

## White Paper No.6

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# FIRM DYNAMICS AND JOB CREATION IN THE UK: TAKING STOCK AND DEVELOPING NEW PERSPECTIVES

**Michael Anyadike-Danes Mark Hart and Jun Du**  
Enterprise Research Centre and Aston Business School  
Aston University, Birmingham, B4 7ET, UK

m.anyadike-danes@aston.ac.uk  
mark.hart@aston.ac.uk  
j.du@aston.ac.uk

#### Overview

A consistent theme in the discussion of attempts to stimulate economic recovery in the UK is a recognition of the need to unlock the growth potential of the private sector. We are motivated in this White Paper by a very simple question – “*what types of firms create the most jobs in the UK economy?*” We then ask a further pair of questions – “*to what conclusions does the evidence lead us?*” and “*what are the choices for policy?*” This White Paper is our first step in bringing together the existing evidence on job creation to inform the discussion of these questions. An obvious corollary question is the extent to which those firms creating the most jobs are also the most productive. However, that will be addressed later in the research programme. For now our review of the evidence has identified three perspectives on the job creation process in the UK focusing on employer-only businesses. These perspectives will provide the foundation for our exploration, at a later stage, of the contribution of fast-growing small businesses to UK productivity growth.

#### ***A Traditional Story of Job Creation and Destruction***

Using a widely accepted methodology we have set out some of the dynamics of that process using some high-level metrics on job gains and losses. In the UK just over a quarter (28.0 per cent) of all

jobs in the private sector were either destroyed or created over a typical 12 month period between 1998 and 2010 – a remarkable level of turbulence in the UK economy.

The majority of jobs in the UK were created by small firms (i.e., less than 50 employees and including micro-enterprises); and these firms also recorded the most churn - the sum of job creation and destruction - which has intensified since 2008. Since the late 1990s smaller firms have been increasing their share of total employment year on year and in 2010 their share was triple that of 1998.

The job creation and destruction metrics are relatively stable over time - even the economic downturn after 2008 did not affect the overall scale of job creation and destruction taking place in the UK economy. Moreover, the metrics on job churn for the US are quite similar to those of the UK over the last decade.

### ***High-Growth Firms and Job Creation – A Closer Look***

We have taken a fresh look at the UK data on the number of jobs HGFs create. Situating HGFs within the job creation contributions of ALL job creating firms in the private sector over three years: the question is a simple one - “*What proportion of job creation is contributed by high growth firms?*” Focusing on **all** job creating firms in the 2007-10 period we find that the relative contributions of other groups of firms were as follows in the same period:

- **New firms (born between 2007 and 2010):** 61% of job creating firms and 36% of job creation
- **Small and Larger firms – non-HGF (10 or more employees):** 6% of job creating firms and 22% of job creation
- **High-Growth Firms:** 1% of job creating firms and 22% of job creation
- **Micro-enterprises – non-HGF (less than 10 employees):** 27% of job creating firms and 15% of job creation
- **Young firms (born in 2007):** 5% of job creating firms and 5% of job creation

Clearly HGFs are *relatively* the most prolific category of job creating firms. However their closest comparators – the larger non-HGFs – are quite prolific too. The point is, surely, that definitions are important, and that summary statements which gloss over the detail of the definitions may seriously mislead researchers and policymakers alike.

### ***Job Creation Re-Visited - From Growth Rates to Growth Trajectories***

Stepping away from growth as the central concern towards 'growth trajectories' allows us to capture the interplay between growth and survival. We have uncovered '**five brutal facts of UK business demography**'.

1. every year a large number of private sector firms are born in the UK ~ typically between 200,000 and 250,000
2. most new born firms are very small ~ around 90% have less than 5 employees
3. a decade later between 70% and 80% of those new born firms will be dead
4. a cohort is born with about 1 million jobs ~ a decade later the survivors employ just half a million
5. of those which have survived to age 10 ~ around 75% of those born with less than 5 employees will **still** have less than five employees

We knew already from the standard accounting by the job creation and destruction components that births and deaths of firms are responsible for a considerable amount of churn, but what the 'brutal facts' remind us is that much of this churn is age-related. It provides a pointer to the dynamic underpinning to the evolution of the stock of firms in the economy over time: as each new 'wave' of firms is born, firms from earlier waves die away.

### ***Policy Discussion***

Missing from this set of 'facts' is an understanding of the processes which drive them, which is required if we are to develop a robust set of policy interventions. In the meantime what can we usefully say about the policy implications? There is an obvious tension in existing policy discussions between the focus on developing the growth potential of existing firms and the promotion of start-ups (particularly by certain under-represented groups e.g., young people). Our evidence suggests that both start-ups and established businesses have rapid growth potential.

### ***Immediate Next Steps***

Our research programme over the next three years is designed to build a more robust set of job creation metrics on which we can build a better understanding of the drivers of both employment and productivity growth at the level of the firm. An important dimension of this will be a closer look at churn rates and the extent to which they might help us understand the growth trajectories of what is always a heterogeneous small business sector.

The research will be connected to the themes on innovation and exporting as well as finance, through a range of firm-level data-linking work, which will assist us to develop a profile of the most prolific job creators in the UK economy. We will also seek to extend our analysis beyond employer-only businesses and incorporate datasets which include the self-employed – to examine their contribution to the job creation story in the UK.