areas close to and inside the City Core.

'The City's charm is its mix of tiny narrow streets and big bold places. They need to make sure they are connected and should not be too sanitised.'



Property and premises

This chapter examines the City's premises offer for SMEs, and looks at the types of buildings that they occupy, their leasing arrangements and their current pattern of occupation and workstyles.

Whilst the iconic view of the City is the cluster of tall modern buildings housing large multinational firms at its core, in fact the range of accommodation on offer is much more diverse.

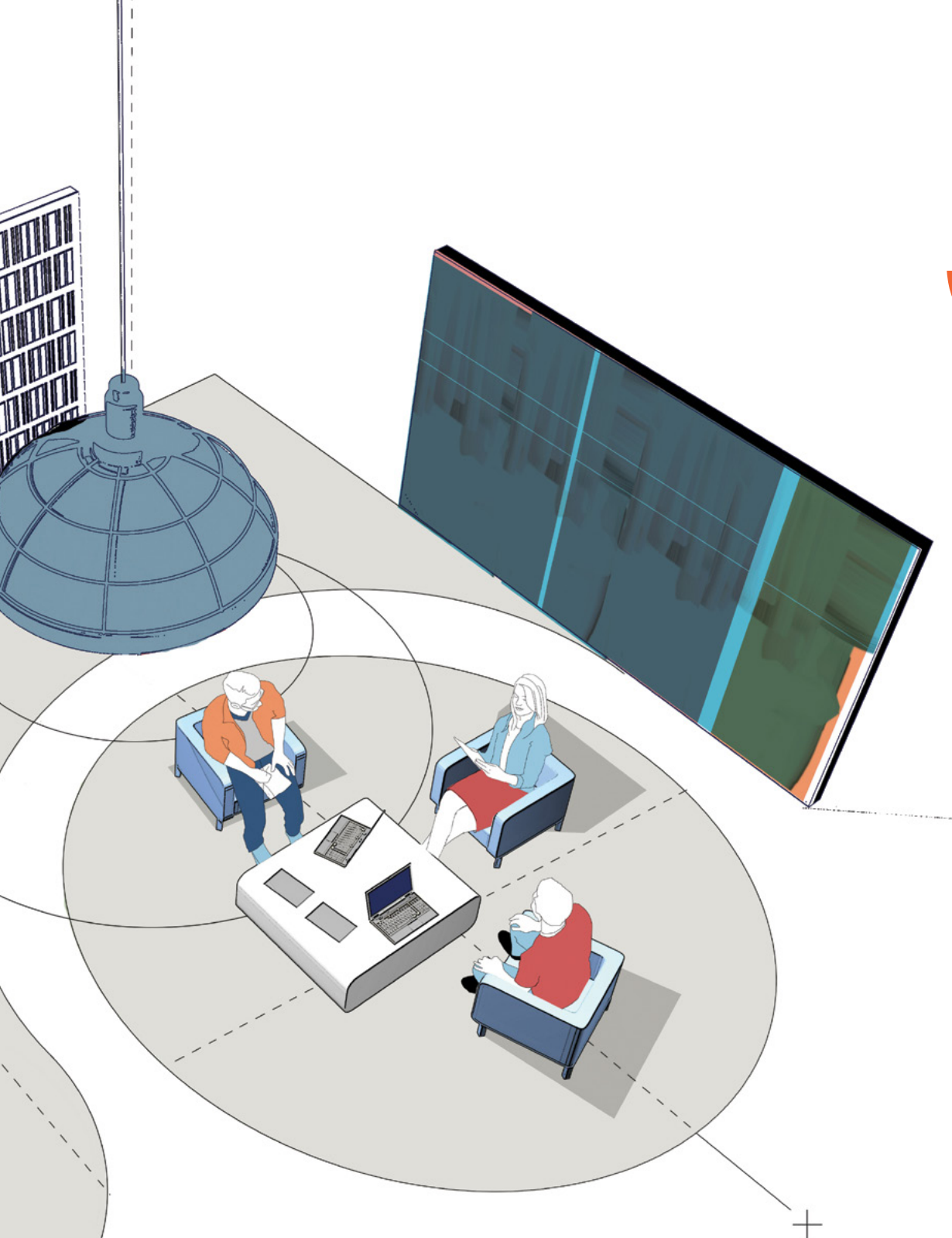
Over 50% of firms occupy units of less than 500 sq m and are distributed across the City in both modern and historic buildings.

Almost 90% of the City's SMEs occupy units of less than 2,000 sq m and over half occupy units of less than 500 sq m.

For all except the smallest SMEs (<10 employees), leasing part of a building is the most common premises type – 75% of the sample.



5



There is clear evidence that there has been a decline in the supply of units sized between 300 sq m and 1000 sq m – referred to here as the 'squeezed middle'.

Cost was flagged as the primary concern amongst SMEs. In recent years, rents have risen even in areas previously perceived as affordable.

The flexible and shared space market has grown in recent years. This type of stock is attractive to SMEs as it addresses challenges

facing smalls business around making long term commitments, and is also able to offer high spec offices traditionally reserved for large corporates. This market meets demands of a growing appetite among SMEs for space that is vibrant, lively, design-led.

Yet, there remains demand amongst SMEs for 'secondary' space – low spec offices that are economically priced. The diminishing supply of secondary stock in the core area is a concern in terms of meeting the needs of SMEs.

5.1

The City's property offer

Firms in the City typically occupy modern office space at a ratio of around 11 sq m per person. The distinction between the size of buildings in the City and the size of occupied units is clearly seen in Figure 17, with 86% of occupied units being less than 2000 sq m, and over 50% less than 500 sq m (Ramidus, 2013).

FIGURE 17

Proportion of Stock and Occupied Units, City of London, by Size Band, 2013

5.2

Survey of premises needs of SMEs

Our survey of SMEs asked about the kinds of office buildings they occupied, their leasing arrangements, occupancy patterns and workstyles. The results highlight both the City's strengths and challenges that are currently faced, which the next sections explore in more detail.

In terms of the characteristics of the survey sample, for all except the smallest SMEs (<10 employees), leasing part of a building was the most common premises type – 75% of the sample overall, followed by managed and serviced offices – 18% of the sample overall, though none of the Insurance firms. Serviced offices were more prevalent among the smallest SMEs, who were as likely to be in serviced offices (50%) as leasing (50%). Even the largest firms (100 – 249 employees – 22%), and those longest in the City (>10 years – 19%) were making significant use of serviced offices. A small number of the firms surveyed leased the whole building – in particular from the Wholesale and Retail sector (33%), Professional Services (15%) and Insurance (10%).

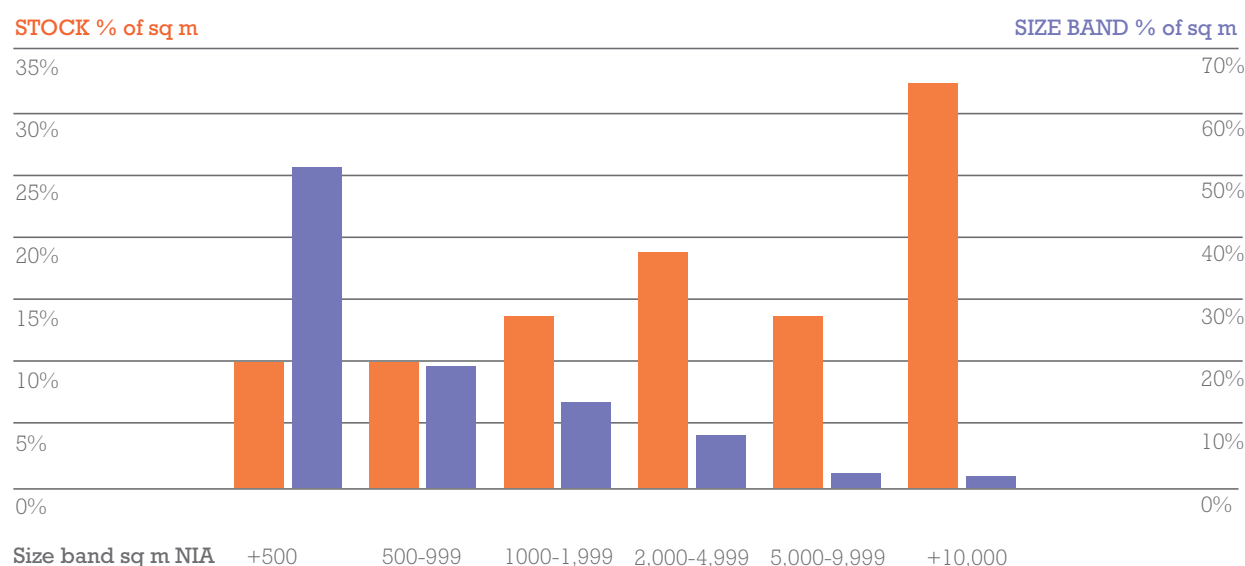
To identify overarching strengths and challenges for different types of SME, we asked SMEs about four key aspects of the City's property offer:

- Being able to find the right premises for their needs;
- Choice and range of premises available;
- Cost of premises;
- Building amenities.

FIGURE 17

Proportion of Stock and Occupied Units, City of London, by Size Band, 2013

Source: Ramidus (2013)



A number of patterns are apparent. In terms of strengths, *being able to find the right premises* was a clear strength for the City across sectors, sizes and length of stay, with the *choice and range of premises available* also scoring positively, albeit with more variation depending on the type of SME. Insurance, Admin & Support, and Wholesale & Retail were the most positive sectors here, while Finance, Professional Services, and TMT were more neutral, as were young firms (<5 years in the City).

Some distinct issues emerged for specific types of firms. The smallest firms (<10 employees) were very positive about being able to find the right premises, but were also the most negative about the range of choice available to them. TMT firms were very positive about *building amenities*, while other firms were broadly positive. This could represent a strong preference for amenities amongst TMT firms. Businesses employing 10-20 employees were much more neutral about *being able to find the right type of premises* than other sizes of firms.

In terms of challenges for the City, across sectors, size and length of stay, firms repeatedly flagged the *cost of premises* as an issue. Across sectors, this was particularly marked for TMT firms, while across different sized firms, the smaller end (< 10 and 10-20 employees) felt this the most keenly, while the large firms (100-249 employees) were the only group to rate this (marginally) above neutral.

In terms of how satisfied businesses were with their premises, there was no difference between businesses in serviced offices and those with conventional leases – both with average satisfaction scores of 7.1/10. Those with their own front door were the most satisfied (7.6/10); though it is increasingly less common for SMEs to occupy a whole building, with the stock of small buildings in decline as they are incorporated into larger developments.

There are issues being highlighted around the cost of premises, and around the right sorts of premises for particular types of firms. The following sections look in more detail at the key strategic issues affecting

cost and supply, and ways in which the City is changing.

5.3 Building requirements

There are few physical space requirements that are specific to SMEs; at a certain level “*an office is an office*”, with requirements for furniture, equipment and facilities being relatively constant regardless of the scale of occupation. Some differences are apparent for building specification, with larger corporates operating at higher densities of occupation and hence making greater demands on systems such as heating, air handling and power.

Smaller SMEs, and particularly those looking for a more economical option in their selection of premises, are more comfortable with lower specified systems. Floor-to-ceiling glazing and centralised lighting, for example, are less important to SMEs who prefer more control over their work environment. A large proportion of SME demand is for ‘secondary’ buildings, where rents are comparatively cheap and building specification rather dated (see Ramidus, 2013). The availability of such buildings provides a foothold for those SMEs who cannot afford prime space, and who are content to pay a low rent, with no add-on services, in a building that is old and likely awaiting redevelopment.

The rise of flexible space and the associated economies of scale that are possible are, however, making it possible for smaller businesses to occupy space of a standard more traditionally expected by large corporates.

5.4 The importance of secondary space

The diminishing supply of secondary stock in the core area is one of the greatest issues for the City in terms of meeting the needs of SMEs.

In the past this need was largely met in peripheral locations, or in buildings coming to the end of their useful lives. In today's market, however, occupier expectations of their office space have changed significantly, meaning that owners of older buildings can substantially enhance rental value at relatively low cost – cost of specification no longer directly equates to rental value. Minimal refurbishment can transform the rental value of a building – the stripped out ceiling being probably the best example of this trend. This means that there is no longer a sharp difference in capital values between the City core and fringe markets, or from Grade A specification to Grade C.

5.5

An appetite for colour

Another emerging trend in the market is a strong appetite among SMEs for 'more interesting' accommodation. In the competition for talent, employers – including SMEs – are looking for workplaces that will appeal to young graduates looking for a new way of working and the opportunity to be 'working in buildings that inspire' (PricewaterhouseCoopers, 2013; Puybaraud et al, 2010, Courier, 2015).

This was picked up in our interviews, for example, the desire to have "social rather than passive environments"; it was also noted that the changes taking place are not specific to a particular age cohort but a more general shift in expectations of all workers. This was also highlighted by large firms in the *Future Workstyles* study (2015).

Interviewees told us that across the City and Central London there is a growing appetite for space that is vibrant, lively, and design-led – design and layout that are 'less corporate', with fewer suspended ceilings, and different lighting and air handling systems. This includes sectors viewed as more traditionally reserved in their tastes, such as lawyers and accountants, now seeking bright colours and a more youthful feel to their office space. Alongside this, traditional conventions of office work are disappearing – "the people making the decisions are younger and the ties are gone". This means that there

has been "a generational shift away from factors important to landlords [such as base build specification] to occupier needs for a different experience of work".

The key point is that SMEs are looking for 'more interesting' space, rather than higher specification – and this is compatible with (though not exclusive to) lower specification buildings and space. In the City Core, however, and for larger occupiers, there is still a preference for a more traditional higher level of specification. Is there, then, a point at which this switch in emphasis occurs? In the view of one agent the threshold is around 800 sq m, with units above this scale being more 'corporate'.

There is clearly a need for the supply chain to keep pace with shifting occupier priorities. Many interviewees felt that the market was not adapting quickly enough to changing demand, however, and flagged two possible causes: specification standards, and agent expectations.

The BCO Guide to Specification – widely respected and adopted by large parts of the property industry – was criticised in our interviews for failing to keep pace with changes in occupier requirements and particularly for its 'one size fits all' approach.

Other interviewees felt that agents were responsible for supply chain inertia in the market, with expectations of a traditional specification, suspended ceilings and air handling systems. Conversely, the agents we consulted who had close relationships with small occupiers were more open-minded about changing specification, with one suggesting that "as an agent you should be challenging your clients all the time".

5.6

Lease length and covenant strength

The flexibility around space commitments that many SMEs need, often coupled with a lack of track record and insufficient covenant strength (normally three years of trading accounts) for young businesses, makes them less attractive to the conventional property

industry – which often views them as both risky and management intensive.

The recent evolution of the flexible space market has helped to address a number of the challenges for small businesses around making long-term commitments, taking on onerous exit obligations, and having variable space requirements. This now provides a real alternative to the traditional leasing market, particularly for SMEs, especially as much of the space available is to a higher quality specification than would have previously been available on a short lease.

5.7 SMEs and the flexible space market

The flexible space market encompasses a range of types of property offer, including serviced offices, managed workspaces, co-working spaces, incubators and accelerators. In recent years, the sector has evolved to become part of the mainstream commercial property market, catering both for the SME market and large corporates seeking shorter term flexible space (e.g. for project teams or short-term expansion).

For the City of London, serviced offices form the overwhelming majority of flexible space. The City market has grown hugely in recent years, from 25 units in 1995 (50,000 sq m), to 85 serviced offices in 2014 containing almost 200,000 sq m of space – almost 3% of the total stock (Ramidus, 2014). SMEs occupy 75% of this space, with most at the smaller end of the SME spectrum, typically ranging from five to nine workers, with an average size of eight people.

The 2014 study predicted the continuing growth of this market, anticipating it doubling by 2025. Since the work was completed, serviced office operators have acquired several more substantial premises in the City, including We Work's leasing of 16,000 sq m at Moor Place; although they still make up a relatively small proportion of total stock, they accommodate a growing proportion of the City's smallest businesses.

The flexible space model offers a number of

advantages to small businesses, including the flexibility around space that is either only occasionally needed – such as meeting rooms – or unpredictable – such as future expansion. In addition, removing the need to allow for potential expansion space and occasional spaces such as large meeting rooms and conference facilities, can offset the higher price per sq ft. The businesses occupying serviced offices in effect combine their buying power for services such as a reception, IT, security, telephony, and meeting rooms with the other occupiers, and allow for central management of these facilities. The model offers flexibility to expand and contract and an opportunity to locate at the heart of their market cluster, on terms that suit their business models.

5.8 Challenges for the flexible space market

There is no doubt that flexible space providers are meeting a significant and growing demand, the market has matured and there is a wider range of operating models. There are, however, ongoing concerns about the operating model in terms of the match of risks and liabilities. While a rise in the base rent in a strong market ought to translate directly into higher desk rates per sq ft, the base rent is reviewed only every five years, whereas the desk rate can be re-set every day. The result is that the ratio between outgoing rent (base rent) and incoming rent (from desk rates) can shift to the detriment of the provider in a weak market.

Most operators therefore remain vulnerable to a fall in either, or both, occupancy rates (% occupied space) and/or desk rates (£ per sq ft). For this reason, landlords have in the past been wary of serviced office operators as tenants and have been more willing to accept an operator's covenant during a weak market than a strong one. The expansion of the sector, particularly in the City, over the past 15 years has coincided with a prolonged period of relatively high supply and low rental growth. Those market conditions have shifted, vacancy rates have dropped and rents are now rising which could impact on the ease with which

the serviced office sector can continue to expand – this could in turn impact on the availability of space for SMEs.

Illustrating this, one operator reported that their centre had 'broken even' at 50% occupancy before a rent review on their base rent; since then the breakeven has risen to 85% occupancy, which means they are far more exposed to any fall in demand.

It seems reasonable to expect some consolidation in the sector as the more secure operators with the capacity to withstand market fluctuations build dominant positions and exploit economies of scale. The recent example of We Work taking 16,000 sq m at Moor Place might be a sign of things to come.

5.9

A premium for flexibility and a new menu of services

SMEs looking for shorter leases in the conventional market tend to pay a premium; for a five year lease, the premium is around 10% and ranges from 8% to 12%. Some City landlords of conventional space have 'switched on' to the appeal of a greater consumer focus by adapting their offer.

In addition, landlords can greatly enhance the appeal of a small building by looking at the amenities offered, for example, converting 'dead' basement space into showers, bike storage, break-out areas or meeting rooms that are bookable by the hour. Other add-ons include: hairdryers, aerated or heated lockers, a towel or dry cleaning service at reception.

An alternative but parallel model that is becoming more prevalent is for a large business to bring together a group of its small brands in a single building so that they can share overheads and facilities and benefit from that camaraderie generated in shared space – in effect to create internal flexible space provision within a single umbrella corporate structure.

5.10

The squeezed middle

The flexible space market has many attractions for the smallest businesses but less appeal for businesses once they need, say, around 300 sq m or more; it would be very unusual for a business needing more than, say, 500 sq m to find its needs met in serviced offices for long. At a certain size threshold, businesses begin to place more value on premises in which they can have a stronger individual identity.

Despite the efforts of some landlords to enhance the appeal of small buildings, there is clear evidence that the City's stock of small buildings, or buildings suitable for sub-division into small units, has declined as properties have been consolidated into larger units over the past few decades. This has left a gap in the market for units of between 300 sq m and 1,000 sq m, the segment of the market that is often known as 'move-on' space, for growing firms.

This has become an apparently intractable problem since it has been shown that large floorplates commonly associated with new stock often cannot be successfully sub-divided into units of less than 1,000 sq m. Floorplates can range from 2,000 sq m to 4,000 sq m in the City and as they get larger they are perceived to be difficult to subdivide for smaller occupiers, as well as requiring more servicing. However, designs shown to us during our supply chain interviews demonstrate that it is possible to design floorplates of 2,000 sq m that are suitable for use by large corporates or for sub-division into units as small as 300 sq m. Nevertheless, such flexibility does entail a compromise, which is that greater sub-division will normally reduce the gross to net ratio because of the additional circulation space required.

5.11

Summarising the needs of SMEs

Figure 18 brings together the key premises issues for SMEs in the City. The chart identifies how the premises needs of SMEs compare to those of larger organisations. For example, while both groups require proximity to clients and supply chain collaborators, SMEs face greater pressure in terms of competing for space in the highest cost areas. Similarly, while both groups place a high value on quality of their workplaces, SMEs often have to resort to secondary space. Similarly, the desire for a prestigious address might lead to compromise in terms of quality of building or tenure.

‘An office is an office.’

FIGURE 18

Premises issues for SMEs and large firms in the City

FIGURE 18

Premises issues for SMEs and large firms in the City

Driver	Feature	Compared to larger firms
Supply chain relationships	Proximity to clients and collaborators	Greater pressure to pay high premises costs
Scale	Lack of growth	Greater reliance on small unit market and lack of access to ‘own front door’
Occupancy cost	Quality of space taken	Greater reliance on secondary space
Internal brand	Design/fit out	Tendency to ‘looser fit’ layout/design
Access	Adjacent to transport	
External image	Prestigious address	Either lower specification space in the core or flexible space
Growth, certainty	Tenure flexibility	Reliance on flexible space market
Staff support	Public realm	Higher priority, particularly for support not provided internally (café, gym, etc)

Addressing SME needs in the City

This chapter looks at factors that could lead to SMEs considering other locations in London.

The cost of office space and changing workstyles (e.g. increased remote working and reduced need for a fixed office space) could affect the importance of having a City location for SMEs.

SMEs are not tied to a City location. This is applicable to smaller firms that have only ever been based in the Square Mile.



6



6.1

Why might SMEs leave the City?

The survey of SMEs looked at factors that might lead to businesses considering an alternative location from the City (Figure 19). Cost was most frequently cited as the factor that could influence firms to leave the City. Several respondents also reported that their need to be physically located in the City may decrease in the future due to the increasing use of technology and electronic communications.

When asked what could be improved to make the City a better place for their business to be based, the most common theme was around price, with comments including better premise options for small firms, such as more non-serviced offices for SMEs. Another common theme was improvements to internet and telephone services in the area.

FIGURE 19

Are there any factors that may lead you to reconsider being located in the City in the future?

6.2

Competing locations

Earlier in the report it was highlighted that businesses in London are generally becoming more footloose. While our sample of SME occupiers were overwhelmingly businesses that had always operated from within the City,² more than half of them said they would consider a location outside the City if they needed to move.

Almost half of all firms surveyed reported that they would not locate anywhere else (Figure 20). However, more than half (57%) of finance sector firms would consider locating elsewhere in Inner London. Of those, half mentioned Westminster as an alternative borough, while other boroughs suggested included Southwark, Tower Hamlets/Canary Wharf, Camden and Islington. One firm noted that a Central London location was important but not necessarily within the City boundary.

² Over 82% of firms that we surveyed have not previously occupied premises outside of the City. Almost 44% have not previously occupied any offices other than their current premises. All firms surveyed in the Insurance sector have only ever located in the City. See Appendix for more information.

FIGURE 19

Are there any factors that may lead you to reconsider being located in the City in the future?

Length of time in City (years)	Cost	Need for more space	Need for less space	Prestige	Recruitment	Proximity to other firms	Proximity to amenities	Other
<5	25%	13%	13%	0%	0%	0%	0%	25%
5-10	38%	8%	0%	0%	0%	0%	0%	31%
>10	46%	9%	2%	0%	0%	2%	2%	14%
Total	43%	9%	3%	0%	0%	1%	1%	18%

FIGURE 20

If you were not located in the City, is there anywhere else you might locate where you feel you could gain similar benefits?

The results illustrate that even businesses that had only ever operated in the City are not tied to a City location. The old locational loyalties that divided London into villages which had close associations with particular sectors – newsprint in Fleet Street, film in Soho, and finance in the City – have all disappeared or loosened. This could be significant for the City in two ways: firstly, it indicates that the traditional clusters of Finance, Insurance and Professional Services could look elsewhere for property; and secondly, it could mean that sectors not traditionally located in the City might consider a City location.

‘A Central London location is important but not necessarily within the City boundary.’

FIGURE 20

If you were not located in the City, is there anywhere else you might locate where you feel you could gain similar benefits?

Sector	A different Inner London Borough	Elsewhere in Greater London	Elsewhere in UK	Elsewhere outside the UK	No other location
Admin, Real Estate & Support Services	38%	8%	8%	0%	46%
Finance	57%	14%	0%	0%	29%
Insurance	22%	0%	0%	0%	78%
Professional Services	33%	6%	0%	6%	56%
TMT	38%	8%	8%	0%	46%
Wholesale, Retail & Consumer	33%	0%	0%	0%	67%
Overall	40%	8%	3%	1%	48%

Outcomes and Implications

This chapter brings together the main findings from the previous sections and offers policy suggestions to ensure the City remains an attractive location for SMEs.

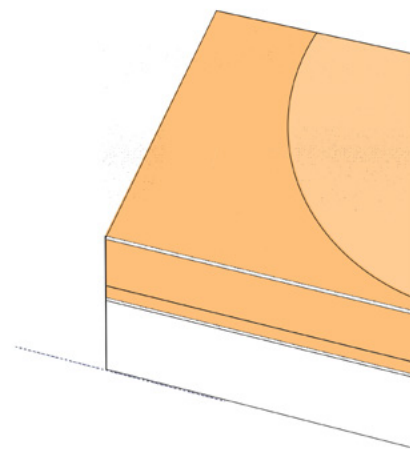


7



Summary of main findings

- SMEs surveyed for this research place a high value on a City location.
- One of the City's greatest strengths is its 'business ecology', the complex web of supply chain relationships that links firms of all sizes and types, creating a strong cluster. More than half of the businesses that we surveyed underlined the importance of proximity to customers.
- The City is regarded by SMEs surveyed as well connected by tube and rail, with 'easy access to good transport links' the second most cited benefit of being in the City.
- SMEs surveyed overwhelmingly agreed that the prestige of a City location helps to attract the best workforce.
- SMEs often perceive the City as being a much wider physical location than the administrative boundary, and the term 'City' is used to refer to other areas such as Clerkenwell and Aldgate East. This also works in reverse as the edges of the City can be perceived as surrounding boroughs.
- The City Core is strongly associated with big corporates in the banking and financial sector. However, the area beyond the core is a more fluid landscape which accommodates a diverse range of enterprises.
- When commentators talk about the City becoming acceptable to TMT, creative, digital, or ICT, they are typically talking about those parts of the City that merge seamlessly into the neighbouring boroughs.
- Many SMEs actively prefer 'secondary space' and are content with basic specification at a low rent and no add-on services. As new developments come into play, the diminishing supply of secondary stock makes it increasingly difficult for the City to meet the needs of a growing SME sector.
- Over half (52%) of the City's occupiers are currently in units of less than 500 sq m, but the number of units of this size is shrinking.
- Serviced office space meets a significant and growing demand in the City, with SMEs benefitting from the flexibility and business model. The impact of market fluctuations and economies of scale may lead to operator consolidation and larger units.
- Cost of office space is a critical factor, as a competitive offer has been seen to be one of the main draws attracting SMEs to the City, but was also singled out by SMEs surveyed as the biggest factor that could cause them to leave.



Policy recommendations

1

Continue to recognise the importance and diversity of SMEs

SMEs are a key driver for growth, and spatial policy should, therefore, remain mindful of SMEs when considering land use allocation.

The term SMEs encompasses an enormously wide range of industries and sizes, each with varying spatial needs. While the City offers a wide diversity of office spaces, one of the challenges for policymakers in the City will be to balance SME needs in the competition for limited space whilst maintaining a diverse business ecology in the City.



2

Safeguarding the supply of competitively priced small office space

Currently, locating in the City is cost-effective. Not only are rents lower than other parts of Central London but business rates are proportionately lower too, meaning that the overall occupancy costs are significantly lower than competing locations. However, rental prices have been increasing in recent years, and cost was highlighted in the SME survey as the largest threat that might cause SMEs to consider leaving the City.

The supply of units between 300 and 1,000 sq m and particularly those of less than 500 sq m is becoming constrained. This is significant because over half of SMEs in the City occupy units within this size band.

This has been partly caused by the consolidation of smaller properties into larger units over the past few decades and exacerbated by the slowdown of construction following the financial crisis in 2008, though the effect of will diminish over time.

Rents are primarily influenced by market forces but there are policies that can help to reduce the financial cost for SMEs. Increasing the supply of suitable office stock would help to reduce pressures on rental values somewhat.

The City has a large stock of heritage buildings, which are preserved by dedicated planning regulations. Many of these could provide spaces suitable for small occupiers. Policies that align heritage and small business interests may help to alleviate the constrained supply of small and economically priced office space, though alone will not be sufficient.

The supply could be bolstered by working with developers to increase the provision of economically priced units within large-scale developments. A forthcoming development, 22 Bishopsgate, will include 50 desk spaces dedicated to start-ups that are under five years of age. This particular example was initiated by the developer and could be used as a model for future developments (City of London, 2015).

3

Ensuring the supply of appealing office stock

Specification needs have become 'less corporate' as workstyles change, and there is a growing appetite for space that is vibrant, lively, design-led and encourages social interaction. However, we found some evidence of resistance among more traditional elements of the property supply industry, leading to inertia in terms of responding to changing needs. It is important that office providers respond to changing SME requirements in terms of the design and appeal of their space with a growing emphasis for the look and feel of office environments.

4

Working with neighbouring boroughs

SMEs surveyed emphasised the interdependencies of City businesses – large and small – within and around the City's administrative boundary. It is vital to continue supporting the City's business ecology, working closely with neighbouring boroughs to support business clusters that extend across administrative boundaries.

Tech City, for example, hosts a cluster of TMT firms located both within and around the City's official boundary. Supporting and nurturing its continued growth involves boroughs such as Islington, Hackney and Tower Hamlets, as well as the GLA with its cross-London remit.

5

Addressing misperceptions of the City

Perceptions of the City as corporate and finance-dominated may deter some SMEs, in particular if they associate this with a misperception around high cost.

The results of stakeholder interviews revealed that some SMEs were reluctant to move into the City based on the perception of high cost, but SMEs who were already based in the City noted its value for money.

Promoting the area beyond the core where a more fluid landscape accommodates a diverse range of enterprises could improve the image of the City as a location for SMEs. The City's diverse range of SMEs, abundance of serviced and flexible space, and central location with excellent transport infrastructure makes the Square Mile a marketable offering.

6

Enhancing the public realm

SMEs surveyed for this research emphasised the value of the public realm, as did larger firms in our previous City research. Since SMEs may have less resource to provide staff with amenities within their office space, meeting and working spaces in the public realm can be particularly important.

SMEs prefer a location which is capable of providing a range of experiences, with a variety of leisure, entertainment and retail opportunities. This reinforces the importance of efforts to improve the design and management of public spaces and the wider offer of the City. There are significant opportunities to address this with the forthcoming developments at Bloomberg Place and 27 Poultry (Soho House) along with the changes proposed to Bank Junction and the establishment of the first Business Improvement District in the City at Cheapside.

Specific ideas might include the active promotion of *'the hidden City'* – for example, raising awareness of *'undiscovered areas'* of the City Core around Leadenhall Market and alleyways between Cornhill and Gracechurch Street, as well as the proximity of street markets and events both in the City and just beyond the boundary.

The previous *Future Workstyles and Future Workplaces in the City of London* report (2015) highlighted the City's *"unique legacy of being the place for knowledge exchange and connections"*. Maintaining this legacy is particularly important for SMEs, for whom connections and collaboration are critically important.

7

Improving digital connectivity

Internet connection is a crucial component for modern businesses, but has been identified by the City as a risk, around access to superfast broadband in particular.

The Superfast City Programme is already underway to improve digital connectivity generally, and with a specific focus on SMEs, to work closely with suppliers in order to improve broadband service for SMEs (City of London, 2015). In January 2016 it was announced that residents and businesses on Golden Lane Estate will soon be able to access and enjoy broadband speeds of up to 80MBit per second (City of London, 2016).

The City should continue its efforts to improve the provision of high quality telecommunications for all businesses and workers, including comprehensive access to Wi-Fi, a high speed broadband network, mobile network stability and power provision and resilience. It should continue to work with telecoms providers to ensure more timely and efficient installation of telecoms for businesses moving premises.

Appendices



A



Appendix One: References

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Appendix Two: Research methodology

This research had four aims:

- o Enhance understanding of how the business approach of City SMEs is changing, and how they are adapting their locational requirements;
- o Increase awareness of the City's competitive offer and attractiveness to SMEs, and of the value they place on different features;
- o Deepen knowledge of how the City's overall business ecology is changing and the aspects that attract new SMEs;
- o Inform the City of London Corporation's strategy and direction, so that it continues to foster a diverse and thriving spectrum of City firms as possible, large and small.

To achieve these objectives, our research involved three main workstreams:

o Literature and data trawl

The project began with an overview of published reports and data relating to SMEs in the City. Official statistics and TBR's unique dataset, TCR, were analysed to understand the characteristics of the SME population in the City (broken down by size, age, and ownership type) and how this has changed over the past decade. The contribution of SMEs to the economy was also assessed.

o Primary research: the SME sample

This took the form of telephone interviews with 80 SMEs (70 established businesses and 10 start-ups). The sample was constructed to provide around 25 SMEs in each of Financial Services; Insurance; Professional Services; Technology, Media and Telecommunications and Wholesale, Retail and Consumer. Firms were divided into two size bands by number of employees (10-49 and 50-249).

o Primary research: the property supply industry

This involved 16 in-depth semi-structured interviews with developers, serviced office providers, agents and designers about how the City's SME business base is changing, and how this is affecting demand for accommodation.

The interviews and analysis intended to answer four main questions:

- o What are the spatial dynamics of SMEs' movement into and out of the City?
- o What is the value that SMEs get from a City location, including access to supply chains, and key reasons for them locating/remaining here?
- o What are the space and workplace needs of SMEs in the City?
- o Are these needs being met?

Appendix Three: Data tables and supporting text

National picture – SMEs

Of the 5.4 million SMEs, almost 1.3 million have no employees, and this sub-set has seen the greatest growth in recent times. In this category, the number of unregistered businesses (not paying VAT or PAYE) has doubled since 2000, rising from 1.497 million to 2.976 million; while the number of registered businesses has risen from 858,400 to 989,000.

Among firms with employees, the strongest growth has been in the 2-4 employee size band, growing from 512,600 to 643,200 firms; while 100-249 size band has remained static. SMEs with five or more employees have grown from 392,300 in 2000 to 469,000 in 2014, a rise of almost 20% (BIS, 2014). Large firms (those with more than 250 employees) have actually shrunk, from 7,200 to 6,700.

London picture – SMEs

The trends in London reflect the national picture. At the start of 2014 London had 933,035 SMEs. In terms of demand for real estate, firms employing 5-249 people numbered a more modest 74,550. Similarly, in employment terms, while SMEs employed some 2.5 million people, the 5-249 size band employed 1.34 million.

FIGURE 21

Business and jobs breakdown by size band, London 2014

Source: BIS, 2014

ONS data also show how the size bands have changed over recent years (ONS, 2013a). The 1-9 employees sub-set has grown most, from 59.7% to 68.1% of all workplaces. The large firms (over 250) initially grew from 10.6% in 2001, to 12.5% in 2007; but have since fallen back to 10.7% in 2012. Firms with no employees have also fallen significantly from 17.0% to 9.7%.

The dynamics of the fall in firms with zero employees and the rise of firms with 1-9 employees is explained by the ONS by an increasing tendency for sole traders to register as limited companies because of the legal and commercial advantages, and because registration has become easier over the past decade. When a sole trader sets up as a limited company, they are recorded as an employee of that company rather than as an owner/proprietor.

FIGURE 21

Business and jobs breakdown by size band, London 2014

Size band (employees)	Businesses		Employment	
	Number	%	000s	%
None	730,565	78.2	783	15.8
1-4	127,920	13.7	346	7.0
5-9	39,080	4.2	262	5.3
10-49	30,165	3.2	581	11.7
50-249	5,305	0.6	534	10.8
>250	1,410	0.2	2,461	49.5
Total	934,445	100.0	4,967	100.0

FIGURE 22

Sectors and size bands, London, 2014

London-based SMEs in the information and communication services sector employ 93,000 people, with 73,000 sole proprietor businesses or businesses with no employees (see Figure 22). These firms account for turnover of £17 billion, equivalent to 24% of the sector's total (Bilfinger GVA, 2015).

FIGURE 22

Sectors and size bands, London, 2014

Source: BIS, 2014

Size band	Information & Communication		Financial & Insurance		Real Estate		Professional & Scientific		Admin & Support	
	Firms	Jobs	Firms	Jobs	Firms	Jobs	Firms	Jobs	Firms	Jobs
1	285	1	105	0	445	1	3,640	8	3,010	6
2-4	12,480	30	2,395	7	6,295	18	21,955	58	9,810	27
5-9	2,620	17	1,110	7	2,575	17	6,265	43	3,320	22
10-19	1,560	21	700	10	1,075	14	3,230	44	1,875	25
20-49	960	30	505	16	230	7	1,590	49	1,095	34
50-99	355	25	225	17	75	5	520	37	460	32
100-199	155	21	155	21	40	6	240	35	240	34
200-249	35	8	30	7	10	2	70	16	55	13
>250	130	226	160	322	35	25	200	186	240	317

City of London – SMEs

The following chart shows similar data for employees in large and small firms in the City of London. Here we can see that the number of employees working for large enterprises dipped in 2005, but otherwise has risen continuously, from 172,400 in 2001 to 235,700 in 2012. SMEs, on the other hand remained relatively stable between 2001 and 2005, but have since risen, from 86,700 in 2005 to 118,100 in 2012 – a rise of 36% in seven years.

249 employees rose from 2,660 to 2,900 over the same period; and those with over 250 employees rose from 1,450 to 1,580. Work undertaken by Ramidus for the Corporation (Ramidus, 2014) using IDBR data broken down by business size, estimated that there were 10,285 office workplaces with fewer than ten employees in the City in 2013, up from 9,435 in 2012. Similarly, Workplaces with 10-249 employees rose from 2,660 to 2,900 over the same period; and those with over 250 employees rose from 1,450 to 1,580.

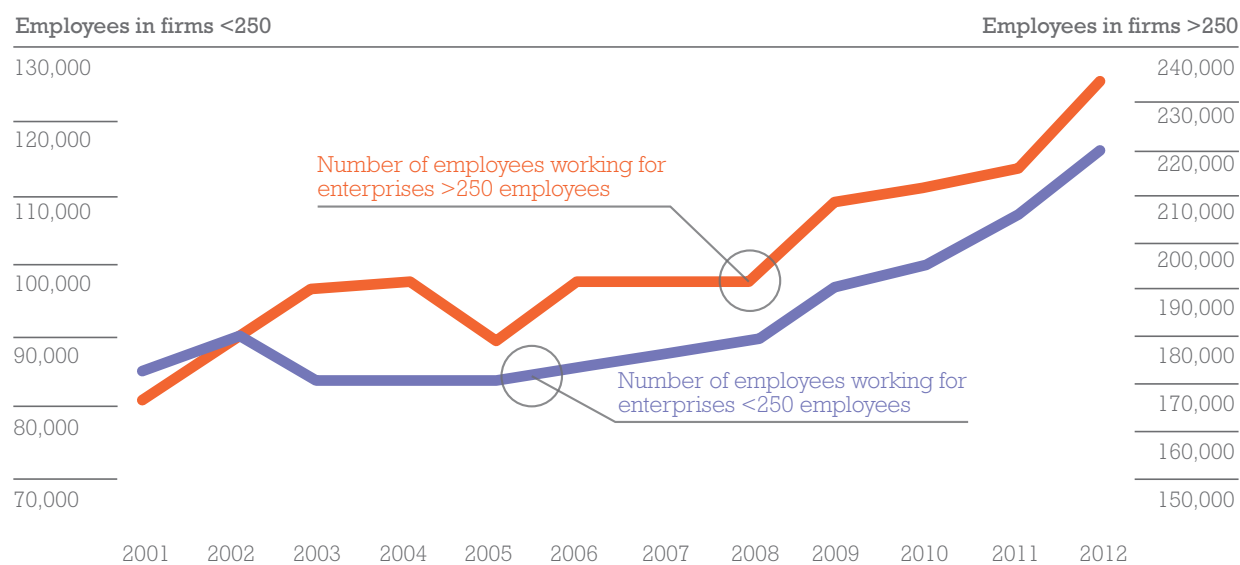
FIGURE 23

Large and small firms in the City of London, 2001-2012

Work undertaken by Ramidus for the City Corporation (Ramidus, 2014) using IDBR data broken down by business size, estimated that there were 10,285 office workplaces with fewer than ten employees in the City in 2013, up from 9,435 in 2012. Workplaces with 10-

FIGURE 23

Large and small firms in the City of London, 2001-2012



Survey of SMEs

The following tables provide supplementary data from the survey of SMEs undertaken for this study.

FIGURE 24

Length of time in the City by sector

Sector	Number of additional staff			Total
	0	1-4	5 -10	
Financial Services	38%	15%	46%	100%
Insurance	5%	10%	86%	100%
Professional Services	0%	20%	80%	100%
TMT	10%	10%	80%	100%
Admin & Support	0%	38%	62%	100%
Wholesale, Retail & Consumer	0%	0%	100%	100%
Overall sample	10%	16%	74%	100%

FIGURE 25

Increase in staff over past five years, by firm size

Size of firm (employees)	Number of additional staff						Total
	0	1-4	5 -10	11-20	21-50	>50	
<10	67%	33%	0%	0%	0%	0%	100%
10 to 20	24%	47%	29%	0%	0%	0%	100%
21 to 49	32%	3%	42%	16%	6%	0%	100%
50 to 99	28%	11%	28%	17%	17%	0%	100%
100 to 249	13%	0%	13%	25%	13%	38%	100%
Wholesale, Retail and Consumer	67%	0%	33%	0%	0%	0%	100%
Total	30%	16%	30%	13%	8%	4%	100%

FIGURE 26

Increase in staff over past five years, by sector

Sector	Number of additional staff						Total
	0	1-4	5 -10	11-20	21-50	>50	
Admin, Real Estate, and Support Services	15%	15%	23%	23%	15%	8%	100%
Finance	29%	14%	29%	10%	10%	10%	100%
Insurance	30%	30%	20%	20%	0%	0%	100%
Professional services	35%	15%	35%	5%	10%	0%	100%
TMT	31%	15%	38%	15%	0%	0%	100%
Wholesale, Retail and Consumer	67%	0%	33%	0%	0%	0%	100%
Total	30%	16%	30%	13%	8%	4%	100%

FIGURE 27

Increase in staff over past five years, by time in the City

Length of time in the City	Number of additional staff						Total
	0	1-4	5 -10	11-20	21-50	>50	
<5 years	25%	0%	50%	13%	0%	13%	100%
5-10 years	15%	31%	38%	0%	15%	0%	100%
>10 years	34%	15%	25%	15%	7%	3%	100%
Total	30%	16%	30%	13%	8%	4%	100%

FIGURE 28

Premises occupied, sq m, by firm size

Firm size (employees)	Square metres							Total
	<100	100-199	200-499	500-999	1,000-2,499	2,500-4,999	>5,000	
<10	33%	0%	33%	33%	0%	0%	0%	100%
10-20	6%	24%	24%	24%	24%	0%	0%	100%
21-49	6%	19%	35%	26%	13%	0%	0%	100%
50-99	6%	0%	22%	28%	28%	11%	6%	100%
100-249	0%	0%	25%	25%	25%	13%	13%	100%
Total	8%	13%	29%	26%	19%	4%	3%	100%

FIGURE 29

Premises occupied by size and sector

Sector	Square metres							Total
	<100	100-199	200-499	500-999	1,000-2,499	2,500-4,999	>5,000	
Admin, Real Estate & Support Services	0%	8%	31%	38%	23%	0%	0%	100%
Finance	5%	14%	24%	29%	14%	10%	5%	100%
Insurance	0%	10%	50%	10%	20%	0%	10%	100%
Professional Services	5%	5%	35%	30%	20%	5%	0%	100%
TMT	31%	23%	15%	15%	15%	0%	0%	100%
Wholesale, Retail & Consumer	0%	33%	0%	33%	33%	0%	0%	100%

FIGURE 30

Space occupied by length of time in the City

Length of time in City	Square metres							Total
	<100	100-199	200-499	500-999	1,000-2,499	2,500-4,999	>5,000	
<5 years	0%	0%	38%	50%	13%	0%	0%	100%
5-10 years	15%	8%	54%	0%	23%	0%	0%	100%
10 years	7%	15%	22%	29%	19%	5%	3%	100%
Total	8%	13%	29%	26%	19%	4%	3%	100%

FIGURE 31

Amenities for staff in the City – e.g. shops, restaurants, leisure facilities – compared with other locations in London

Length of time in City (years)	Much worse	Worse	Same	Better	Much better
Up to 5	0%	25%	25%	38%	13%
6-10	0%	0%	54%	38%	8%
>10	3%	19%	49%	24%	5%
Overall	3%	16%	48%	28%	6%

FIGURE 32

City of London start-ups, 2012-2014

Source: BankSearch, 2015

Sector	2000	2005	2010
Primary, Manufacturing & Utilities	41	36	106
Wholesale, Retail & Accommodation	106	86	108
Transport & Communication	110	101	105
Real Estate, Professional Services & Support Activities	449	399	506
Financial & Insurance	57	42	39
Public Administration & Defence	3	1	6
Education	25	18	13
Health, Social Work, Personal & Community Services	102	109	101
Total	895	792	984

Appendix Four: Acknowledgements

This study was undertaken with the generous help of a number of people who gave their time, shared their knowledge and insights during our research. We would like to acknowledge and thank all of those listed below.

Interviewee	Organisation
Kabir Choudhury	Eddisons
James Danby	British Land
Matthew Flood	Land Securities
Nigel Fuller	Legal & General
David Guttentag	Pearl and Coutts/Structadene
Gerald Kaye	Helical Bar
Tom Kuhn	CoWork
Nick McCalmont-Woods	McCalmont-Woods
James Meikle	Cushman & Wakefield
Richard Morris	Regus
Ian Mulcahey	Gensler
Bill Page	Legal & General
Adrian Penfold	British Land
Freddie Rothwell	CBRE
David Silverman	Derwent London
Shaun Simons	Hatton Real Estate
Charlie Thompson	Farebrother
Jonathan Weinbrenn	Instant Office Group
Matt Yeoman	Buckley Gray Yeoman

Clusters and Connectivity: The City as a Place for SMEs

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