Policy Briefing

Fast-growth firms and their wider economic impact: UK evidence

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Small groups of fast-growth firms make a significant contribution to job creation and economic growth. Yet we know little about their broader impact on the economy. This research investigates how the number of fast-growth firms in a region and industry impacts on growth of other firms.

By linking the ONS Business Structure Database (BSD) with additional data at the industrial and regional level over the period 1997-2013, we test different channels of wider effects of fast-growth firms in the manufacturing and professional service sectors. They are horizontal industrial spillovers within an industry, vertical spillovers between upstream and downstream industries, spatial spillovers and gravity forces.

We examine fast-employment-growth firms (based on OECD high-growth firm definition) and fast-productivity-growth firms (based on labour productivity-based super-growth hero definition) to capture a wide business population and identify different growth channels.

Key findings

1. Fast-growth firms exert varied effects on the growth of other firms across the regions, even after controlling for industry-region specific characteristics, summarised as follows:
2. Fast employment growth externalities in the manufacturing sectors:
   - Higher incidence rate of fast employment growth firms has an overall negative effect on the employment growth of other firms in the same industry-region (a competition-led crowding-out effect).
   - A fast-growth incidence rate of 1% leads to overall slower employment growth by 0.35% in the same manufacturing industry in the same region, *ceteris paribus*. This translates to almost 122,000 jobs across the UK.
   - However, an increase in demand for services and products by fast-growth firms has a positive market-creating effect on employment growth in the upstream sectors (suppliers).
   - The strongest negative effects are found in peripheral rural areas (e.g., the Highlands, Cheshire, and north-east England). The major urban areas (e.g., Surrey, London, and Kent) experience the most positive spillover effects from an increased incidence of fast employment growth firms.
   - The effects are particularly strong on small and old non-fast-growing firms, especially in the medium-low tech sectors.

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3. Fast labour productivity growth externalities in the manufacturing sectors:
    - Higher incidence rate of fast labour productivity growth firms has overall positive externalities on other firms' labour productivity.
    - A 1% increase in fast-growth incidence results in a 1.5% increase in the average labour productivity of non-fast-growth manufacturers.
    - The effects are particularly strong on firms closer to market.
    - The fast labour productivity external effects are more evenly distributed across regions than the fast employment growth externalities are.

- Our analysis on the professional service sectors yields different patterns from the manufacturing sectors. We find positive, market-creating impact of high-employment-growth firms on employment growth within the same region and industry, and market-replacing effects from suppliers in the value chains, while negative spillovers of high-productivity-growth firms on other firms in the same region and sector, and positive spillovers along the value chains. These different patterns highlight the distinct features of these sectors and the specific challenges faced by the firms in the context of rising competitive pressure, digital economy and disruptions of business models.

Policy implications

- Achieving job creation and promoting productivity at the same time may prove challenging. National and subnational policy-makers need to be mindful of this tension, and may require prioritising one over the other given specific circumstances in an industry-regional economic and social context.
- Overall, the externalities of fast growth firms in the manufacturing sectors seem to show that in the short run, more fast-productivity-growth firms are beneficial to other firms, potentially due to competition effects and knowledge spillovers, while more fast-employment-growth firms may put a strain on other firms' abilities to attract skills and labour.
- In professional service sectors, fast-productivity-growth firms have market-replacing effects, while fast-employment-growth firms have market-creating effects. These findings reflect the distinct features of these sectors and the specific challenges faced by the firms in the context of rising competitive pressure, digital economy and disruptions of business models.
- Therefore, targeted growth policies can be compounded in their impacts by maximising positive spillovers through a focus on industrial clusters (to exploit the benefits of geographical agglomeration) and vertical integration, whilst at the same time taking in to account regional limitations which could lead to negative spillovers arising due to competition-led crowding-out.
- The mediating factors of the external impact of fast growth firms include the industrial characteristics, the position in the value chain, firm age and size, specific geographical location, and the degree of agglomeration. They inflate or reduce the externalities and may be considered when designing policy instruments.

- Further investigations are needed to better understand the mechanisms of the external effects of fast-growth firms, and what appropriate measures need to be taken to promote long-term balanced growth.

Full paper link: https://www.enterpriseresearch.ac.uk/our-work/publications/