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Modes of firm growth

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Background

There is now a general consensus that high growth firms (HGFs) are economically important, and governments across the world have targeted resources to help firms achieve high growth. Yet while there is a large evidence base on the nature of HGFs, little research considers 'how' potential HGFs are trying to grow and 'what' is preventing firms from achieving sustained growth (i.e. the barriers firms face to sustain a longer period of rapid growth).

This report aims to better understand the nature of growth processes within high growth firms (HGFs). A HGF is defined by the OECD as '*an enterprise with average annualised growth (in number of employees or turnover) greater than 20% per annum, over a three year period, with a minimum of 10 e employees at the beginning of the growth period*' (OECD 2008, p. 61).

The report has three main components: (1) a review of the literature on HGFs and their growth paths, (2) data analysis using the ONS Business Structures Database to investigate how HGFs grow, and (3) a series of interviews with HGFs and potential HGFs about how they have achieved growth.

Findings

Literature Review

The literature review found that despite decades of firm growth research, we still understand relatively little about the growth process in firms. While entrepreneurship researchers have been examined the question of 'how many' firms grow rapidly, little attention has been focused on 'how' firms grow.

In the past, firm growth was meant to correspond with a linear model where firms undergo sequential phases of growth similar to the human life-cycle. In recent years there has been a significant shift away from this perspective: instead of transitioning through relatively orderly growth stages, rapid growth is seen as erratic, unpredictable and often limited in duration.

Recent academic literature has stressed the importance of key episodes during firm growth which play a strong role in shaping the growth trajectory of firms. Bursts of growth have been found to result from external growth opportunities or "growth triggers". These triggers may result in erratic growth or relatively rapid decline.

Data Analysis

Our data analysis shows that firms have a variety of growth trajectories. We show that 41% of HGFs were already growing in the period before their high growth spell. In contrast, 25% of HGFs achieved high growth from a standing start – without having experienced employment growth in the period before. A minority of firms (14%), had been shrinking in the period before high growth. 20% of HGFs were startups, newly founded firms that entered the market one or two years before the start of the high growth period.

However, it is very difficult to sustain high growth. Almost half of HGFs decline or cease to exist after their rapid expansion, with 40% of HGFs experiencing shrinkage and 6% dropping out of the market – 'Icarus firms' which experience rapid growth, but then fall quickly. 17% of firms manage to sustain their size after rapid employment growth while 37% continue on their growth trajectory.

Firms in the hotel and restaurant sector are most likely to decline after their high growth period, with 55% of firms declining or exiting. The high share of financial intermediates that exit the market after a high growth period is also notable. However, the share of financial intermediates that continue to grow after a period of high growth is also the highest across industries, indicating a larger variation in the ability to cope with high growth than in other sectors.

Larger firms are more likely to shrink following their high growth spell, while younger firms are more likely to exit the market (as a business failure or by being taken over). The highest exit rate (10%) is for firms born two years before experiencing high growth. In other words, start-ups who grow rapidly are the most likely firms to encounter difficulties in terms of business continuity.

Qualitative Findings

We also interviewed firms to investigate how they had achieved growth. The interviews showed a very diverse picture. No one mode of growth dominated. For many of the firms interviewed, product innovation, diversification and internationalisation had only played a relatively small role. By contrast, investment in human and managerial capital and the strategic use of business models was important for the firms interviewed.

The “growth triggers” varied. For a significant minority of firms, introducing a new product was important. Others had improved their processes and used this as a trigger to further growth. But one common theme was a changed mindset amongst the entrepreneurs: many had a reasonable business, but had later decided to focus on growth and entered new markets. However, growth itself caused problems. One key barrier to growth noted by the interviewees was coping with the uncertainties entailed with rapid growth and the erratic nature of growth.

In terms of perceived support requirements, the greatest demand seemed to be access to finance, especially to ease problems associated with cash-flow. Support for management to help navigate the growth process was identified as a key factor to enable firm growth to continue.