ERC *Insights*

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UK's Hidden Growth Champions

The Enterprise Research Centre (ERC) has developed an alternative approach to identifying groups of fast-growing firms which contribute disproportionately to job creation and output. This will have significant implications for policy discussions on the relative importance of SMEs and which types of firms drive growth in the economy.

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What do we mean by fast growth?

The starting point for most discussions of fast-growth is the OECD High-Growth Firm (HGFs) definition. This definition is clear but its value is debatable. For example, the OECD definition of high growth excludes firms with less than 10 employees and any jobs created by new firms over a three-year period arbitrarily chosen for the HGF metric. The first published calculations for the UK using the OECD definition found that HGFs represented around 6% of all UK private sector firms with more than 10 employees, hence the 'Vital 6%' [1].

Using a slightly improved version[2] of our UK longitudinal business demography dataset we have now updated this analysis and extended it to cover the period of the recent economic downturn up to 2013. We do this solely to provide the most recent data on the metric for the UK to aid international comparisons. These results for the number of HGFs and the HGF incidence rate on the OECD definition were reported earlier in 2014[3].

In summary, the incidence rate of HGFs averaged 7.2% over the period between 2002-05 and 2007-10 and then dipped to an average of 5.9% in the period of economic downturn before 'bouncing back' to 6.6% in 2010-13. So, in broad terms, the ‘vital 6%’ construct, as measured using the OECD definition, survived the most severe post-war economic shock. There were 10,172 HGFs in 2010-13, one thousand more than in the preceding two periods, and back to pre-2008 levels.

Which Firms Create Jobs?

The earlier observation in 2009, that HGFs, as defined by the OECD, create around half of net new jobs, now seems to be treated as a ‘stylised fact’ in policy discussions. However, we need to be clear that this ‘*fact*’ relates not to *all* new jobs but purely those in firms with more than 10 employees over an arbitrarily chosen 3-year period. It ignores any new jobs created by micros and by new firms and is, as a consequence, misleading[4].

As a first step in providing more informative evidence for policymakers we revisited the official ONS data and asked the question ‘which types of firms have been creating jobs since the economic downturn in 2008?’ The headline conclusion is that a small group of small businesses (new, young and established and in all sectors of the economy employing fewer than 50 employees), accounting for less than 1% of the total business population, account for a large proportion (36%) of net job creation between 2008 and 2013.

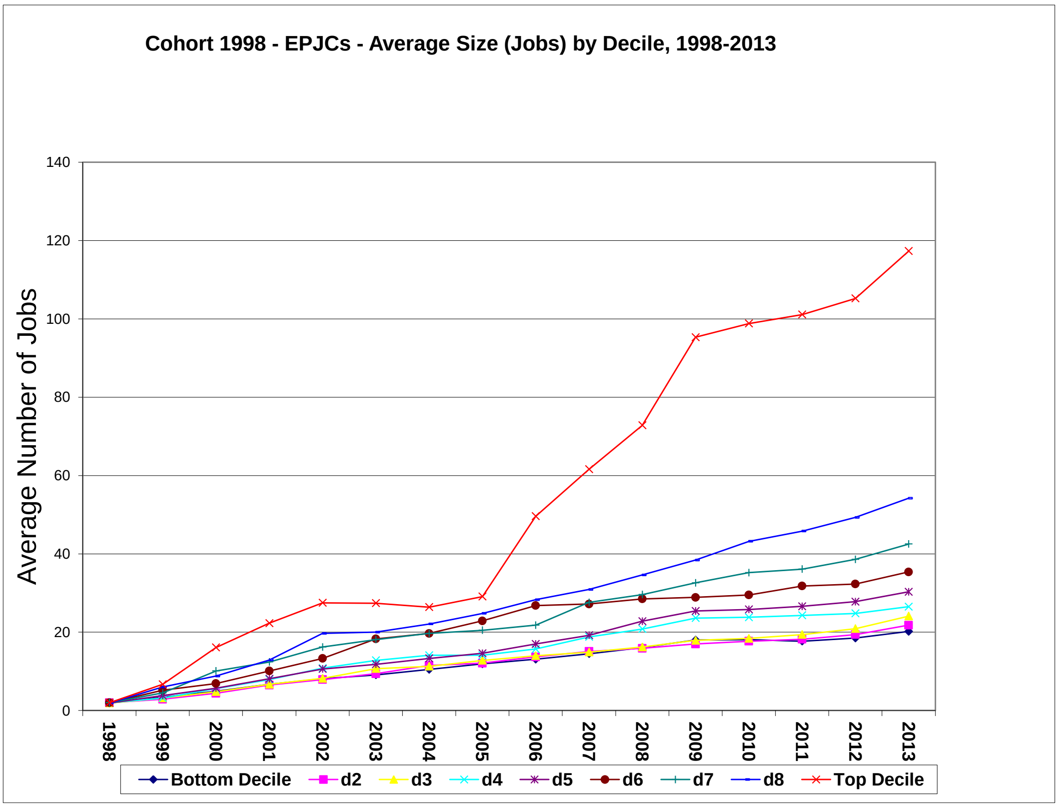
The UK’s hidden growth businesses

But what happens if we look at growth over a longer period, recognising that firms have periods of fast growth followed by periods of slow or no growth and periods where they scale back? Looking at ‘growth trajectories’ - our shorthand term for the dynamics of job creation over a firm’s life - rather than growth rates as the central concern (the preoccupation of the OECD HGF metric) better captures the interplay between growth and survival and the episodic nature of firm growth. It provides a different approach to measuring the contribution of rapidly growing firms to job creation and economic growth.

If we focus on a cohort of start-ups in 1998 and follow them over 15 years (1998-2013), we find that just 11% of start-up firms born in 1998 survived until 2013. By 2013 these firms had about 390,000 employees, up from about 160,000 at birth. Although, taken together, the survivors have added about 230 thousand jobs this is a ‘net’ figure:

some firms will have added jobs; some shed jobs; others will have exactly the same number as they had at birth[5].

In fact, about 60% of these surviving firms are job creators and the bulk of these job creators (like the bulk of firms) were born very small, with less than five employees and most of them remain very small and create very few jobs. Within the class of very small firm start-ups (those. with less than 5 employees in 1998) there is, however, a small group (6% of them: 1,248 firms) which are **extraordinary prolific job creators (EPJCs)**. Between them they accounted for 90,000 added jobs, about 40% of all job creation, and they can be found in all sectors of the economy. Even within this small group of firms we find that there is an even smaller number of 100 or so firms who have really employed a lot of people especially since 2005 (Figure 1).



Taking the same longitudinal approach but looking at revenue generation as opposed to employment growth, we have also identified another group of 1,224 firms who started out with sales of less than £100K in 1998 (aggregate turnover in 1998 was £83m) and by 2013 their sales exceeded £9.6bn. These **extraordinary prolific revenue generators (EPRGs)** come from all sectors of the economy and they also now employ 44,000 people – and we know that 40% of EJPCs are also in this group.

Despite their obvious importance to economic growth these long-lived EPJCs and EPRGs are likely to have been excluded at times from the OECD definition of high growth due to the episodic nature of their growth over a 15 year period!

Having identified this group of small firms, what, if anything, can we learn from reverse engineering the growth strategies of these quite remarkable firms? We have an opportunity to reveal an invaluable story of quite phenomenal growth over a very varied and challenging macro-economic environment and are now undertaking further analysis to understand in more detail the key drivers of their growth using a range of business surveys to explore such issues as the role of innovation, exporting as well the relative importance of organic growth and growth by acquisition.

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[1] Anyadike-Danes, M., Bonner, K., Hart, M. & Mason, C. (2009) *Measuring business growth: high growth firms and their contribution to employment in the UK*. London: NESTA; NESTA (2009) *The Vital 6 per cent: How high-growth innovative businesses generate prosperity and jobs*, NESTA, London.

[2] The newer version of the dataset has, amongst other improvements, a better algorithm for determining births and deaths and produces smaller numbers of HGFs and slightly higher estimates of the incidence rate.

[3] Hart, M and Anyadike-Danes, M (2014) “Moving on from the ‘Vital 6%”, Enterprise Insight Paper, (February)

[4] Hart, M and Anyadike-Danes, M (2014) *op cit.*

[5] Anyadike-Danes, M and Hart M. (2013) "Extraordinarily prolific job creating firms: the OECD high growth firm metric in perspective", conference paper, RENT XXVII - RESEARCH IN ENTREPRENEURSHIP AND SMALL BUSINESS, Vilnius, November (available on request).