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Business Environment in the WMCA Region

By

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March 2018

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A briefing note for the Productivity and Skills Commission

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Executive Summary

Evidence

There is a clear connection between business dynamism and growth in productivity at the national level and this is also the case for the WMCA and the three constituent LEP areas. The key metrics of **business dynamism** in the WMCA region demonstrates that there are some challenges to be addressed and especially around the growth of start-ups and established businesses.

Our findings show that:

- The **job reallocation rate**, which is the key metric of business dynamism, for the West Midlands is average and lags behind other regions with higher productivity levels.

- There is a range of **start-up rates** across the region with Coventry and Warwickshire LEP performing well against the English LEP average with the Black Country LEP lagging well behind that benchmark.

- The Black Country LEP has a better track record on the **initial scaling** of its start-ups compared to the other two LEP areas in the WMCA region and is above the English LEP and UK average. This emphasises the point that it is not the volume of start-ups which matter *per se* but their ability to survive and grow which is the key. Yet still productivity levels in the Black Country LEP lag behind regional and national averaged.

- There are very few firms in the WMCA region which can be categorised as **'high-growth' or 'scaling'** – this is particularly true of the Black Country LEP where the number of OECD High-Growth Firms is well below that of the other LEP areas and indeed the UK average.

- **Growth ambition** among early-stage entrepreneurs in the WMCA region is around the national average in Greater Birmingham and Solihull and Black Country LEPs but well below the national average in the Coventry and Warwickshire LEP area.

At individual LEP level 'weak' business growth metrics show some correlation with low levels of productivity. However, a word of caution is necessary about firm growth and productivity gains, especially, with respect to the various policy narrative around 'high-growth' or 'fast-growing' firms, as the relationship with positive productivity outcomes for these firms growing fast in terms of jobs and revenue is tenuous.

So, in the case of the Black Country LEP, the below average proportion of 'high-growth' firms (as defined in terms of rapid job growth) cannot be seen as the sole cause of the weak productivity position.

Policy Responses

It is clear that business support needs clear segmentation. Support for the long tail of firms that hitherto have shown no ambition to grow should be generic, non-selective and cost-effective. This might include informational campaigns or brokering initiatives. There is some limited evidence that intensive support does enhance performance. We argue that for those firms currently experiencing high-growth episodes or about to, intensive support should be conditional: supported firms need to generate positive 'national (or local) spillovers', or have the potential to do so - high-growth episodes *per se* do not make the case for public support.

Despite their limited resources and their different approach to the task, the Growth Hubs in each of the LEP areas are in the frontline and need to step up and engage more effectively with building a pipeline of businesses who have a clear growth orientation. The following specific recommendations flow from this guiding principle:

- First, there is a need to provide a clearer focus on the 'growing businesses' agenda in the region. There is a real tension in the public sector in particular between supporting growth-oriented businesses (the 'few') and making business support and advice available to all start-ups and established businesses (the 'many'). This requires an open and honest discussion about which business support inputs will have the greatest outcomes and impact for the region. The identification of the 'few' remains a challenge but current developments in BEIS, HMRC and the ONS (part of the DECA Project), using AI and machine learning techniques, are designed to help focus business support operations across the LEPs and regions. It is important to note that the evidence shows that fast-growing firms occur in ALL sectors of the economy so the identification of the 'few' should not be driven solely by a sector focus.

- Second, we need to ensure that business leaders are aware of the wide range of support available to them from the private and public sector to support their business development opportunities. Despite many abortive attempts the 'business support ecosystem' remains too dis-jointed and businesses still complain that they do not know where to go for support. The proportion of businesses in the WMCA region contacting the Growth Hubs is low, but that is not unique to this region and is in evidence across all 38 Growth Hubs. A greater effort on marketing the range of business support available and how they connect to each other is required as current efforts are clearly not having the required impact.

- Third, leadership, management and entrepreneurial skills are crucial in driving growth and productivity gains. There needs to be an audit of all the available programmes and initiatives in this space across the region with a view to categorising them in terms of low, medium and high intensity (e.g., hours of support) as well as which ones are delivering real impact. This is important to maximize the brokerage role of the Growth Hubs and the eventual impact for businesses and regional growth.

- Fourth, there is clear evidence that engagement with universities, and Business Schools in particular, brings bottom line benefits to SMEs over and above the value of the knowledge exchange experience. While all of the universities are engaged to some extent with SMEs across the region it is still the case that they remain a 'best kept secret' to the small business leader and as a result engagement remains low. To address this, individual universities need to make it easier for SMEs to find out what expertise is available and, in parallel there should be a regional campaign by the universities in association with the Small Business Charter, which was launched by Lord Young in 2014, to raise the profile of the value of the HE collective to small businesses.

1. Introduction

We interpret here business environment in the region as 'business dynamism' which is a crucial driver of growth and productivity. Unpacking what this means in the context of the WMCA region will drive the nature and intensity of future business support interventions. The aim of the briefing note is to provide an overview of the key headline metrics on business dynamism in the region, benchmark them against other regions and the UK, and set out some recommendations for the WMCA Productivity and Skills Commission.

2. Approach

The number of start-ups in an economy is often seen as the headline metric of 'enterprise' and 'entrepreneurial ability'. Start-ups have been rising steadily in the UK in recent years but seems to have stagnated in 2017. It is argued in the economics literature that the movement of resources from low-productivity firms to high-productivity firms drives economic efficiency and growth. Start-ups contribute significantly to this reallocation process. Many start-ups fail within a few years, so start-ups contribute to both job creation and job destruction.

A small subset of start-ups, however, grow quickly, and contribute disproportionally to net job growth and to improvements in industry productivity. Workers also move among firms at tremendous rates which means that gross job creation and destruction are much larger than net job creation. As workers ***reallocate***, it is argued that productivity increases, knowledge diffuses, and the structure of production changes. There is a standard methodology to undertake this analysis of ***job reallocation rates*** which we have just completed for the UK and can update the analysis we did for the West Midlands region some years ago (Davis et al., 1996).

Alongside this standard analysis of job creation and destruction in the UK and the West Midlands we have developed other metrics of business dynamism which focus on survival and growth and include:

- 3-year survival rates of start-ups (2013-16)
- Proportion of 2013 start-ups that reach £1m T/O (2013-16)
- Proportion of £1-2m T/O businesses born before 2013 which grow to £3m T/O (2013-16)
- High-Growth Firm (OECD Definition) Incidence Rate (2013-16)

- Small High-Growth Incidence Rate (2013-16) - adopting a methodology to avoid the exclusion of firms with less than 10 employees from the OECD definition.

3. Data Sources

The dataset used in the production of the **firm-level** growth and start-up data is the Business Structure Database (BSD). This is a dataset produced by the Office of National Statistics (ONS) and is an annual snapshot of the Inter-Departmental Business Register (IDBR) which is a live register of data collected by HM Revenue and Customs via VAT and Pay as You Earn (PAYE) records. The IDBR data are complemented with data from ONS business surveys. If a business is liable for VAT (turnover exceeds the VAT threshold) and/or has at least one member of staff registered for the PAYE tax collection system, then the business will appear on the IDBR (and hence in the BSD). We use the firm-level BSD for firm growth rates, start-ups, and T/O calculations and the site-level BSD for the calculation of new and gross new jobs.

In addition, we use data from the Global Entrepreneurship Monitor (GEM) UK research consortium has been **measuring entrepreneurial activity of working age adults** across a wide range of countries in a comparable way since 1998. In 2016 the GEM global study conducted surveys in 65 sovereign nations and represented the world's most authoritative comparative study of entrepreneurial activity in the general adult population.

The 2016 GEM global study was based on an analysis of adult population survey (APS) results from 65 economies and more than 182,000 adults across the world. The core of the APS is identical in each country and asks respondents about their *attitudes* towards entrepreneurship, if they are involved in some form of entrepreneurial *activity*, and if so what their *aspirations* for their business are. The global GEM Executive 2016 Report was published in February 2017[1] and can be downloaded from www.gemconsortium.org.

[1] Herrington, M. and Kew, P. (2017) Global Entrepreneurship Monitor 2016/17 Global Report. London: Global Entrepreneurship Research Association.

From the APS survey, we examine individual entrepreneurs at three key stages:

- Nascent entrepreneurs (NAE): The stage at which individuals begin to commit resources, such as time or money, to starting a business. To qualify as a nascent entrepreneur, the business must not have been paying wages for more than three months.
- New business owner-managers (NBO): Those whose business has been paying income, such as salaries or drawings, for more than three, but not more than forty-two, months.
- Established business owner-managers (EBO): Those whose business has been paying income, such as salaries or drawings, for more than forty-two months.

It is important to understand that the main subject of study in GEM is entrepreneurs rather than the businesses that they run. GEM measures the entrepreneurial activity of people from intention to exit. The first two stages of active business development, the nascent entrepreneur stage and the new business owner-manager stage, are combined into one index of Total early-stage Entrepreneurial Activity, or TEA[2], which is represented in Figure 1 below.

[2] TEA is calculated in an identical way in each country. A telephone and/or face-to-face survey of a representative sample of the adult population in each country is conducted between May and September. Respondents are asked to respond to three questions that are the basis of the TEA index: 1) "are you, alone or with others, currently trying to start a new business independently of your work?", 2) "are you, alone or with others, currently trying to start a new business as part of your work?", and 3) "are you, alone or with others, currently the owner or manager of a business?" Those who respond positively to these questions are also asked filter questions to ensure they are actively engaged in business creation as owners and managers, how long they have been paying wages to employees, and other questions about cost and time to start up, sources of finance and numbers of jobs created. A distinction is made between two types of entrepreneurs: nascent entrepreneurs (those whose businesses have been paying wages for not more than three months) and new business owner-managers (those whose businesses have been paying salaries for more than three months but not more than 42 months). The TEA index is the proportion of nascent entrepreneurs and new business owner/managers (minus any double counting, i.e. those who respond positively to both are counted once) in the working age population.

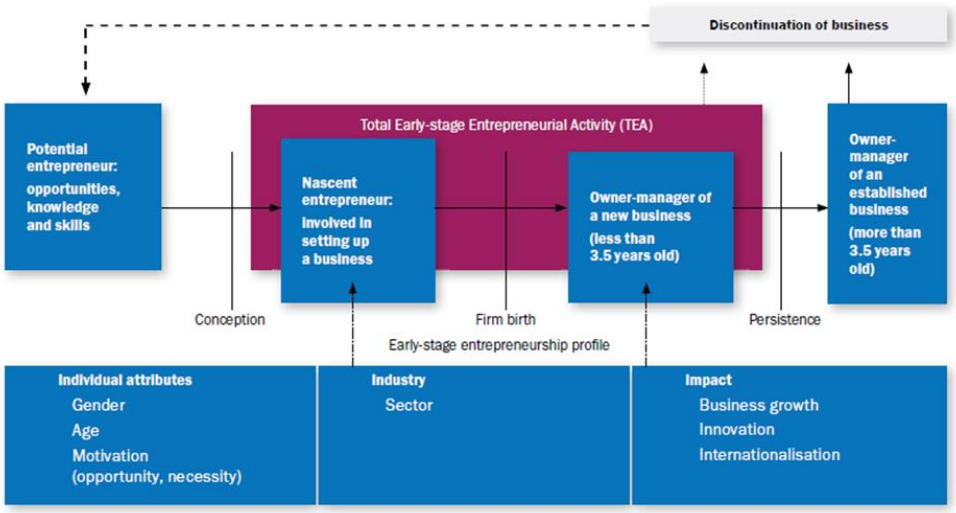


Figure 1: The Entrepreneurial Process and GEM Operational Definitions
(Source: Herrington and Kew, 2017, pg.15)

As much of this entrepreneurial activity is pre-start-up or includes very small new businesses that do not have to register for VAT, TEA rates will not necessarily match with published official statistics on business ownership and, indeed, should not be interpreted as such. Rather, GEM enables the measurement of the *propensity* of individuals in particular countries to be entrepreneurial *given* the current social, cultural and economic framework conditions that exist there.

4. Benchmark Data

There are a three main sub-sections addressing the key aspects of the business environment in the WMCA region:

- Business dynamism – job reallocation rates
- Firm-level start-up and growth metrics
- Early-stage entrepreneurial activity and ambition

4.1 Business Dynamism in the UK and the West Midlands

The job creation and destruction rates presented below are defined in the conventional way:

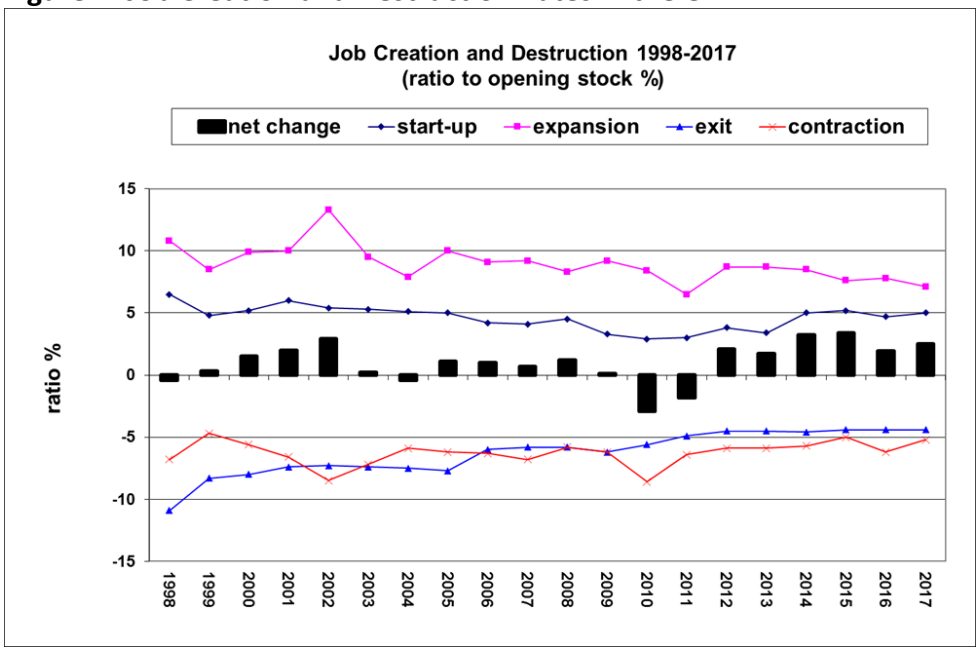
- ***Job Creation*** – employment changes summed over all businesses that expand or start up in a given year.
- ***Job Destruction*** – employment changes summed over all businesses that contract or exit in a year

These job creation and destruction figures are expressed as rates by dividing by employment averaged over the current and previous year (businesses with no change in employment do not contribute to either job creation or job destruction).

So the change in employment between two years – often referred to as the net employment change – is equal to the difference between job creation and job destruction over the period and the net employment *rate* equals the job creation *rate* less the job destruction *rate*

The sum of the job creation rate and the job destruction rate is referred to as the ***job reallocation rate.*** It summarises the overall volume of change and in essence represents the 'reshuffling of job opportunities across locations' (Davis *et al.,* 1996). Tracking the job reallocation rate allows us to arrive at a measure of business dynamism for the economy. Figures 2 and 3 present the job creation and destruction rates for the UK for the period 1998-2017.

Figure 2: Job Creation and Destruction Rates in the UK



Source: ONS Business Structure Database (1998-2017)

We can see that there was very little variation in these rates of job creation and destruction over the period – averaging around 20-28% over 20 years (i.e., the job reallocation rates):

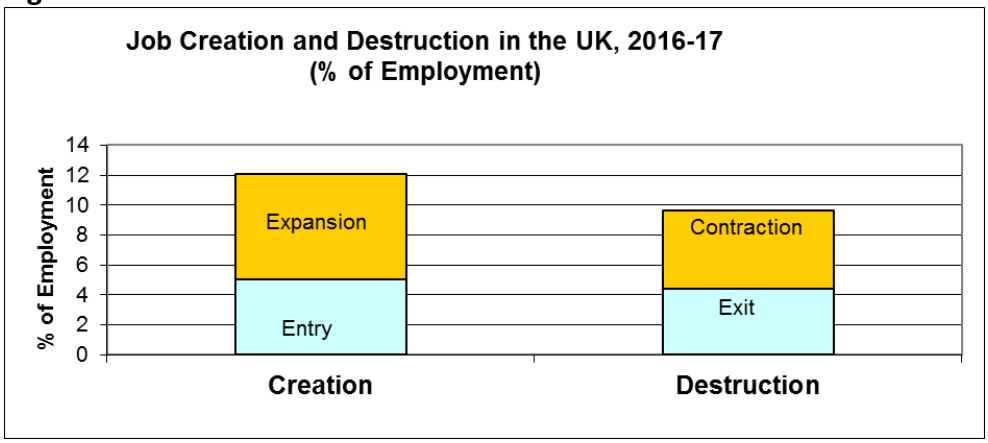
- The Great Recession reduced job creation through entry and expansion, but what is very noticeable is the steady decline since the turn of the century in the amount of job creation through the

expansion of existing businesses – a challenge recognised by the recent Industrial Strategy White Paper.

- Job creation through start-ups, however, has been on the rise since the economic downturn.
- Job destruction through exit and contraction have been falling steadily since 2010 and are much lower now than they were 20 years ago.

This is in marked contrast to the US where there is growing evidence that business dynamism and entrepreneurial activity are declining as over the last 30 years the number of start-ups and the scale of job reallocation rates have been in decline (Goldschlag and Tabarrok, 2018).

Figure 3: Job Creation and Destruction Rates in the UK



Source: ONS Business Structure Database (1998-2017)

The job reallocation rate in the 2016-17 period is just under 22% in the UK and translates into 4.5m jobs (Table 1). This is slightly lower than in previous years but does not exhibit the same scale of decline as was observed in the UK

Table 1: Job Gains and Losses in the UK, 2016-17

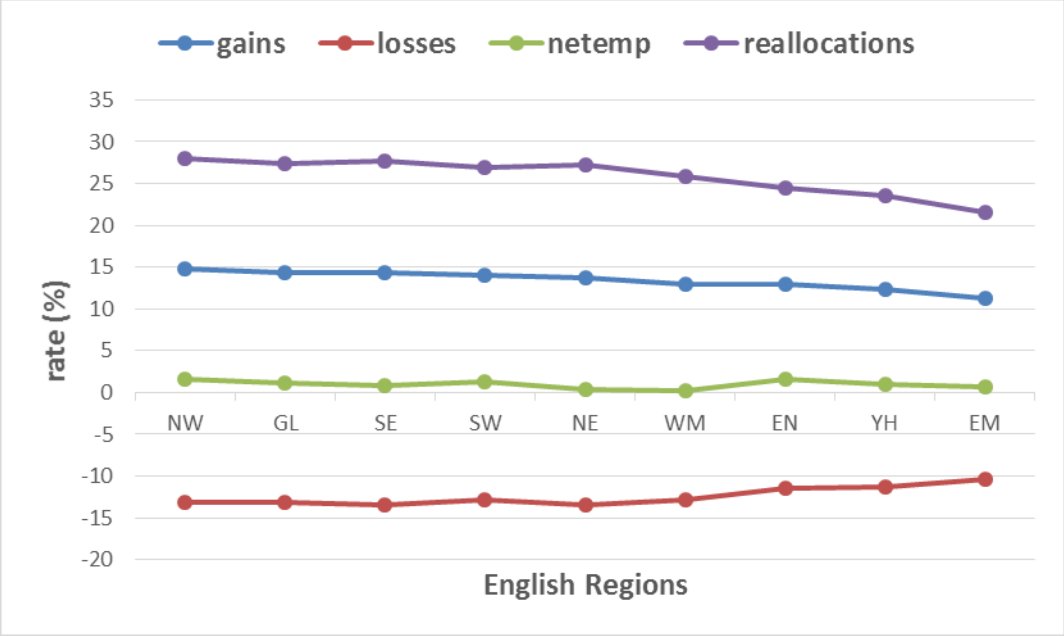
	Job Gains	Job Losses
Start-ups	1,037,843	
Expansion	1,466,305	
Closure/Exit		916,433
Contraction		1,075,047
Total	***2,504,148***	***1,991,480***
Net Job Change	**+512,688**	
Gross Job Churn	**4,495,628**	

Source: ONS Business Structure Database (1998-2017)

UK regional analysis on the key metrics of business dynamism was undertaken for BEIS some years ago (Anyadike-Danes, Hart and Bonner, 2011). In that report, which covered the period 1998-2010, it was found that with the exception of the West Midlands, all regions/home nations recorded a small positive net employment change on average each year between 1998 and 2010. The analysis has now been updated to 2017 and the results show that the West Midlands and the North East recorded the lowest average percentage of net employment growth (Figure 4).

The average job reallocation rate, the key metric of business dynamism which connects to productivity, for the West Midlands is the same as the national average – 25.9% - and above that in the East Midlands, East of England and Yorkshire and Humberside. A number of regions had an above average job reallocation rate - South East, South West, Greater London, North West and the North East.

Figure 4: Job Creation and Destruction Rates, Aggregated Components by Region, %, UK, Average 1998-2017



Source: ONS Business Structure Database (1998-2017)

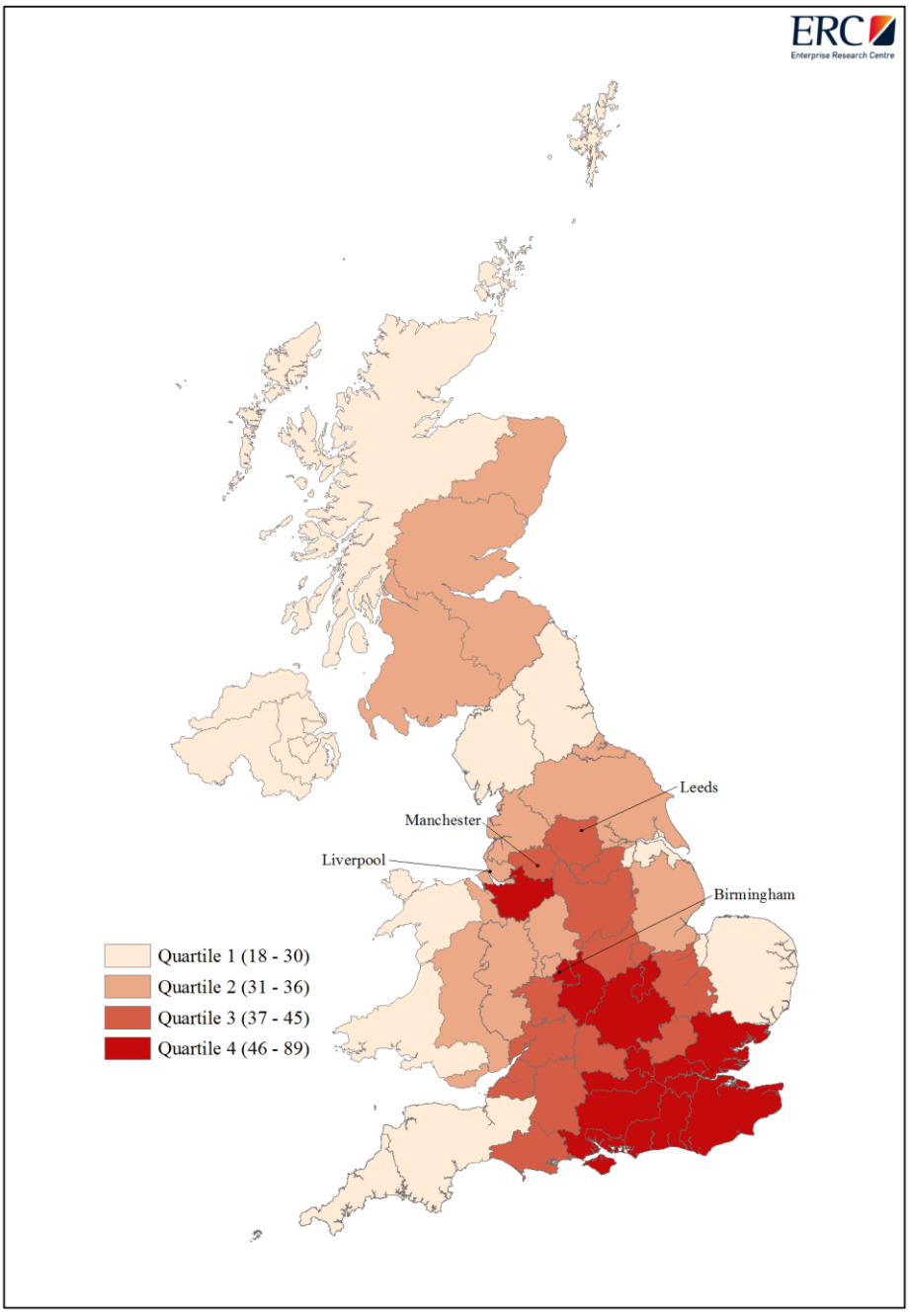
4.2 Firm-level Start-up and Growth Metrics

Underpinning the job reallocation rates and the constituent components of job creation and destruction are the simple business dynamics of start-up and growth on the one hand and business closure and contraction on the other. Of course, there is also the vast majority of firms who survive and experience no change in their employment head count.

The South East, and especially London, has the largest rate of start-ups and there are generally smaller numbers of start-ups as we move north and west (Figure 5). However, there are some notable exceptions in England as West of England (Bristol) and the three northern city-regions of Manchester, Leeds and Liverpool also exhibit high rates of start-up on a par with the South East.

Generally, start-up rates in Northern Ireland and Wales are much lower than elsewhere and in Scotland there is a great variation between higher rates in Aberdeen and Edinburgh and some of the lowest rates in Dumfries and Galloway.

Figure 5: Start-ups per 10,000 Population in the UK (2016): Quartiles



Source: ONS Business Structure Database (1998-2016)

The position in the WMCA region is set out in Table 2 where the data is normalized by population density rather than the absolute number of start-ups which is rather misleading. There is a great deal of variation within the region with start-ups in the Coventry and Warwickshire LEP exceeding the national average while the Black Country LEP was significantly below the

national average. The start-up rate for the Greater Birmingham and Solihull LEP is the same as that for the UK overall and slightly below that for England.

Table 2: Business Start-ups per 10,000 Adult Population in the WMCA Region (2016)

LEP Area	Number of UK-owned firm births per 10,000 population
Black Country	33.8
Coventry and Warwickshire	49.5
Greater Birmingham and Solihull	46.0
England	**48.9**
UK	**45.8**

Source: ONS Business Structure Database (2016)

The importance of small business growth to the objective of driving economic growth and re-balancing the UK economy cannot be over-stated. So we now turn to a range of business growth metrics which can provide a more fine-grained analysis of the local business dynamic which can inform the development of local and regional business support initiatives.

Growth of Start-ups – Initial Scaling

It is a matter of record that the UK has now a larger number of start-ups than ever before, yet what is less well known is the proportion, if they survive, that go on and generate at least £1m in revenues after 3 years.

Table 3 shows that the proportion of UK-owned start-ups that achieve this early indication of 'scale' is very small indeed (2% nationally) but that there is a great deal of variation across the LEPs in England and in the WMCA region.

The dominance of the South East in terms of business start-ups is less evident with 'hot spots' of initial scaling in all parts of the UK. Of note are those local economies with relatively low levels of start-up activity that have the highest proportions of their start-ups achieving at least £1m in revenues after three years.

Table 3: Business Start-ups Scaling in the WMCA Region (2013-2016)

LEP Area	UK-owned firms born in 2013 and surviving to 2016 that grow to £1m+ turnover in 2016 (%)
Black Country	2.5
Coventry and Warwickshire	1.4
Greater Birmingham and Solihull	1.8
England	**2.0**
UK	**2.0**

Source: ONS Business Structure Database (2013-16)

In England there are 11 local areas (i.e., LEPs) with above average rates of start-ups showing early signs of scaling. London tops the list in 2016 with the **Black Country LEP in second place**. Looking at the remaining LEPs with an above average score on this metric there is a mix of urban and rural LEPs which demonstrates that it is not all about cities in terms of the survival and initial scaling of start-ups. For example, while Greater Manchester has an above average proportion of start-ups scaling, Greater Lincolnshire, Lancashire, Cheshire and Warrington, Cornwall & Scilly Isles are all areas which are above the average for England.

In the WMCA region the Black Country exceeds the national average on 2.5% while Coventry and Warwickshire LEP is well below the national average. The Greater Birmingham and Solihull LEP is just below the national average (1.8%).

Growth of Existing Businesses - Stepping Up

Across the UK we observe that around 7% of existing firms with turnover of £1-2m per annum in 2013 grow to at least £3m turnover in 2016. Within England there is a much more complex pattern across the LEPs (Figure 3). Although Dorset has the highest proportion of these businesses (8.8%) and London the second highest this is not a simple north-south pattern. Following these two areas we find above average proportions of these 'stepping up' businesses in the North and the Midlands: for example, Cheshire and Warrington, Greater Manchester, Tees Valley, Derby, Derbyshire, Nottingham and Nottinghamshire (D2N2), Stoke-on-Trent & Staffordshire, Coventry and Warwickshire and Northampton.

Table 4: Survivors Stepping Up in the WMCA Region (2013-2016)

	Survivor firms (born <2013) with £1-2m turnover in 2013 scaling to £3m+ in 2016
Black Country	5.5
Coventry and Warwickshire	7.1
Greater Birmingham and Solihull	6.4
England	**6.8**
UK	**6.7**

Source: ONS Business Structure Database (2013-16)

The variations across the WMCA region on this metric are quite stark with the Black Country LEP recording proportions of existing business scaling beyond £3m turnover well below the national average: 4.7% and 5.5% respectively. Greater Birmingham and Solihull LEP sits just below the national average on this metric (6.4%).

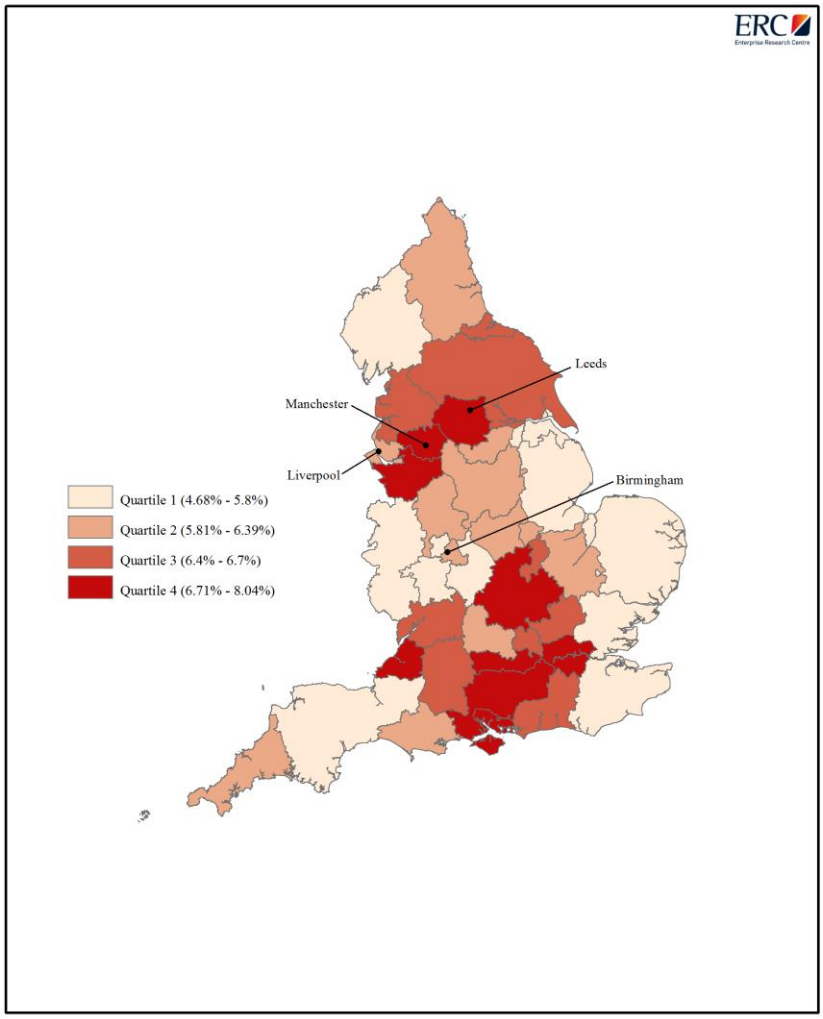
High-Growth Firms

We now turn to a well-known firm-level growth metric – what the OECD define as a High-Growth Firm. High-Growth is defined by the OECD as annualised average growth in employment of 20% or more over a three year period (2013-16) and restricted to a business having at least 10 employees in 2013.

The number of high-growth firms (HGFs), as defined by the OECD, in the UK declined in the 2013-16 period –the absolute number fell from 11,855 (2012/15) to 10,865 (2013/16) which means that the overall incidence rate is now 6.1% for the UK compared to 7% in the previous three-year period. The incidence rate of high-growth firms in England varies from 4.7% in the Black Country to 8.0% in London (Figure 6). The spatial pattern within this range is complex but the overall message is one of higher rates of HGFs in many of the northern and midlands local areas of England.

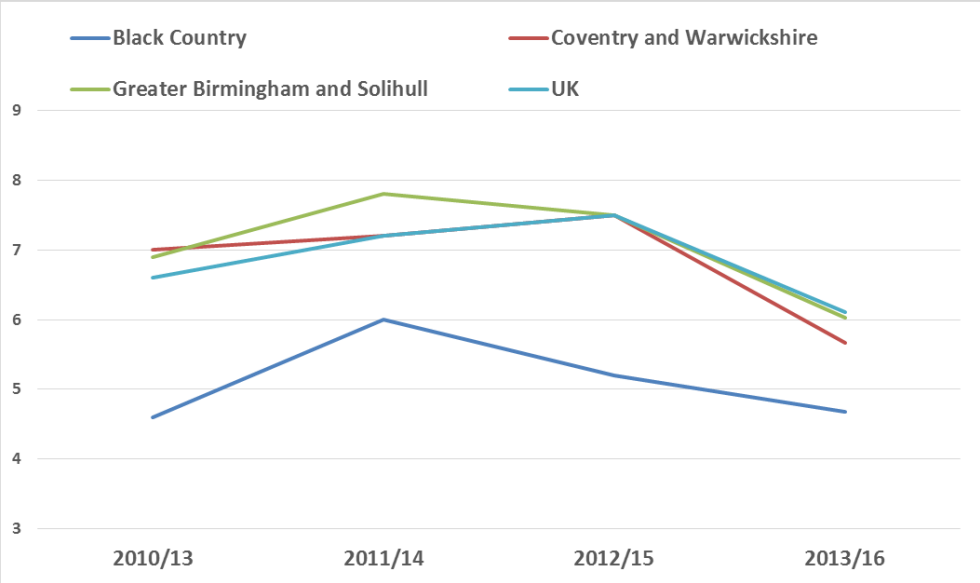
In England, outside London, the highest rates are in the North West (Greater Manchester, Cheshire and Warrington, Leeds City Region), West of England, Thames Valley Berkshire and the two southern LEP areas of Coast to Capital and EnterpriseM3. In general, the Midlands is an area of average or below average proportions of HGFs with the exception of South East Midlands and Northampton and the Black Country has the lowest rate in England.

Figure 5: High-Growth Firm Incidence Rate in LEPs (2013-16)



Source: ONS Business Structure Database (2013-16)

Figure 6: Trends in HGF Incidence Rate in the WMCA Region (%)



Source: ONS Business Structure Database (2010-16)

Looking at the trend data in the incidence of HGFs it is clear that the differences observed between the 4 LEP areas in the WMCA region are not new and the Black Country has had a lower proportion of HGFs since the end of the Great Recession (Figure 6).

Small High-Growth Firms

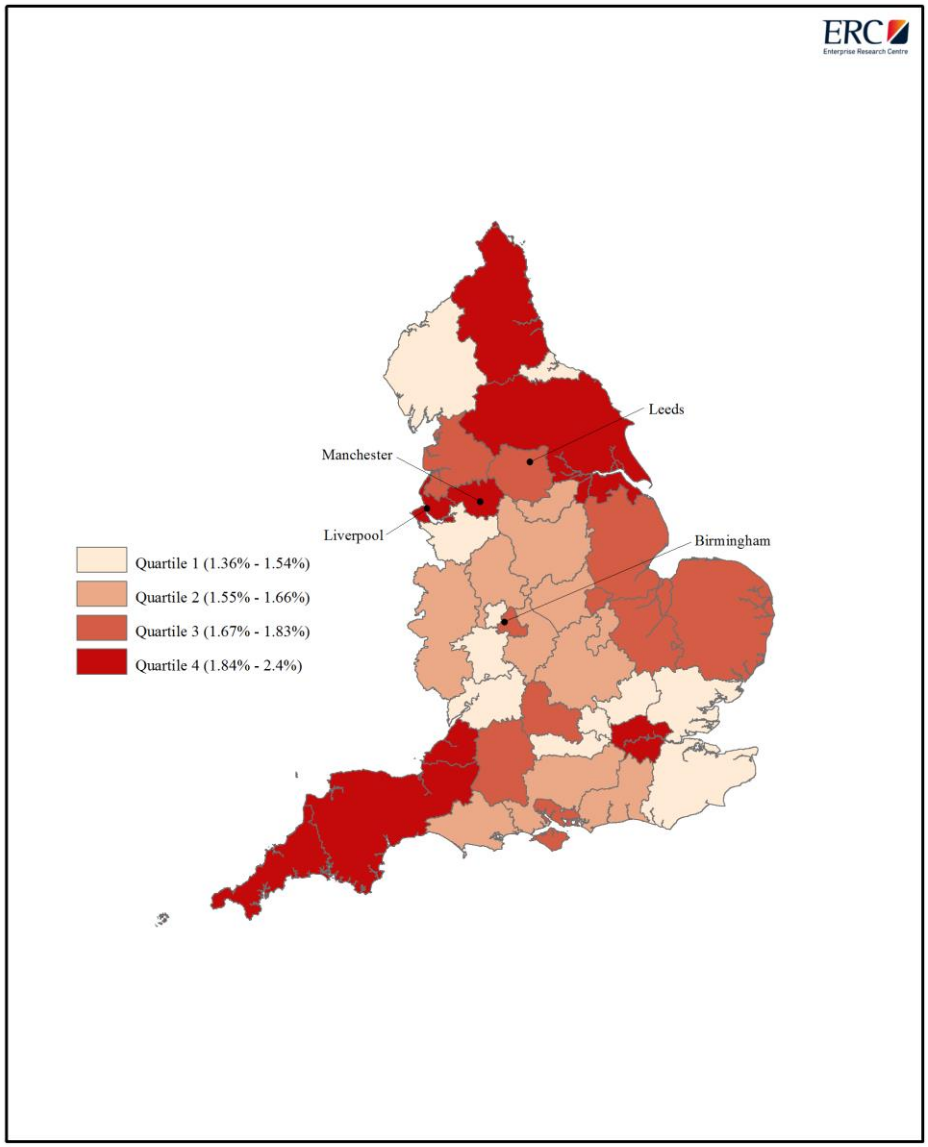
There has been growing criticism of the OECD HGF measure in recent years and in the US the Bureau of Labor Statistics (BLS) argued that the OECD measure was too narrow and excluded firms with less than ten employees in the first year of the three year growth period. The BLS developed an alternative measure which extended the definition of a high-growth firm to include firms with less than ten employees if the firm added eight or more employees during the three year growth period. Here we adopt this measure for the first time and refer to these as Small High Growth Firms (SHGFs).

Overall, the SHGF incidence rate in the UK is 1.7% for the 2013-16 period which is lower than in previous periods: 2.0% in 2012-15 and 2.4% in 2011-14. As with the HGF measure the SHGF measure exhibits a complex geography and in general, stand in contrast to that for the HGF measure (Figure 7).

The only common feature is that London dominates on both measures. Beyond the capital, however, it is the more peripheral parts of England together with the northern cities which have above average proportions of SHGFs.

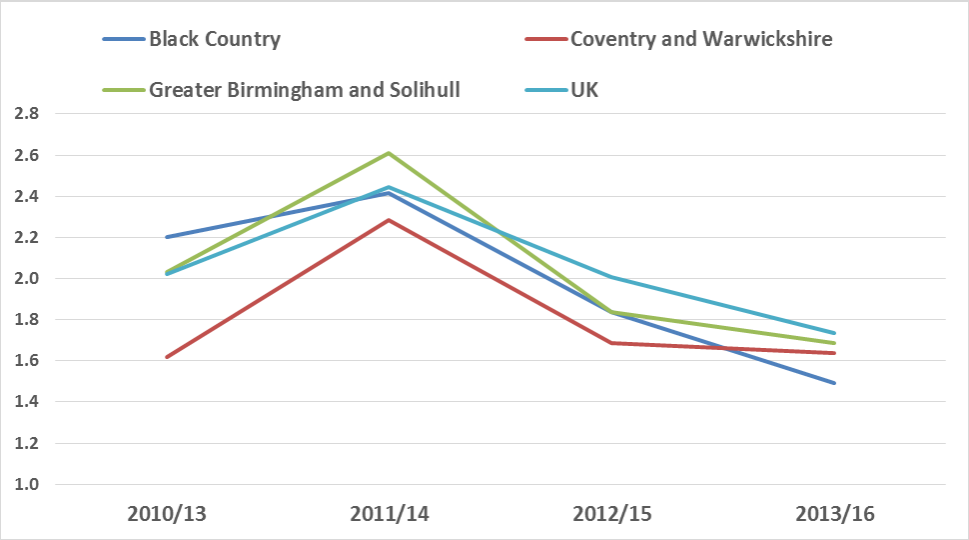
For example, the four city regions of Liverpool, Manchester, Leeds and Sheffield all have above average shares of SHGFs. The highest rates are in Cornwall and Isles of Scilly (2.4%) followed by York, North Yorkshire and East Riding (2.1%) while the Humber and the North East also have above average incidence rates of SHGFs.

Figure 7: High-Growth Firm Incidence Rate in LEPs (2013-16)



Source: ONS Business Structure Database (2013-16)

Figure 8: Trends in SHGF Incidence Rate in the WMCA Region (%)



Source: ONS Business Structure Database (2010-16)

Within the WMCA region there is very little difference between the incidence rate of SHGFs across the three LEP areas and the trend since 2010-13 has broadly followed the national average.

The introduction of this new variation on the official OECD HGF measure is an important innovation and provides a more comprehensive overview of growth in local businesses. The fact that it provides a rather different geography across the English LEPs underlines the importance of resisting the acceptance of a single metric for 'high-growth' firms.

Summary on Firm-Level Growth Metrics

This overview of a range of business growth metrics has underlined the fact that, irrespective of the measure adopted, there are very few firms in the UK and the WMCA region which can be categorised as 'high-growth' or 'scaling'. We also know that this small group of firms, whether start-ups scaling or more established businesses growing rapidly for the first or second time, have had a disproportionate impact on job creation. They are crucial to the growth of the UK economy and the re-balancing of the economy away from London and the South East.

The analysis shows a complex LEP geography of 'scaling' which challenges some of the preconceptions about the 'hotspots' of business growth across England and indeed within the WMCA region. When we look at the GVA data for the three LEPs in the region we note that poor performance on business

growth metrics correlates with below average GVA levels per worker. This is particularly the case for the Black Country LEP which has fewer OECD high-growth firms as well as fewer established businesses scaling to over £3m T/O in the three-year period to 2016.

4.3 Early-stage Entrepreneurial Activity and Ambition

Levels of entrepreneurial activity are a vital sign of any economy as it has been shown that the creation of new ventures is positively connected to the drivers of economic growth and productivity through increased innovation, competition and job creation. While recent years have seen record levels of start-up in the UK in an international context there remains a clear 'entrepreneurial deficit' across the country as measured by business start-up activity.

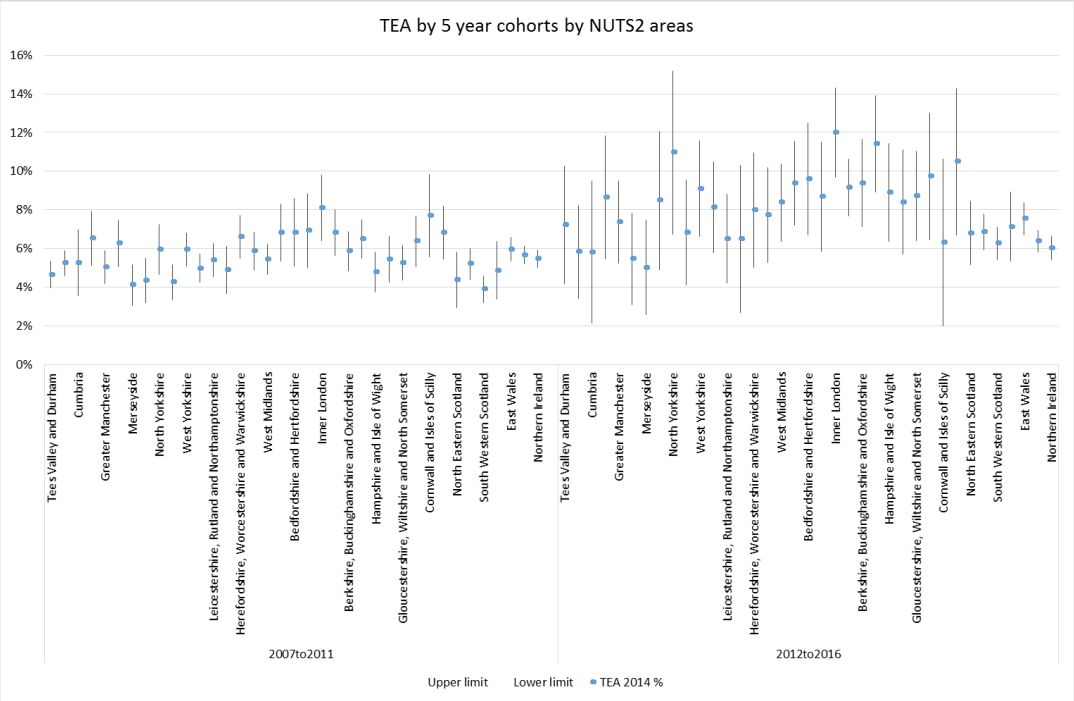
The GEM UK datasets since 2002 represents a unique annual survey which focuses on the measurement of new business formation at the level of the individual. So, to be clear the GEM data should be read alongside the early data on start-ups which is based on ONS administrative data on firms/businesses. Together, they provide a comprehensive overview of one aspect of what contributes to business dynamism in the WMCA region – that is, new venture creation.

Nascent Entrepreneurs and New Business Owners

Figure 9 presents data on the proportion of the adult population in the West Midlands who are involved in early-stage entrepreneurial activity (i.e., both nascent entrepreneurs and new business owners – the GEM TEA rate). The data is pooled over sub-periods to counter the influence of small sample sizes: 2007-2011 and 2012-2016. In the earlier period the English RDAs boosted the UK sample which explains the smaller confidence intervals on the chart. In the latter period the UK sample size was around 10,000 each year.

The rate of early-stage entrepreneurship in the West Midlands in the 2007-2011 period was 5.5% which was significantly lower than in Inner London (8.1%). It was not significantly different from Greater Manchester, Merseyside and West Yorkshire. In the later period the TEA rate in the West Midlands had risen to 8.4% but, given the larger confidence intervals, was not significantly different from any other region except Northern Ireland (6.0%) and East Wales (6.4%).

Figure 9: Total early-stage Entrepreneurial Activity in the UK NUTS2 Areas (2007-2016)

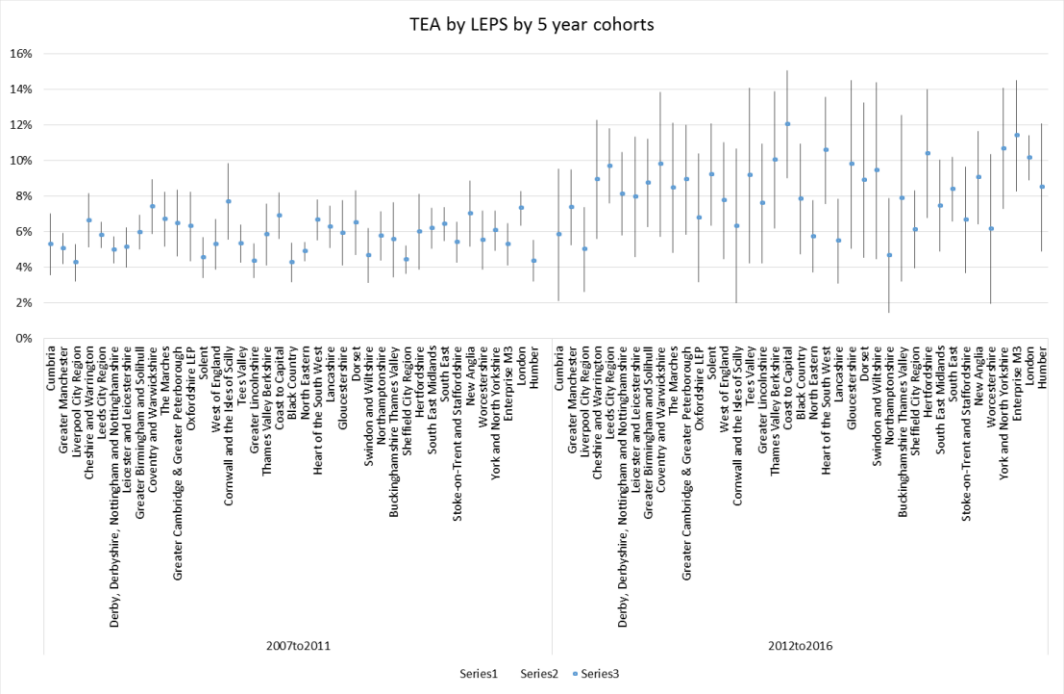


Source: GEM UK APS 2007-16

Figure 10 shows the same TEA rate for the English LEP areas and it is possible to see the differences across the three LEP areas in the WMCA region. There are clear differences in the 2007-2011 period which are statistically significant. The TEA rate in the Coventry and Warwickshire LEP (7.4%) was higher than in the Black Country LEP (4.3%) and the TEA rate in Greater Birmingham and Solihull LEP was 6.0% (not significantly different from the other two LEP areas.)

In the later period the TEA rates in each of the three LEP areas had risen quite markedly: Coventry and Warwickshire LEP (9.8%); Greater Birmingham and Solihull LEP (8.7%) and the Black Country LEP (7.8%).

Figure 10: Total early-stage Entrepreneurial Activity in the English LEP Areas (2007-2016)



Source: GEM UK APS 2007-16

Growth Ambition

Using the pooled GEM UK datasets outlined above we can examine the proportion of early-stage entrepreneurs who have ambition or high aspiration. These individuals are defined as early-stage entrepreneurs (i.e. either involved in start-ups or owners-managers of young companies up to 42 months) who,

- aim to increase employment by 50% or more over the next five years, and…
- will employ 10 people or more.

This definition combines two characteristics used alternatively in the literature:

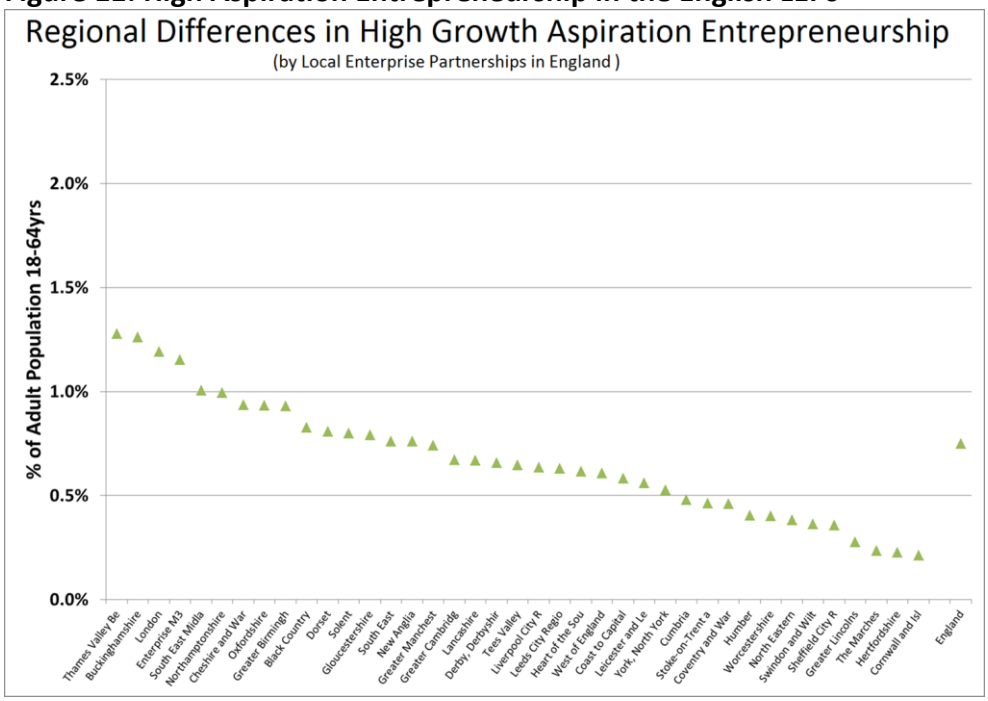
- Looking at the expected ***level*** of employment after 5 years (but companies could start large, hence no dynamism)
- Looking at expected percentage ***change***, controlling for initial level (but a self-employed adding an employee produces lots of dynamics but little impact)

Figure 11 shows that overall in the UK there is a very low incidence of high aspiration early-stage entrepreneurs which mirrors the evidence from the firm-level growth metrics.

There is also great deal of variation across the LEP areas and within the WMCA region. Greater Birmingham and Solihull and the Black Country LEPs have the highest proportion of high aspiration early-stage entrepreneurs (around the English average) and much higher than in Coventry and Warwickshire LEP. The LEP areas with the highest proportions are in four southern English LEPs (Thames Valley Berkshire; Buckinghamshire; London and Enterprise M3).

Analysis to understand these differences can be found in Mickiewicz and Hart (2016) who showed that – compared with those who are not spatially mobile – both internal (regional) migrants and immigrants are more likely to start new ventures characterised by high growth aspirations.

Figure 11: High Aspiration Entrepreneurship in the English LEPs



Source: GEM UK Pooled APS datasets (2003-2013)

5. Conclusion and Recommendations

5.1 Summary of Findings

There is a clear connection between business dynamism and growth in productivity. However, the evidence assembled in the previous sections illustrates that there are some challenges for the WMCA region in terms of the many elements that contribute to business dynamism and hence productivity. In simple terms the challenge revolves around the issue of 'scaling' whether it be of the many start-ups in the region or more established businesses. Our findings show that:

- There is a range of start-up rates across the region with Coventry and Warwickshire LEP performing well against the English LEP average with the Black Country LEP lagging well behind that benchmark. This is confirmed by both the ONS data and the GEM UK data.

- The Black Country LEP has a better track record on the initial scaling of its start-ups compared to the other two LEP areas in the WMCA region and is above the English LEP and UK average. This emphasises the point that it is not the volume of start-ups which matter *per se* but their ability to survive and grow which is the key.

- There are very few firms in the WMCA region which can be categorised as 'high-growth' or 'scaling' – this is particularly true of the Black Country LEP where the number of OECD High-Growth Firms is well below that of the other LEP areas and indeed the UK average.

- Growth ambition among early-stage entrepreneurs in the WMCA region is around the national average in Greater Birmingham and Solihull and Black Country LEPs but well below the national average in the Coventry and Warwickshire LEP.

- Start-ups scaling or more established businesses growing rapidly for the first or second time, have had a disproportionate impact on job creation.

These findings lead to the conclusion that in terms of the business environment reflected in the key metrics of business dynamism there are some faulty valves in the Midlands Engine which need urgent attention in order to drive the productivity agenda. It is perhaps no coincidence that a below average number of 'high-growth' firms in a local economy correlates with significantly lower levels of GVA per worker – the Black Country LEP being the prime example in the WMCA region.

5.2 Reflections on the Scale-up Agenda

However, a single-minded preoccupation with HGFs and indeed SHGFs may not be a sensible focus for policy-makers. Not only are these measures somewhat artificially defined, they also have the disadvantage of rendering invisible the reality of growth for the majority of businesses. It would be more informative to concentrate on the importance of creating a growth pipeline at local level and monitoring its development over time. Tracking cohorts of start-ups over time, and other groups of established firms as they begin to engage in a range of activity which prepares them for future growth, would be a more meaningful focus for business support policy and demands richer data.

Recent analysis has demonstrated the value of this approach by shedding some light on the nature of high-growth episodes over the life cycle of a firm (Anyadike-Danes and Hart, 2017). Whilst we know something of the characteristics of these firms – about their age, size, sector and location – we know relatively little about the dynamics of the HGF population as it evolves over time. For the most part attention is focused simply on the annual count which, as we shall see, is not an entirely appropriate measure of HGF activity.

Anyadike-Danes and Hart (2017) develop a measurement framework designed to track the population of high-growth firms (HGFs) between 1998 and 2015: the innovation here is the explicit allowance for firms which experience 'repeat' episodes of high growth (HGEs). The headline findings are as follows:

- The average age at which a firm becomes categorised as a High-Growth Firm (HGF) – that is, records its first High-Growth Episode (HGE) – is about six years, and;

- Tracking HGFs over their lifetime, almost two-thirds of HGEs recorded during a 3-year period, and conventionally referred to

as HGFs, are actually repeat episodes being recorded by HGFs 'born or first classified some years previously.

This analysis provides for the first time a clearer understanding of the dynamics of HGFs over time, and although there is a clear age decay effect, it reveals the importance of HGEs in driving growth in these firms. This is an important consideration in any attempt by policy makers to identify the lead indicators for HGFs, a group of firms which plays such an important role in job creation.

In practice though, identifying a firm about to have its first HGE may involve quite different lead indicators or triggers than the indicators which might be relevant for firms having a second or third HGE. We might hypothesise that:

- the first episodes of high-growth might be related to strategic decisions to innovate and/or engage in international activity for the first time.
- Repeat episodes may stimulated by different factors such as the decision to look for additional debt or equity finance to consolidate and kick-on after an initial burst of high-growth. This will require further research to test such hypotheses.

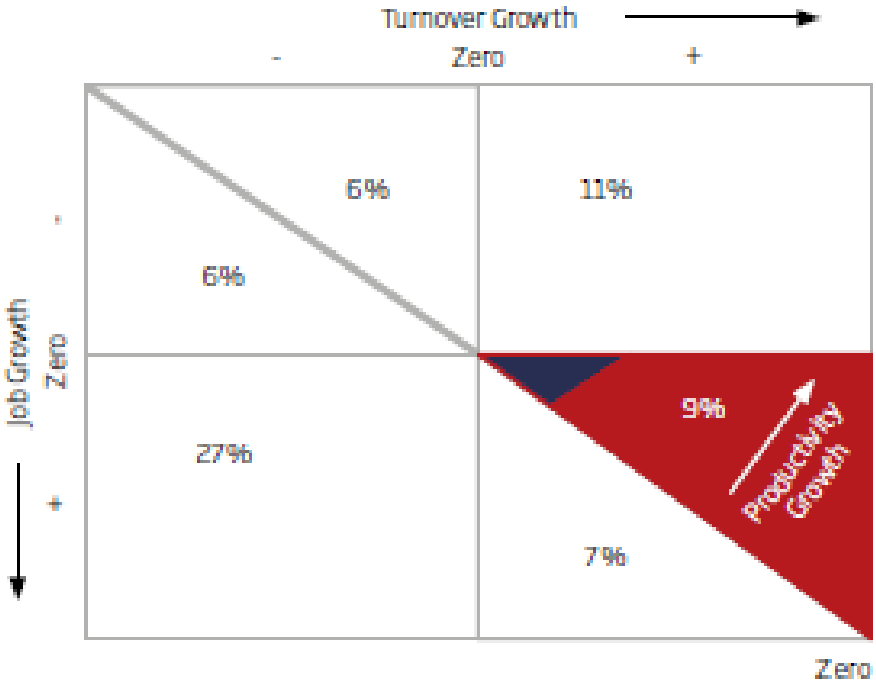
Moreover, it is important to note that firms being categorised as a HGF for the first time in a birth cohort of firms grow faster and makes a more substantial contribution to job creation than when it has further HGEs.

5.3 Job Growth or Productivity Growth?

A word of caution is necessary about firm growth and productivity gains, especially, with respect to the various policy narrative around 'high-growth' or 'fast-growing' firms, as the relationship with positive productivity outcomes for these firms growing fast in terms of jobs and revenue is tenuous (Du and Bonner, 2017). So, in the case of the Black Country LEP, the below average proportion of 'high-growth' firms (as defined in terms of rapid job growth) cannot be seen as the sole cause of the weak productivity position.

Figure 12 shows that only 9% of a panel of 250,000 non-financial firms, aged at least 10 years in 2008, experienced positive gains in labour productivity over the period 2008 and 2015, and only half of these just made it across the 'frontier' into positive growth in labour productivity – the blue triangle (Anyadike-Danes and Hart, 2016).

Figure 12: Relationship between Jobs, Turnover and Productivity (2008-2015)



Source: Anyadike-Danes and Hart (2016) and British Business Bank (2018)

5.4 Towards a Policy Framework

Finally, some thoughts on a business support policy framework in the WMCA region. Driving growth across the region will require a focus on firm-level factors, including the mindset and growth orientation of individual business leaders/entrepreneurs, which include such things as differences in access to, and effective use of, technologies, in private sector investment rates, and in management and entrepreneurial capacity. These are the key factors that help explain differences in productivity across the heterogeneity of firms, and especially SMEs in the UK and between the UK and other nations.

So, how do we set out to develop a sustainable and impactful policy framework for the WMCA region which builds on the foundations of business success while addressing some of the weaknesses across the private sector? The following headline principles form a recent paper submitted to BEIS as part of the 'Business Support and SME Productivity Review' (as flagged in the Industrial Strategy) offer a useful starting point (Overman, Hart and Roper, 2018).

Why support: One way to improve productivity is to have lots of firms make (small) improvements in the way that they are run. For these firms most of the effort needs to be on low cost ways of getting new technologies/practices into firms – new to the firm innovation - or on increasing their capacity to use them effectively. Government has a role to play here because there is a clear market failure in terms of technology adoption and use.

Who to support: The evidence indicates that there is no underpinning rationale for a business support offer aimed at 'picking winners' and certainly no logic on a myopic focus on High-Growth Firms as defined by the OECD. Our reading of the evidence is that it makes no sense to try to identify high-growth firms as a distinct 'type' of firm in any discussion of 'who to support'. Instead, high growth is episodic so the key question is when to support rather than who to support.

When to support: Here we focus on the question of *when* to offer different kinds of support and how to help and encourage firms to access the appropriate support for their stage in the lifecycle. A public sector support offer needs to be demand-led, enabling effective self-selection into different types of support which overcomes many of the pitfalls of targeting and screening. The evidence suggests that a strong element of self-selection is inevitable in the targeted provision of support for high-growth episodes. Enabling effective self-selection by firms requires a clear proposition from the scheme as well as a clear statement of required commitments. The support offer needs to be both ambitious and engaging, and participating in the scheme needs to carry a certain cachet.

How to support: We argue that business support needs clear segmentation. Support for the long tail of firms that hitherto have shown no ambition to grow should be generic, non-selective and cost-effective. This might include informational campaigns or brokering initiatives. There is some limited evidence that intensive support does enhance performance. We argue that for those firms currently experiencing high-growth episodes or about to, intensive support should be conditional: supported firms need to generate

positive 'national (or local) spillovers', or have the potential to do so - high-growth episodes *per se* do not make the case for public support.

Having set out some principles it is now the task to provide some guidance on how this can be done within the existing business support framework within the region. Notwithstanding the potential outcome of the current 'Business Support and SME Productivity Review', which may provide some form of 'English' business support solution aimed at driving growth, it is timely to review some local options.
Despite their limited resources and their different approach to the task, the Growth Hubs in each of the LEP areas are in the frontline and need to step up and engage more effectively with building a pipeline of businesses who have a clear growth orientation. What are the main priorities?

First, there is a need to provide a clearer focus on the 'growing businesses' agenda in the region. There is a real tension in the public sector in particular between supporting growth-oriented businesses (the 'few') and making business support and advice available to all start-ups and established businesses (the 'many'). This requires an open and honest discussion about where the business support inputs will have the greatest outcomes and impact for the region. The identification of the 'few' remains a challenge but current developments in BEIS, HMRC and the ONS (part of the DECA Project), using AI and machine learning techniques, are designed to help focus business support operations across the LEPs and regions. It is important to note that the evidence shows that fast-growing firms occur in ALL sectors of the economy so the identification of the 'few' should not be driven solely by a sector focus.

Second, we need to ensure that business leaders are aware of the wide range of support available to them from the private and public sector to support their business development opportunities. Despite many abortive attempts the 'business support ecosystem' remains too dis-jointed and businesses still complain that they do not know where to go for support. The proportion of businesses in the WMCA region contacting the Growth Hubs is low, but that is not unique to this region and is in evidence across all 38 Growth Hubs. A greater effort on marketing the range of business support available **and how they connect to each other** is required as current efforts are clearly not having the required impact.

Third, leadership, management and entrepreneurial skills are crucial in driving growth and productivity gains. There needs to be an audit of all the available programmes and initiatives in this space across the region with a view to categorising them in terms of low, medium and high intensity (e.g., hours of support) as well as which ones are delivering real impact. This is

important to maximize the brokerage role of the Growth Hubs and the eventual impact for businesses and regional growth.

Fourth, there is clear evidence that engagement with universities, and Business Schools in particular, brings bottom line benefits to SMEs over and above the value of the knowledge exchange experience. While all of the universities are engaged to some extent with SMEs across the region it is still the case that they remain a 'best kept secret' to the small business leader and as a result engagement remains low. To address this, individual universities need to make it easier for SMEs to find out what expertise is available and, in parallel there should be a regional campaign by the universities in association with the Small Business Charter, which was launched by Lord Young in 2014, to raise the profile of the value of the HE collective to small businesses.

1

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