

WHITE PAPER

The SME Telecoms Market

1. Abstract

An SME, or 'Small or Medium Enterprise', is an often used term with a myriad of definitions. There is a formal, statistical definition, based largely on the number of employees, but writers of SME business plans would do better to use a definition which is either based on behavioural criteria - such as a company without dedicated in-house ICT expertise - or one which bears relevance to their own businesses - such as linked to PBX or data networking requirements.

At the end of 2004 the UK had 4.36 million enterprises. If one excludes the 3.13 million which are sole proprietorships or represent the self-employed, then we still have 1.23 million which employ at least one person. 1.04 million are 'micro, leaving 201,000 'small' and 'medium' and 8,200 'large'.

However, SMEs account for 55% of all employment and 44% of turnover. There is great disparity between the distribution of enterprises by size, within the various sectors. For instance, construction, retail and business services include huge numbers of SMEs, but utilities and mining very few.

A Profundus study undertaken first in the mid-1990s and updated in 2000, showed that on average £339 was spent on business telephony per worker. This is an industry where it is widely accepted that the most attractive customers are large companies, it is counter-intuitive to find that the spend per employee varies inversely with enterprise size - that is, the smaller the enterprise the greater the spend per employee.

Further modelling showed that SMEs accounted for two-thirds of all business telephony expenditure in the UK.

The same study also plotted variations by sector and pioneered a means of 'predicting' high spending SMEs, so that they can be identified by sort of criteria included in databases and mailing lists.

All too often, telcos and large suppliers of products and services tend to treat SMEs as just scaled-down versions of their larger customers. This is a fundamental error which often leads to marketing failure. SMEs are very, very different and need to be treated differently. A good understanding of their typical behavioural traits is a key component of success.

Profundus has a reputation for understanding the needs and behaviour of SMEs and advising clients on SME marketing strategies (including the all important channel to market). Profundus SME studies fall into four categories:

- segmentation
- market modelling
- marketing strategies
- sector studies.

2. What is an SME?

'SME', of course, stands for Small or Medium Enterprise. But:

- How small (or medium)?
- In what units is size measured?
- What is an enterprise?

2.1 Enterprises

An enterprise is a legal entity, be it a registered company, a partnership or a sole trader.

It is not a site. So, multi-site companies count as just one enterprise. Very often it would be very useful to measure the number and distribution of sites, for two reasons:

1. Some products are sold on a site-by-site basis; for instance, in the case of PBXs the total available market is far more closely correlated to sites than enterprises.
2. Some sites behave as autonomous decision-making units; for instance, a company might have headquarters offices for management and marketing staff and a remote factory, where each has its own IT/telecoms manager, making separate decisions with distinct suppliers.

So, it must be recognised that an enterprise may represent more than one business opportunity, depending upon the product or service being marketed to it.

2.2 Size definition criteria

The boundaries between 'small', 'medium' and 'large' are usually defined in terms of either employees or turnover. When comparing enterprises across sectors or between countries, turnover is not a very good measure.

For instance it is not very meaningful to compare turnover between, say, a professional services company, with virtually no cost of sales, and a wholesaler, which exists solely to buy products and sell them on at a margin. In some sectors, such as banking, turnover has little worthwhile meaning at all.

Currency fluctuations, along with GDP and PPP disparities, will make international comparisons, even between companies in the same sector, meaningless.

And so the number of employees is generally used as the definition criterion. This, too, is far from perfect, especially in telecoms. Consider, for example, a firm of consultants, in which all the staff communicate with clients and others with great frequency. Then think about an engineering manufacturer, with most of its employees working on the shop floor. A consultancy with 25 employees might spend more on telecoms than a manufacturer with 250.

A few years ago, Profundus Consulting pioneered ways of defining SMEs in terms of their behaviour; for instance:

- how purchasing decisions are made;
- the typography of the owner/manager (e.g. entrepreneur or one of a number of other characteristics);
- growth ambitions (research has shown that 62% of SMEs do not seek growth);
- the number of 'communicators' within an organisation.

In the fourth of these, it is reasonable to consider there to be three types of employee:

- those who depend on communications to do their job (e.g. salespeople);
- those who use communications a great deal (e.g. senior management);
- those who rarely need to communicate (e.g. shop-floor workers).

When a typical profile of companies in each sector is constructed in these terms and an appropriate telecoms revenue generation weighting is applied to each, then a great deal more sense can be made of sector variations.

In many respects the most valid boundary between an SME and a 'large' enterprise is in terms of the first of the above behavioural criteria. The most useful definition of all is that an SME is one without dedicated in-house IT/telecoms expertise. It is in these that the owner/manager makes the purchasing decisions (or sometimes the admin or accounting manager). Then the investment and selection criteria are totally different to the case where a professional evaluates the options.

A further group of valid definition criteria are specific to the data need. For instance:

- a telco might define SMEs in terms of number of telephone lines;
- a PBX manufacturer in terms of the number of telephone extensions;
- a supplier of IP products and services in terms of the number of PCs.

In the ideal world Profundus will define for its clients an SME in the most useful terms for that client and map onto that definition data taken from available statistics.

2.3 A common denominator

The national statistics offices of most developed countries formulate statistics on the number of enterprises in that country. In the UK, the Small Business Service of the Department of Trade and Industry publishes annual data in the following employee size bands:

0 (that is, sole traders)	50 - 99
1- 4 employees	100 - 199
5 - 9	200 - 249
10 - 19	250 - 499
20 - 49	500 +

Other countries choose different bands. However, Eurostat, the statistics office of the European Commission, collects data from each member country and publishes it in a standardised format. For this purpose, Eurostat defines 'micro', 'small', 'medium' and 'large' enterprises according to the criteria shown below.

	<i>micro</i>	<i>small</i>	<i>medium</i>
Maximum employees	9	49	249
Maximum turnover	€ 7m	€ 7m	€40m
Maximum balance sheet	€5m	€5m	€27m
(maximum ownership by other enterprise(s) not satisfying the same criteria: 25%)			

The turnover criteria included in this definition are principally to remove anomalies; for instance, a holding company with only a handful of head office staff might own several large companies, yet it would be ridiculous to describe the holding company as an SME.

This Eurostat definition has been adopted throughout Europe, even in countries like Switzerland and Norway which are not in the EU, and it has become the standard European definition of the SME market and its subdivisions.

2.4 Other SME definitions

'SoHo' (Small Office / Home Office) is a term in common use, yet this has no official definition. It is generally taken to mean enterprises at the lower end of 'small': 0-3, 0-5 or 0-9. 0-9 is the most useful to adopt, since it is then synonymous with Eurostat's 'micro' and statistics are widely available.

Sometimes 'teleworkers' are regarded as SMEs. We would advise against this, since most teleworkers have little choice over what products and services they use in their homes; these decisions are made by their employers, more often than not large companies. So, teleworkers have little in common with the self-employed.

The US definition of an SME should be mentioned. Officially, 'small businesses' are those which employ between one and 99, while 'the middle market' covers those employing between 100 and 999. In the telecoms market, for most purposes, these boundaries are unhelpful since middle market companies will behave in a very similar manner to large companies and there is no distinction between micro/SoHo and other 'small'.

Finally, there are many proprietary definitions of an SME, such as BT's 3-500 employees. This might seem but a minor departure from the standard Eurostat definition, but its impact is great when comparing statistics - it excludes about 2.8 million enterprises employing up to two staff, 75% of all SMEs!

3. The size of the UK SME market

The following summary data is taken from the latest Statistical Bulletin of the UK Small Business Service.

3.1 By enterprises

At the start of 2004 UK there were 4.36 million enterprises, divided thus:

micro (sole proprietorships and the self-employed)	3.13 million
micro (1 - 9 employees)	1.04 million
small (10 - 49 employees)	171,000
medium (50-249 employees)	28,800
large (250 + employees)	8,200

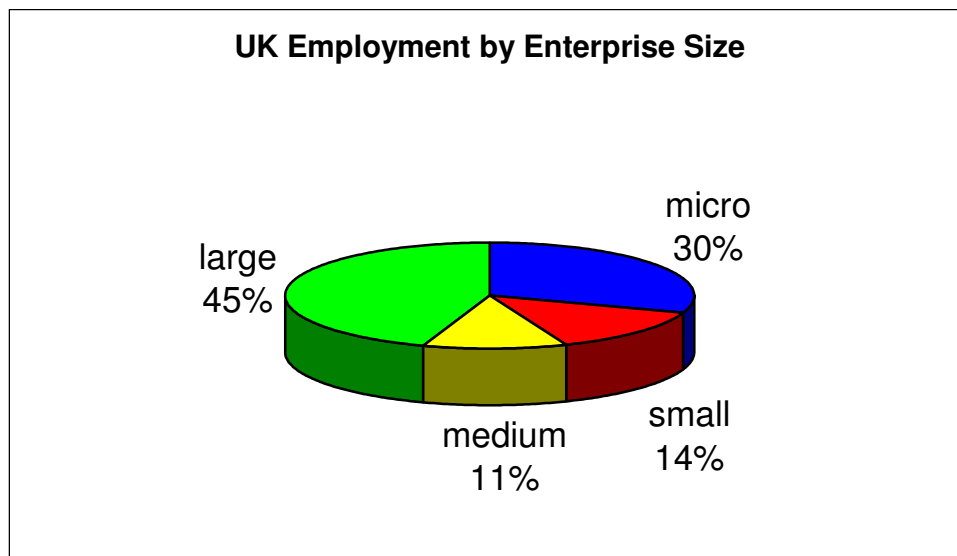
The first point to note is how the UK's 4.36 million businesses are dominated by micro enterprises. Indeed, all but 1.23 million are 'zero employees' (i.e. sole traders).

The second point concerns medium-sized companies. There are not really very many of them! Many telecoms operators and equipment suppliers that have traditionally marketed to the corporate sector, but have become disillusioned by the tough competition and wafer-thin margins, have turned to the SME market for salvation. They decide 'medium' is their first goal, but have difficulty finding the mass market. This is because the 'medium' segment is not a mass market; it is almost as selective as the large business segment.

The real mass market is small enterprises. These companies, with less than 50 employees, can be significant customers, and there are 171,000 of them.

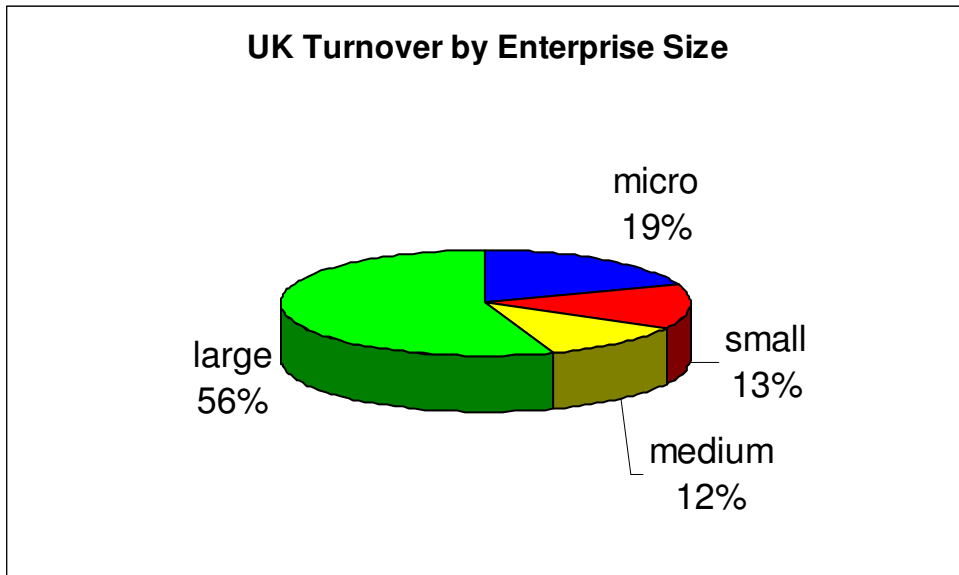
3.2 By employees

A much clearer picture emerges if, instead of looking at the number of enterprises, we look at how this country's 24.7 million employees are distributed within those enterprises. This shows that 55% of all UK workers are employed by SMEs.



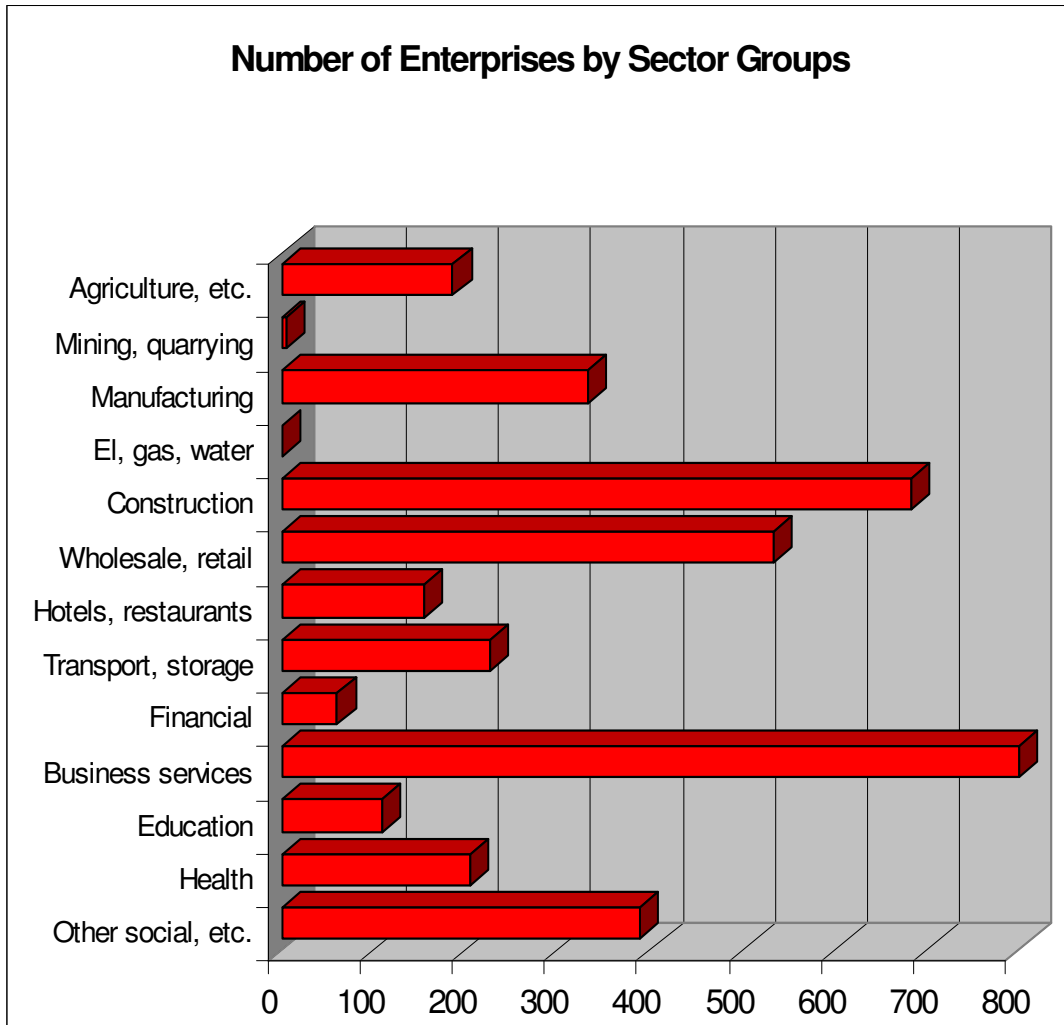
3.3 By Turnover

The picture for turnover (the total of which is £2.5 trillion) is similar, but is more biased towards larger enterprises and away from micros.



3.4 Enterprises by sector

As can be seen below, there is a very wide disparity between the number of enterprises by sector groupings.



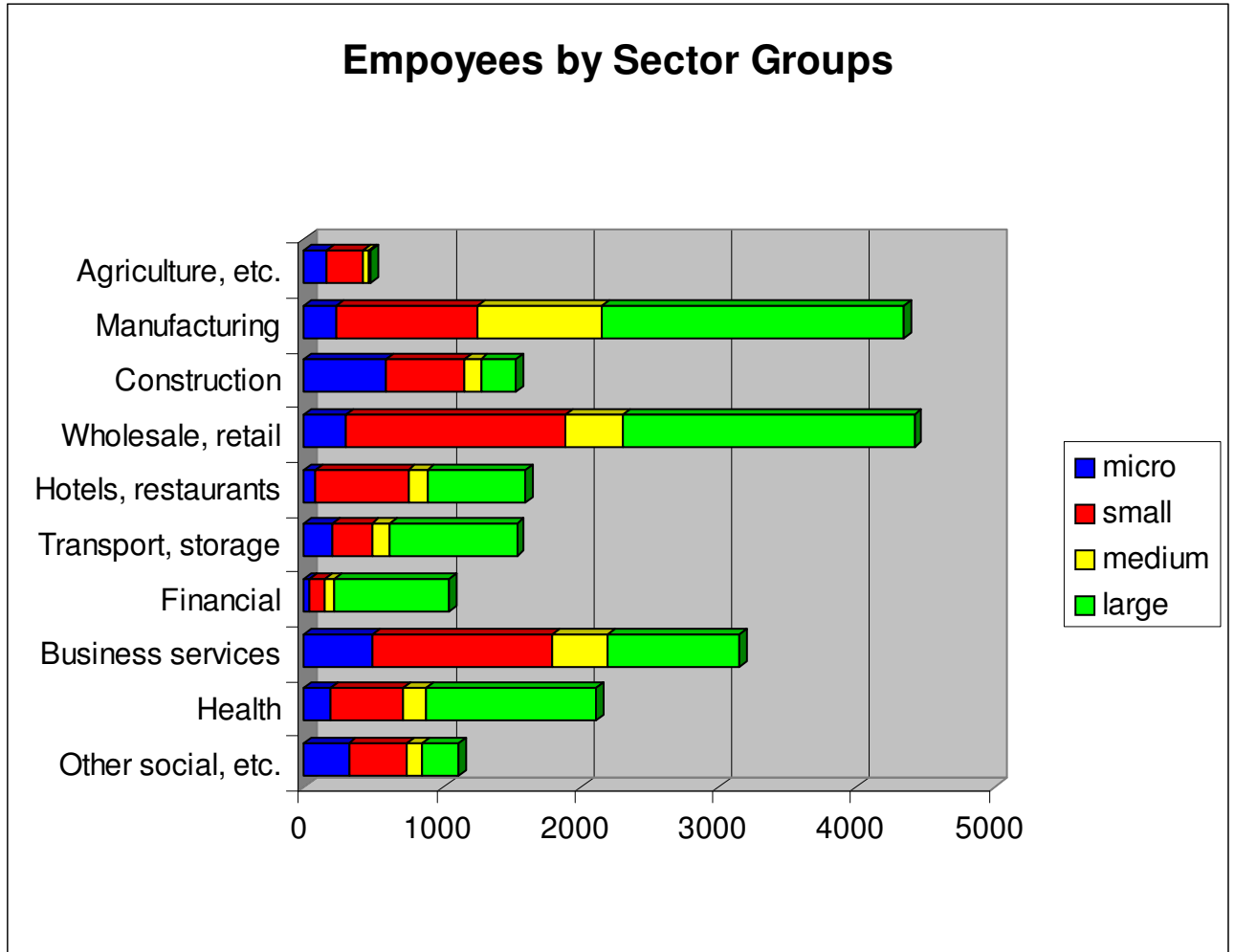
The largest, numerically, are:

- business services, owing to the very large number of self-employed and small partnerships;
- construction, again because of the tradition of self-employed labourers and craftsmen;
- retail and wholesale - most shops are still small, single units.

On the other hand, there are very few small utilities or mining companies!

3.5 Employment by sector

A more interesting pattern emerges when enterprises are substituted by employees. The chart below omits the three sector groups with very low numbers of employees: Mining and quarrying, Electricity, gas, water and Education.



This demonstrates how it is manufacturing and wholesale/retail that dominate in terms of employment, though in both cases about half of employees are in large enterprises. The number of SMEs in business services is about the same as these two.

3.6 The value of the SME segment to telecoms operators

Profundus has built a model of the UK SME market. A survey ascertained how much each of 1000 SMEs spent on telecoms services. From this data it was possible to calculate variations from the mean per employee and, from the available market statistics, calculate the value of the market. This model was later updated with data from 1999/2000 and a summary is produced below.

Of tel's 'Market information Update' shows supply-side data for July 1999 to June 2000 in respect of business telephony:

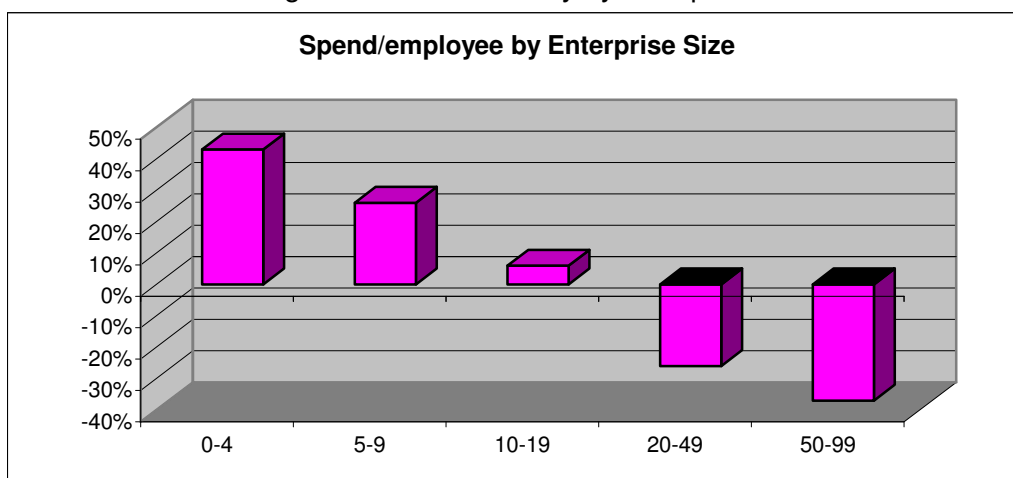
Fixed line calls	£ 4179 m
Lines and connection	£ 1718 m
Mobile (one quarter)	£ 1470 m
TOTAL	£ 7367 m

Mobile revenues are not split between business and residential. We have arbitrarily attributed one quarter to business, which is believed to be about right.

From this total and using market data totals, simple arithmetic gives us:

- 3.7 m enterprises spend on average £1991 pa on business telephony
- The average for each of 21.7m employees is £339 pa.
- The proportion of business turnover spent on telephony is 0.34%.

The figure of £339 pa - the average spent on business telephony per worker - is key. This is because the average varies considerably by enterprise size:



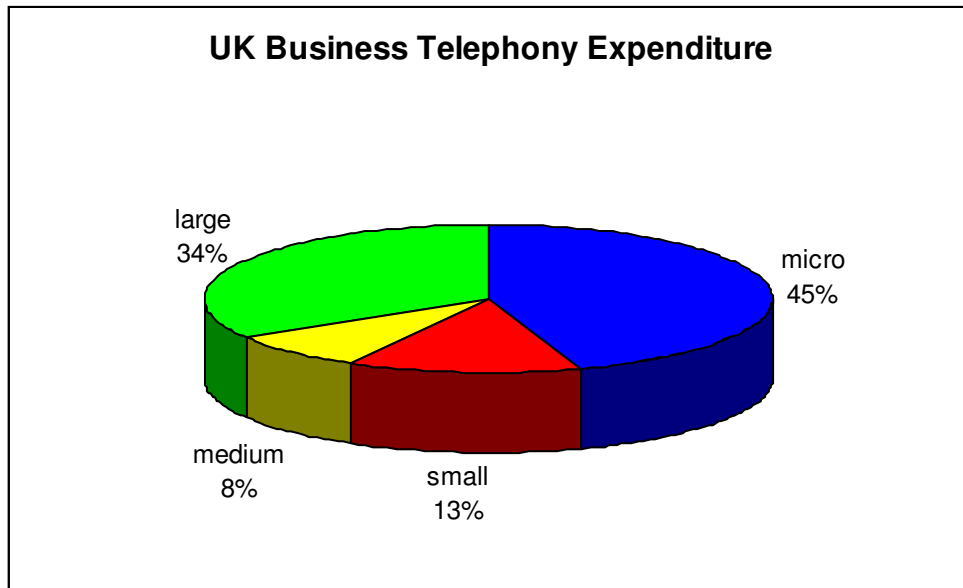
Telecoms is very much an industry where 'big is good' and it is macho to pursue large company business. So it comes as a considerable surprise to many in the industry that, in spend/employee terms SMEs are well ahead of the corporate segment.

Why do SMEs spend more per head on telecoms? The most important reason is that the smaller the enterprise the greater the proportion of communication is external. At the other end of the scale, in large companies, most communication is internal, so spend on public services is limited.

Two other, minor reasons can be added. Firstly, there are fewer economies of scale available to SMEs - for instance, to have a private network between sites; secondly, fewer discounts are available to SMEs.

One further note: beyond 100 employees, as we get into the 'medium' bracket' and towards the 'large' enterprises, average expenditure per employee then rises again slightly. This might be because of call centres, freephone numbers, etc.

So, to recap: 55% of UK workers are in SMEs (and, indeed, 30% in micro enterprises) and the smaller the company the greater is its spend per employee. The end result of these two pieces of data is that two-thirds of business telephony expenditure in the UK is accounted for by SMEs:



4. Key characteristics of SMEs

The most common error committed by telcos is to regard SMEs as just scaled-down large businesses. In fact, their decision-making, sources of finance, attitudes to technology and purchasing behaviour are all very different.

The defining characteristic of a small business is that the owner/manager makes the decisions. He/she is interested in the business and its problems, not in your technologies, products and services. The classic case-study illustrating this principal is from the early days of frame relay. Though eminently suitable for LAN interconnection, it was slow to take off in every European country except Finland.

Profundus set out to find why and discovered that it was usually sold as an exciting new technology. Brochures and salesmen told of packet size, CIR ('Committed Information Rate') and an immensely complex set of tariffs. However, Telecom Finland took a different approach, just advising customers of a new, cost-effective means of interconnecting LANs. Frame relay was not even mentioned and the price list was straightforward. Customers saw it as an improvement on expensive private circuits and bought the new service.

A large company will have a telecoms manager - or even a department - whose job it is to understand technologies and produce spreadsheets demonstrating cost savings. The SME owner/manager will measure the impact of an investment in more customer enquiries, fewer complaints, a more professional image, etc., not in terms of tangible cost savings.

Hence, SME decisions can often be surprisingly swift, but the process is sometimes disparagingly referred to as 'seat of the pants'.

The second myth to be exploded is that SMEs all want to grow, like acorns, into big oak trees. Big companies generally measure their success in terms of growth and they assume that their customers do as well, but research has shown that only about one third of SMEs seek any growth - and a much smaller proportion still desire to become sizeable corporations. A third wish to remain the same size (many SME founders rate quality of life and enjoyment as highly as profit) and the remainder are trying just to survive, are willing to shrink or want to sell-out.

So, promotions emphasising how a product and service will help you grow big will largely fall on deaf ears.

SMEs - at least in Europe (the USA differs) - are quite conservative. They do not like to experiment; they are more comfortable with proven solutions. This has an important implication for suppliers, since all that is normally required is a re-packaging of existing products and services.

Profundus research has confirmed that a phenomenon found in other industries is equally applicable to telecoms: brand counts for far less than suppliers and their advisors would like to believe. SMEs are rarely impressed by the big name. Rather, they seek suppliers who are prepared to understand their business problems and to provide sensible solutions backed by good support. This is why local dealers have achieved such good acceptance in the IT sector.

Although price - or rather value for money - figures highly in SMEs' buying criteria, they are very loyal to suppliers providing a good service at a reasonable price. This explains why BT inertia sales to SMEs are so strong.

Only with a good understanding of SMEs' characteristics and behaviour can a working SME marketing strategy be properly developed.

5. Profundus Services

Profundus specialises in market studies, segmentation and market modelling. Through some ground-breaking studies during the last decade, Profundus has developed a reputation for understanding the needs of SMEs and advising clients on SME marketing strategies. Studies undertaken by Profundus fall into four categories:

Segmentation

The SME market is very large and diverse. To be profitably exploited a degree of sensible segmentation is usually necessary. It is easy to segment by size or sector. However, these are parameters that mask the true value of an SME customer - for instance, in telecoms terms a business services enterprise employing 50 staff might be a more desirable customer than a manufacturing concern with 500.

Segmentation by spend is a worthy goal, but one that is very difficult to one to achieve. Profundus has found that behavioural segmentation, such as degree of entrepreneurship or willingness to become an early adopter of new technologies, are often the most useful.

Market modelling

Many Profundus clients need to know how large is the SME market, or the segment of it which they are addressing, and how it will grow and change. Profundus has extensive experience of such modelling.

The objective of one, a multi-client study, generated predictors of high-spending SMEs. These were of great value to the group of telcos among its sponsors.

Marketing strategies

SME marketing across Europe is, on the whole, appalling. It is poorly understood and badly executed by the majority of telecoms operators and many equipment suppliers. Satisfaction surveys demonstrate this. There are still opportunities for new entrants to strike at the 'soft underbelly' of incumbents and dominant suppliers.

In particular, channel to market and the development of lasting relationships are the issues which need to be addressed most urgently. Only a sound understanding of SME needs and successful strategies elsewhere can provide the impetus to improve.

Sector studies

SMEs do not want to buy technologies; they want solutions to their business problems. Because problems - and opportunities - tend to be fairly consistent within sectors it often pays to create SME solutions on an industry-by-industry basis. Profundus has a wealth of experience within key SME sectors.