Business Dynamism and COVID-19 – an early assessment

ERC Insight Paper

April 2020

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The Enterprise Research Centre is an independent research centre which focusses on SME growth and productivity. ERC is a partnership between Warwick Business School, Aston Business School, Queen's University School of Management, Leeds University Business School and University College Cork. The Centre is funded by the Economic and Social Research Council (ESRC); Department for Business, Energy & Industrial Strategy (BEIS); Innovate UK, the British Business Bank and the Intellectual Property Office. The support of the funders is acknowledged. The views expressed in this report are those of the authors and do not necessarily represent those of the funders.

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ABSTRACT

How will Covid-19 affect business dynamism in the UK? Although, this question is yet to be answered, this paper aims to provide an early assessment by comparing company incorporations and dissolutions in the first quarter of 2020 with the same period in 2019 using the latest available data from the FAME dataset. We observe a drop in incorporations and an increase in dissolutions. The analysis shows that there has been a 70% increase in the number of company dissolutions in March 2020 compared to March 2019. In absolute terms, London had the biggest increase with over 6,400 more dissolutions. In relative terms, this sharp increase was particularly striking in the West Midlands and Wales both of which experienced more than a 100% increase in dissolutions. The sectors particularly influenced by this trend are Wholesale & Retail, Professional Services, Transportation & Storage, Information & Communication and Construction. One important point is that the increase in company dissolutions is driven by young firms which appear as the most vulnerable when facing uncertainty and the current unprecedented challenges.

The UK Government has unveiled a substantive package of support for UK firms, but at the time of writing many firms are struggling to access this assistance and there are some obvious gaps in the range of initiatives announced. If those shortcomings are not remedied quickly, it is foreseeable that we will continue to see a long, slow decline in the number of private-sector firms that support millions of jobs across the economy. In that context, rather than seeing a V-shaped downturn and rebound as some economists such as the OBR have predicted, we could instead see an L-shape recession dragged down by a net loss of companies over a long period.

1. INTRODUCTION

A forecast by the Office of Budget Responsibility (OBR), assuming a three-month lockdown, followed by another three-month period when restrictions are lifted partially, expects real GDP to fall by 35% in the second quarter of 2020 as a result of the COVID-19 crisis and lockdown but they also expect it to bounce back relatively quickly. The OBR also expect unemployment to rise to 10% (an increase of around 2 million) and decline slowly.

The ability of an economy to bounce back quickly will obviously depend on businesses still being around to re-engage with their customers and indeed their workforce if they have been furloughed, and get back to pre-crisis levels of performance.

Results from wave 2 of the ONS Business Impact of COVID-19 Survey (BICS)[1] found that 25% of those that responded to the survey had closed temporarily and 0.4% had permanently closed. For those that were still trading, 21% of the workforce had been furloughed and 38% reported "substantially lower than normal" turnover. All businesses that stated turnover was abnormally affected, 99% of them attributed this to COVID-19.

The latest release of British Chamber of Commerce (BCC) Coronavirus Business Impact Tracker[2] show that the large majority of firms (66%) have furloughed staff in anticipation of the Job Retention Scheme (JRS) going live on 20th April. It also reports that 59% of firms have three months or less cash in reserve. The on-going issues with the Coronavirus Business Interruption Loan Scheme (CBILS) only serves to exacerbate the liquidity problems for these firms[3].

Taken together these two surveys help us understand the OBR forecast of what will happen to the UK economy in the current quarter (i.e., Q2). However, they also serve to flag that the assumption of a V-shaped downturn is perhaps a rather optimistic one and, with the precarious position of a majority of firms with respect to cash reserves, there is a distinct possibility that the downturn could transform itself into an L-shaped

[1] Published on 9th April 2020. The ONS BICS is a voluntary survey with 5,000 respondents and is, therefore, not representative of the total business population in the UK
[2] Released on 15th April 2020.
[3] Only 2% of surveyed firms in the BCC CBI Tracker had successfully accessed CBILS and 9% of respondents were unsuccessful reporting slow or no response from lenders as the main reason.

recession quite quickly if a significant number of the business population close their doors definitively. Once these businesses are gone no bounce back is possible.

In this paper we take a look at recent trends in company incorporations and dissolutions from the FAME dataset[4] with a particular focus on comparing Q1 in 2019 and Q1 2020. The intention is to see whether there is any noticeable change in these trends as the COVID-19 crisis unfolded in the UK.

At the outset it is important to recognise that while it is fairly easy and quick to set up a limited company in the UK[5], by contrast, dissolving a company can be a much lengthier process. If 90% of shareholders agree it can happen within 7 days but it could take at least 3 months for a company to be officially dissolved and struck off the Register after the application to Companies House has been made and advertised. It could take longer if the situation is complex or if any objections are raised following the publication of notice.

2. MARCH 2020 – 31 DAYS THAT SHOOK THE UK ECONOMY?

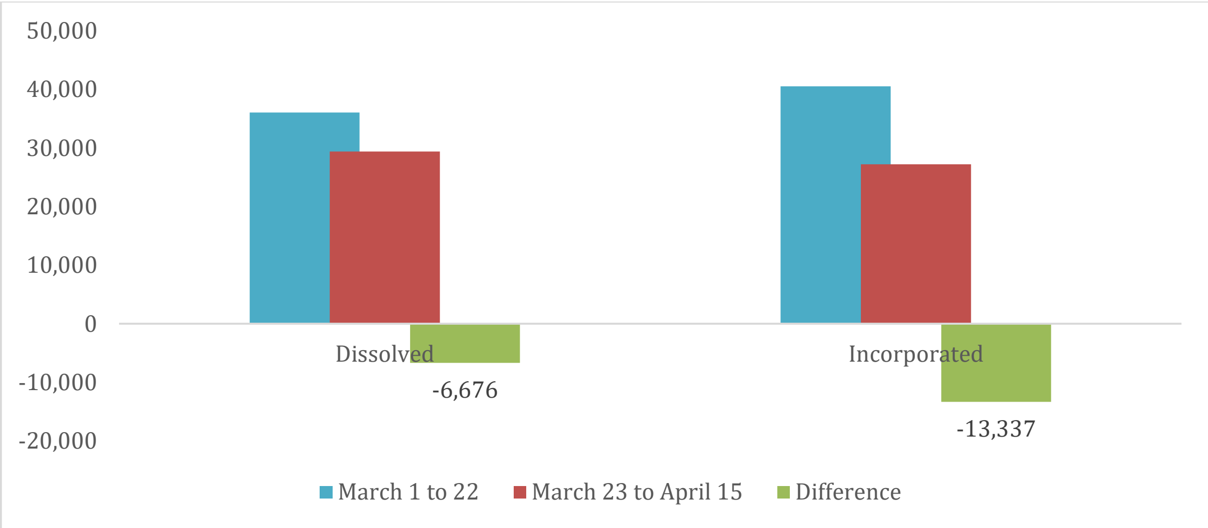
The first case of the COVID-19 virus in the UK was in January and by early March it had begun to take hold among the UK population. The scale of the outbreak in the UK was such that the Government announced a 'lockdown' for all non-essential work on Monday 23rd March. This had an immediate and dramatic effect on the economy as businesses were forced to close their doors with the resultant collapse of revenues and the knock-on effect on levels of employment.

Figure 1 shows that the 'lockdown' on 23rd March appears to have had an immediate effect on the number of incorporations being filed at Companies House. There were just over 13,000 fewer incorporations in the period 23rd March to 15th April compared to the first three weeks of March. There is no corresponding rise in the number of dissolutions when these two short periods are compared and indeed there was a fall in company dissolutions after the lockdown announcement. Perhaps, the effect of the

[4] FAME is a comprehensive company information dataset provided by Bureau van Dijk covering over 11 million companies in the UK and Ireland with different levels of detail including 'no longer active' companies.
[5] The process is facilitated by online application and once it is submitted and £12 fee paid, a new firm could be registered at Companies House within 24 hours. Postal applications take 8 to 10 days and cost £40. https://www.gov.uk/limited-company-formation/register-your-company

announcement was to signal that as the economy was effectively shutting down this was not the best time to be going ahead with incorporating a new business.

Figure 1: Number of dissolved firms before and after March 23rd 2020



Source: FAME

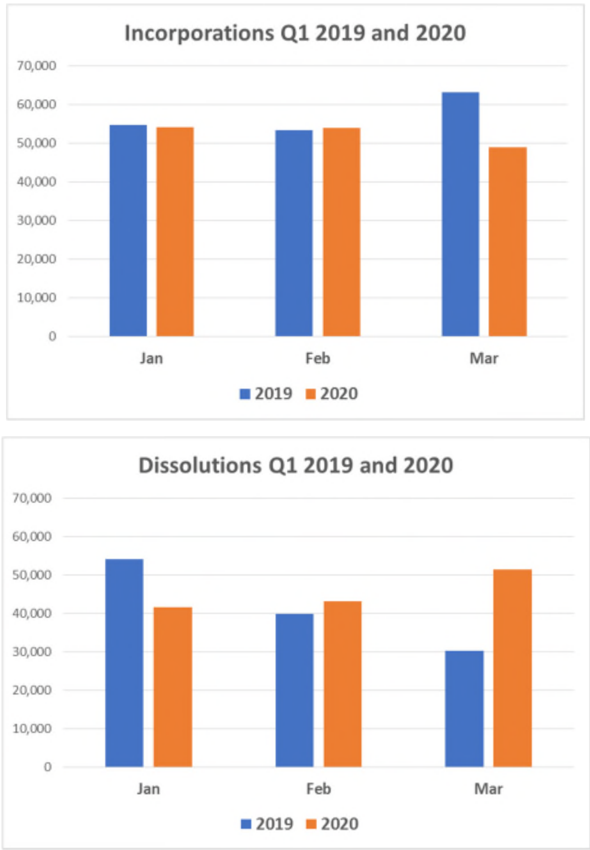
Of course, such an analysis of business incorporations and dissolutions which focuses on a particular Government announcement is a little spurious and one should not read too much into these trends. The process of company incorporation and dissolutions takes time and for that reason alone one should take these trends with a pinch of salt!

Let us turn to a more reliable analysis of company dissolutions and incorporations and try to understand what happened in March 2020 as the COVID-19 virus took hold compared to March 2019. Figure 2 shows that with respect to incorporations the numbers in January and February for both years were almost identical with just over 50,000 incorporations in each month but March 2020 was very different to March 2019. There was a slight fall in incorporations in March 2020 compared to the first two months of the year – down by about 5,000. This is also significantly lower than in March 2019 when there were just over 63,000 new incorporations but that may be more to do with a particular explanation related to the 2019 figures. Overall, what we can conclude is that there has been a slight dip in the number of new incorporations in March 2020.

Looking at company dissolutions the most startling point to note is that there has been a sharp increase in the number of dissolutions in March 2020 compared to March 2019 – an increase of just over 21,000 or 70.1% (Figure 2). What we also observe is that there has been a rise in dissolutions between February and March 2020 by just over 8,000 companies (19.3% increase).

Can this be explained by a backlog in the pipeline of company dissolutions or an increase in the number of quick seven day dissolutions referred to earlier? Further analysis is needed to explore these trends more robustly but for the moment we simply note that the scale of dissolutions in March 2020 may serve as early evidence that the ability of the economy to bounce back after lockdown could be impaired.

Figure 2: Number of dissolved firms Q1 2019 and 2020



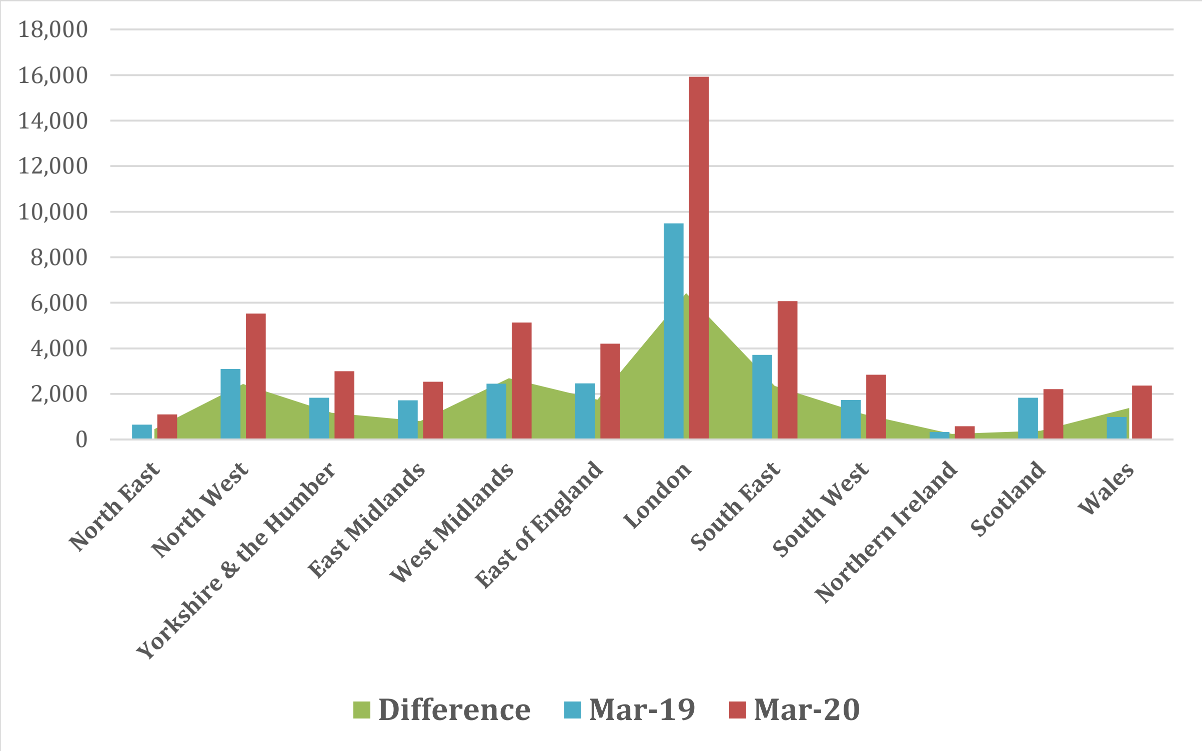
Source: FAME

The following sections will now look in more detail at the uplift in dissolutions between March 2019 and March 2020 to see if they were occurring in particular regions and sectors and whether they were more or less likely to be younger or older businesses.

3. COMPANY DISSOLUTIONS BY REGION/NATION: MARCH 2019 AND 2020 COMPARED

Figure 3 shows that London had the biggest absolute increase in company dissolutions (+6,431, or nearly a third of the total) followed by the West Midlands (2,685), the North West (+2,440) and the South East (+2,357). Together they accounted for almost two-thirds (65%) of the 21,206 increase in company dissolutions when we compare March 2019 and March 2020. When looking at individual regions, the West Midlands and Wales experienced more than a 100% increase in dissolutions.

Figure 3: Number of dissolved firms by region: March 2019 and March 2020

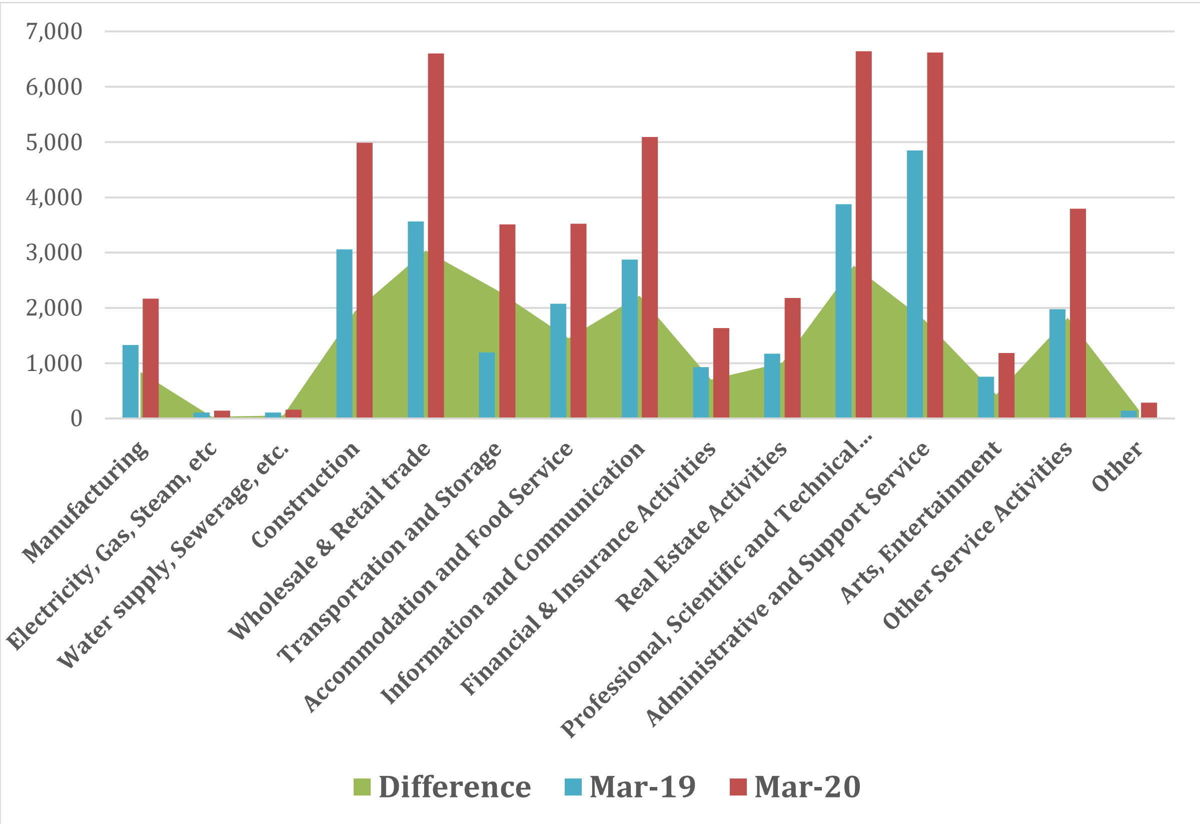


Source: FAME

4. COMPANY DISSOLUTIONS BY SECTOR: MARCH 2019 AND 2020 COMPARED

When we look at the sectoral distribution of the large increase between March 2019 and March 2020 we find that the majority of them are in Wholesale & Retail (+3,039), Professional Services (+2,766), Transportation & Storage (+2,316), Information & Communication (+2,219) and Construction (+1,929). Together these five sectors account for 60% of the increase in company dissolutions when we compare these two months (Figure 4).

Figure 4: Number of dissolved firms by sector: March 2019 and March 2020



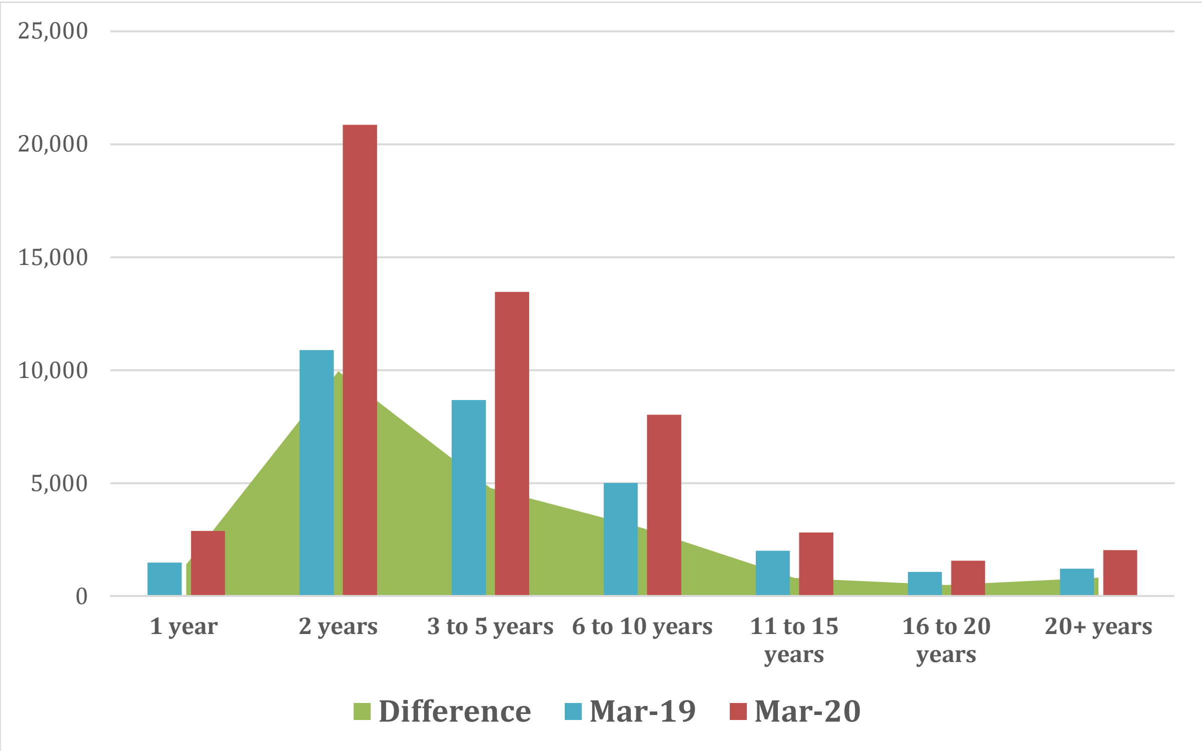
Source: FAME

5. COMPANY DISSOLUTIONS BY AGE OF FIRM: MARCH 2019 AND 2020 COMPARED

The increase in company dissolutions observed in March 2020 compared to March 2019 is driven by a large number of younger companies being wound up – that is, less than 6 years (Figure 5). Three-quarters of the increase is for companies aged between 1 and 5 years and almost 50% were less than 3 years of age.

These younger firms, and especially those just 1 or 2 years old, are perhaps more vulnerable in the market place as they were established in a period of uncertainty anyway in 2018 and 2019 and any sharp downturn in demand as the COVID-19 crisis emerged would put them in a very precarious position.

Figure 5: Number of dissolved firms by age of firm: March 2019 and March 2020



Source: FAME

6. SUMMARY

The evidence presented here is perhaps an early indication of the immediate effects of COVID-19 on business dynamism in the UK. Notwithstanding the obvious caveats with the dissolution data we observe large increases in the number of firms dissolving in March 2020 compared with March 2019, with the West Midlands and Wales showing the largest relative increases. There are also certain sectors that a more heavily impacted, including the Transport and Storage, Professional, Scientific and Technical Activities and Wholesale and Retail sectors and firms less than 2 years old experienced a sharp increase in dissolutions.

All these findings point to the severe impact COVID-19 and the lockdown is having on businesses and the economy and highlights the fundamental importance of enabling firms to survive so the economy can bounce back and recovery quickly. While coronavirus is likely to be a major factor in both the rise in company dissolutions and the fall in new incorporations, it is important to note that winding down a limited company could take months, owing to the need for 75% of shareholders by value to agree. The latest data therefore needed to be seen in the context of an economy that had already seen dampened growth due to Brexit uncertainty.

Overall, the data suggests that there has been higher levels of business closures and a concurrent lack of new businesses starting due to an understandable fear about what the future holds. The Chancellor has unveiled a substantive package of support for UK firms, but at the time of writing many are struggling to access this assistance and there are some obvious gaps in the range of initiatives announced. If those shortcomings are not remedied quickly, it is foreseeable that we will continue to see a long, slow decline among the private-sector firms that support millions of jobs across the economy. In that context, rather than seeing a V-shaped downturn and rebound as some economists such as the OBR have predicted, we could instead see an L-shape recession dragged down by a net loss of companies over a long period. We will continue to monitor these data on a weekly basis going forward.

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