

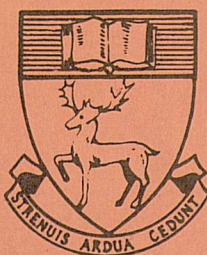
**Department of Geography
University of Southampton**

**SMALL BUSINESSES IN
THE RECESSION:**
A Follow-up Study of New
Manufacturing Firms
in South Hampshire

C. M. Mason

No.25

**Discussion
Papers**



REFERENCE ONLY
This book may not be
taken out of the Library

SOUTHAMPTON
UNIVERSITY LIBRARY

BOOK NUMBER	84-037743
CLASS MARK	LF 789.563
	Univ Col

840.5 / 743



SUMMARY

The paper reports on a follow-up study, undertaken in mid-1983, of 52 new manufacturing firms in South Hampshire, all started since 1975, and which were originally interviewed in 1981 in a study of new firm formation (the results are presented in Discussion Paper No 13). The study therefore covers a two year period, 1981-1983, in which the economy was in a deep depression, having "bottomed out" following the steep fall in the level of economic activity in late 1979/1980. However, such adverse economic circumstances do not appear to have had as detrimental an impact on the panel of firms as might have been anticipated. Admittedly, 23% of the original group of firms had closed in the period between the two surveys, but some were already clearly in difficulty as a result of internal problems when first interviewed. Moreover, less than half of the surviving firms claimed to have been adversely affected by the recession. Indeed, as a group the panel of surviving firms is characterised by increases in turnover, floorspace and employment and improvements in the quality of premises, capital stock and technological sophistication - all supporting the notion of a company 'life cycle' model. However, changes in other dimensions of business development - notably management structure, markets and customers - tended to be quite limited. The panel is also characterised by increased variability in employment, with the upper quartile value increasing by a greater rate than the median on most indicators - a result of the rapid growth of the small number of 'high fliers' which have pulled further away from the majority of firms in the group. Moreover, it is this small group of 'high fliers' in the panel which has made the greatest contribution to employment generation and economic development. It is concluded that policy would achieve more substantive results by shifting from its present indiscriminate assistance to the small firm sector towards a more selective approach which attempts to encourage the creation of greater numbers of rapid growth firms.

CONTENTS

	Page	
1	Introduction	1
2	Survival and Closure Rates	4
3	Closures	5
4	Surviving Firms: Developments Between 1981 and 1983	7
	4.1 Legal status and ownership changes	8
	4.2 Finance and investment	10
	4.3 Products, customers and markets	16
	4.4 Premises	21
	4.5 Employment	25
5	Conclusion	27
	Notes	33
	References	34

LIST OF FIGURES

1	Output of the Production Industries 1978-1983	2
2	Insolvencies in England and Wales 1979-1983	2
3	Number of New Companies Registered in Great Britain 1979-1983	2
4	Gross Turnover in Surviving New Enterprises: 1980/81 to 1982/83	11
5	Capital Investment by Surviving New Enterprises: 1981 to 1983	13
6	Floorspace Occupied by Surviving New Enterprises: 1981 & 1983	24
7	Employment in Surviving New Enterprises: 1981 and 1983	26
8	Evolution of Small Companies: characteristics of each stage of development	30

1. INTRODUCTION

The recessionary conditions of the early 1980s have provided an extremely harsh economic environment for industry. Small businesses, generally lacking the financial resources and diversified products and markets of the corporate sector to provide at least a temporary cushion against a downturn, have been particularly hard hit. Since most small manufacturing enterprises serve other manufacturing firms, generally by supplying components and equipment or else by undertaking industrial services on a sub-contract basis, the massive drop in industrial output since mid-1979 (Figure 1) - a result of plant closures, destocking and cutbacks in capital investment by the manufacturing sector - has led to a considerable contraction in the demand for many of the products and services which they offer. Public sector spending on capital projects and equipment has also contracted, thereby reducing the amount of work for those small firms which act as sub-contractors and suppliers to the larger 'prime contractors', while the rapid rise in unemployment has meant that fewer consumers have had the income to purchase the products and services provided directly or indirectly by small firms. Paradoxically, the volume of retail sales reached record levels during 1983 (up from a value of 104 in 1980 to 114 in mid-1983 at 1978 prices, 1978 = 100), reflecting not so much an increase in real personal disposable income (which fell from 100 in 1980 to 97.3 by the third quarter of 1983) but a decline in the proportion of personal disposable income which is saved (Financial Times, 29.9.83). However, much of this 'consumer boom' has involved the purchase of imported goods; imports of finished manufactures and consumer goods have risen substantially during the recession.

This decline in industrial and - to a lesser extent - non-industrial demand since 1979 has predictably led to a sharp rise in the number of business failures (Figure 2) especially amongst small firms, leading to fears amongst some large companies of supply and bottleneck problems in any economic upturn (Elliot, 1982). However, the closure of large numbers of small firms has not necessarily enhanced the business prospects of surviving companies because it has been accompanied by a rapid increase in the formation of new businesses (Figure 3) as rising unemployment has 'pushed' many people into entrepreneurship (Harrison and Hart, 1983; Binks and Jennings, 1983), while start-up costs have been minimized by the availability of secondhand machinery from liquidators auctions. It has been suggested (Binks, 1983; Binks et al. 1983) that by obtaining cheap machinery and through working long hours with very little personal financial return, new firms have been

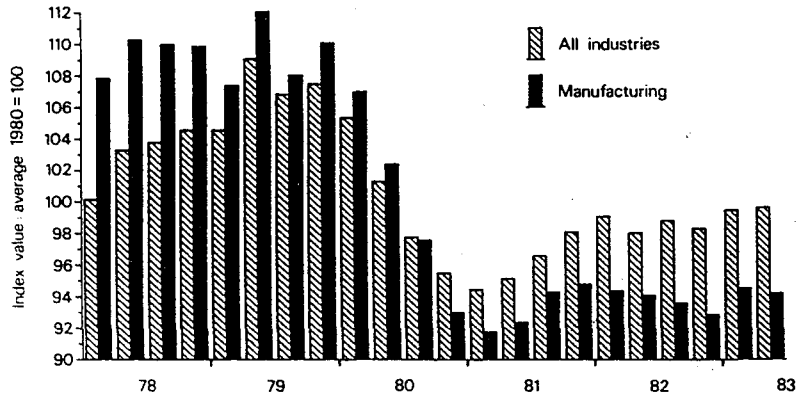


Fig 1. Industrial Output 1978-83

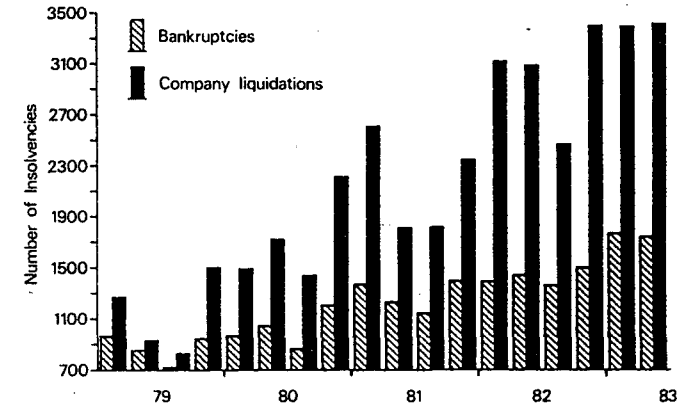


Fig 2. Insolencies in England and Wales 1979-83

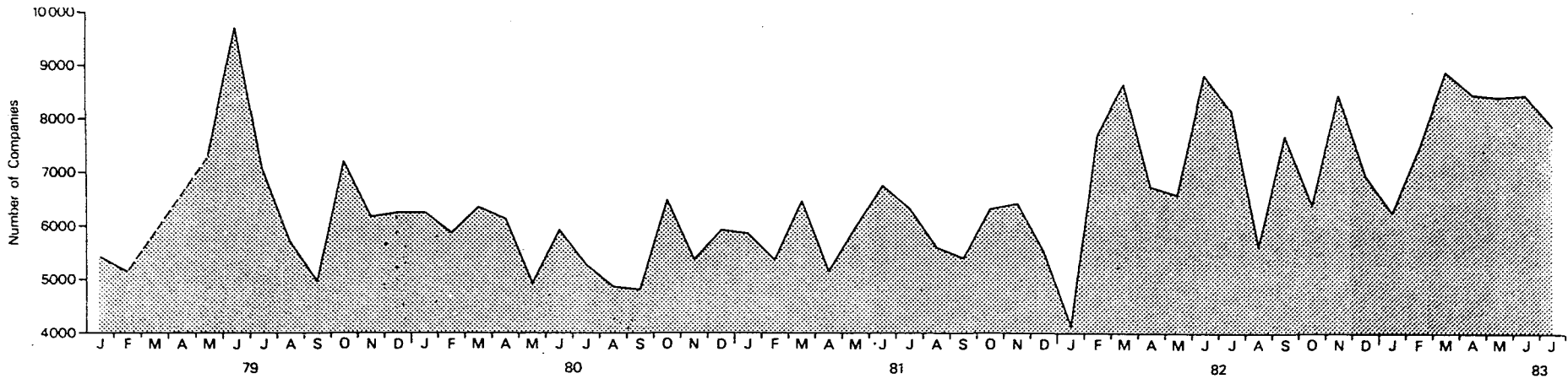


Fig 3. New Companies Registered in Great Britain 1978-83

(source : British Business)

able to compete with established firms in the same industry who will, in all probability, be paying realistic wages and have incurred higher capital costs, threatening their survival in some cases. In addition, the ability of established small firms to re-invest in new machinery may be threatened by the distortions in the secondhand machinery market caused by the large numbers of companies in liquidation. The effect of this will be to reduce the return which established companies can obtain through the disposal of their secondhand machinery, thereby increasing the amount of finance required to purchase modern equipment, perhaps to an impossibly high level. Overall, the short run effect of large numbers of company liquidations may therefore be to pull established firms towards, and in some cases across, the margin between survival and failure.

Various industrial organizations (e.g. CBI, Association of Independent Businesses, Chambers of Commerce) have attempted to monitor the effects of the recession on small businesses through their regular surveys of members. However, such appraisals are, of necessity, highly generalized, limited in detail and unrepresentative in coverage. This study is one of the few which attempts, albeit in limited terms, to assess at a local scale the effect of the recession on small firms (also see Lloyd and Dicken, 1982, pp 41-43, 106-112; Leigh et al, 1983). It examines a panel of 52 new manufacturing firms in South Hampshire which were originally interviewed during the first half of 1981 in a study of new firm formation (Mason, 1982; also see Mason and Lloyd, 1983). The follow-up study, which was undertaken between mid-May and early August 1983, examined the developments in each firm since the original interview. The study therefore covers the fortunes of the firms during a period of just over two years in which the economy was in a deep depression; as Figure 1 shows the recession had 'bottomed out' by early 1981 but there were few signs of sustained recovery by mid-1983 despite some short-lived upturns in certain economic indicators.

The firms themselves - described in Mason (1982) - were all post-1975 start-ups. The oldest firm was therefore only in its eighth year of operation when interviewed in the follow-up study while the median age was five years. Although the panel of firms had, with only a few exceptions, passed what is statistically the most hazardous age for a new business - the first three years (Ganguly, 1983) - the original survey nevertheless hinted that many were vulnerable to a prolonged economic downturn. For example, the majority were already experiencing cash flow problems, generally regarded as the most common immediate cause of company failure (Dickson, 1983),

and for some of these businesses any further deterioration in the state of their working capital could have been fatal. In addition, one-quarter of the firms in the panel reported either that their turnover had fluctuated since start-up or else that it had peaked and was now declining. Moreover, most firms were serving the local/regional manufacturing sector, primarily by undertaking sub-contract work, and therefore were sensitive to any decline in demand from this source. However, in this context it was to the advantage of South Hampshire's new manufacturing firm sector that - according to both the London Chamber of Commerce and Industry and the CBI Southern Branch - economic recovery was considerably stronger in the south of England than in the rest of the country (London Chamber of Commerce and Industry, 1982; Financial Times, 3.10.83). Nevertheless, over one-quarter of the panel relied on a narrow range of key customers and were therefore vulnerable to changes in the economic fortunes of these firms.

A significant proportion of the firms surveyed in 1981 therefore appeared to be at risk on one or more counts in the event of a prolonged recession. In contrast, only a small minority of firms in the panel seemed relatively favourably positioned to ride out the recession by possessing one or more of the following characteristics: their own proprietary product (which in some cases had innovative properties); substantial export business; significant sales to the service sector; and operating in a market niche with few competitors.

In order to intrude as little as possible on the good will of the companies (and thereby keeping open the option of future follow-up studies) the interviews were restricted to a relatively narrow range of topics. These comprised shareholding structure and legal status, finance and investment, products and markets, locational change and employment. The response rate was very satisfactory, with only three of the firms which survived as independent companies unable to be interviewed again (a response rate of 92%), in each case as a result of the pressures of work on the owner-managers. However, information was obtained from these firms on their current employment levels and turnover.

2. SURVIVAL AND CLOSURE RATES

Of the 52 post-1975 start-ups interviewed in the original study, 37, (71%) survived as independent companies over the period 1981 to 1983. The fortunes of these firms are discussed in Section 4. The remaining firms fall into three categories (Table 1). The first comprises one firm which was taken over by an established private company, apparently as a

way out of its financial difficulties.² The second category comprises two firms which in 1981 each operated two plants, one in South Hampshire and the other outside the sub-region (in Dorset and Somerset respectively). By mid-1983 both these companies had closed their South Hampshire operations and transferred production to their other plant.³ The third and largest category comprises 12 firms which had gone out of business since being interviewed in mid-1981, a closure rate of 23%.⁴

Table 1 Fortunes of the Original Panel of Firms

	number	%
Survivor (as an independent company)	37	71
Taken-over	1	2
Moved out of South Hampshire	2	4
Closure	12	23
	52	100

Intuitively it would seem that the failure rate amongst this panel of new manufacturing firms in South Hampshire has been high, but in the absence of comparative data from other areas or other time-periods, this conclusion must remain speculative. However, comparison with the Department of Trade and Industry's detailed life-span analysis of new firms, defined as companies registering for VAT purposes between 1973 and 1982 (Ganguly, 1983) does tentatively support the view that the failure rate recorded by the panel of new manufacturing firms in South Hampshire is slightly excessive. In the DTI study the stock of businesses which closed each year (defined as companies de-registering for VAT purposes) varied between 8 and 11%, with the average over the period being slightly greater than 9% per annum, whereas in South Hampshire the closure rate was 23% over two years. Reworking the DTI data to make it more comparable with the South Hampshire study indicates that 9.7% of those businesses which started in the period 1976 to 1980 inclusive and were still operating in 1981 closed during the subsequent twelve months. If this rate of failure was repeated or even slightly increased over the next year then it would still represent a lower figure than that recorded by the South Hampshire panel between mid-1981 and mid-1983.

3. CLOSURES

Primarily because of the limited time and resources available for the follow-up study, no attempt was made to contact the founders of companies

that had ceased to trade. In addition, it was considered that any conclusions reached after interviews with founders about the reasons for the failure of their companies would be invalidated by the small numbers involved. Moreover, there would be inevitable difficulties in tracing the founders who - even if contacted - might be unwilling to discuss the failure of their enterprise because it would reflect badly on them. (In the event, this fear was not borne out in the one interview which was conducted with a failed founder.) A pilot study to examine the feasibility of identifying, contacting and interviewing the founders of failed enterprises would, however, represent a worthwhile methodological exercise.

Information obtained from the interviews in the original survey indicated that three of the twelve firms which subsequently failed were already close to closure in 1981 and three others were facing quite serious demand or production problems. However, none of the other six firms which subsequently closed displayed any obvious signs of future failure or indicated that they were encountering serious difficulties of any kind, but this might simply serve to underline that problems which lead to failure in small firms frequently appear with great rapidity, although it is equally the case that many small firm owner-managers fail to notice or react to early danger signals (Dickson, 1983). Nevertheless, half of the firms which subsequently closed reported a declining or fluctuating trend in turnover at the original interview (representing nearly half of all the firms in the original panel which fell into this category) whereas only four of the subsequent failures reported a steady growth in turnover since start-up. Moreover, three-quarters of the firms which subsequently closed reported at the original interview that they were experiencing liquidity problems, representing about 30% of firms in the original panel which experienced this problem.

In most respects the characteristics of firms which subsequently closed displayed at most only marginal discrepancies from surviving firms. For example, the median date of start-up was the same for both failures and survivors (1978) although this does mask the tendency for more recent start-ups to display a slightly higher failure rate. Hence, for firms which started in 1979 or 1980 the failure rate was one-third compared with only around one-quarter for firms started in 1976 and 1978 and just 8% amongst 1977 starts. Half of the failed firms were engaged in metals and engineering activities but this did not represent an excessive concentration when compared with the industrial distribution of the original 52 firms. However, it is noticeable that only one of the seven firms in the 'high tech' sectors

of electronics and instrument engineering closed. Perhaps surprisingly, firms undertaking sub-contract work were no more vulnerable to closure than those with their own products, but a narrow customer base did seem to be associated with a greater probability of closure, with one-third of the firms in the original panel which depended on a small number of key customers subsequently closing. In terms of start-up characteristics, there was a slight tendency for firms started by a single founder to display a higher closure rate, but the previous experience of a founder in starting a business did not appear to influence the likelihood of subsequent failure. In contrast to the anticipated pattern, firms which were started on a financial shoe-string were not excessively vulnerable to closure. Indeed, there is greater evidence for the reverse relationship to hold since firms which had over £15,000 of launch capital displayed the highest failure rate (38%) and two of the three firms which used over £100,000 of start-up funds subsequently closed. Other financial criteria - notably turnover and plant and equipment valuations - confirmed that closures were not disproportionately concentrated amongst the smallest firms but were represented throughout the size distribution. Indeed, in terms of employment size larger firms were more likely to close, the mean and median workforces of closures (14.7 and 12 employees) being higher than those of survivors (11.4 and 7 employees).

In summary, on the basis of the data collected in the original survey, firms which subsequently failed between 1981 and 1983 appeared in most respects to be broadly representative of the original group of 52 firms. Certainly, there was a slight tendency for firms which subsequently closed to have had a fluctuating or declining level of turnover up to 1981 and most had cash-flow problems. More recent start-ups, sole founder businesses and firms with a limited range of customers also displayed slightly high failure rates. However, characteristics such as reliance on sub-contract work, large numbers of competitors, limited start-up capital and a low level of capital assets, which might have been expected to be associated with failure, were equally common amongst surviving enterprises. Indeed, financial and employment data both indicate that larger firms were just as likely as their smaller counterparts to subsequently fail.

4. SURVIVING FIRMS: DEVELOPMENTS BETWEEN 1981 AND 1983

The primary aim of the interviews which were conducted with the owner-managers of those firms in the original panel which survived as independent companies to 1983 was to identify and account for changes which had occurred

in each business since the original survey some two years earlier. Within this general framework it was also possible - where relevant - to examine the role of the recession in inducing (or constraining) change and generally to assess its impact on the panel of firms.

4.1 Legal Status and Ownership Changes

Limited liability remains the dominant, but not the unanimous, form of legal status amongst the surviving businesses. Indeed, one-third of firms continued to operate as sole traders or partnerships and only two firms, on the advice of their accountants, opted in favour of limited liability. The owner-managers of the 11 unincorporated firms (seven of whom were very small, with turnovers of less than £65,000 in 1982/83) each indicated that they could not see any merit in incorporation given their particular circumstances and their accountants had not been able to advise them of any advantages. However, most reviewed the balance of advantages and disadvantages each year with their accountants.

Changes in ownership and management were similarly restricted to a small number of firms. The break-up of founding partnerships occurred in three firms (to add to the seven similar cases noted in the original survey); in each of these firms one of the co-founders left as a result of disagreements with the remaining founder(s) (one such departing founder subsequently set up a new firm on his own) but in only one case did the remaining founder(s) take on a replacement partner. In a further two firms a director (but not one of the founders) was removed from office following serious conflict with his colleagues, but again only one firm appointed a replacement. (A further five firms made minor changes in the composition of their boards of directors.)

The involvement of small firm owner-managers in legally-separate business ventures was a more frequent development amongst the surviving enterprises, with six individuals developing new personal business interests outside their own firms. These comprised three sole founders who each set up legally-independent new firms in non-manufacturing trades that were unrelated to the manufacturing activities of their existing companies; a founder whose wife and daughter set up a new business; a managing director who took a financial stake in a newly established company in a related line of business; and a sole founder who joined the board of an investment trust (which already had a shareholding in his firm). Adding all these new outside involvements of owner-managers to those made by others prior to the original survey in 1981 reveals that in 49% of surviving firms at least one of the founders had

developed outside business interests in legally separate, generally new, enterprises.

These founders can be divided into two groups. The first group consists of those owner-managers of surviving firms who have set up new companies, frequently representing a logical diversification of their existing business, but choose to personally own the shares rather than establishing the new enterprise as a wholly-owned subsidiary of their existing firm either because of tax and accounting considerations or else in order to minimize risk by ensuring that the failure of one company will not affect the other. The second group comprises those new firms that were set up by two or more founders, one of whom was already running his own business and who acts either in a part-time capacity or as a sleeping partner in the new enterprise. This arrangement can have a significant impact on the development of the new business, not just at the start-up stage where, as noted in the original survey (Mason, 1982), the founder who already runs his own business is able to provide the new enterprise with a "track record" and sometimes also supplies resources (e.g. machinery, factory space, staff) at a subsidized or zero cost, but it can also influence the day-to-day operations of the new venture notably with respect to its input and output linkages whereby the founder's established firm may act as a supplier or customer - or even the sole supplier or customer - of the new enterprise. While such operational links may be beneficial to both companies there are potential dangers of inefficiency and conflicts of interest in this type of arrangement.

In summary, the majority of surviving firms had already achieved stability in terms of both their legal status and the composition of their partnerships, directors and owner-managers prior to the original interview. Consequently, there have been relatively few changes in this aspect of the panel during the past two years. However, a further group of owner-managers had become involved in some capacity with legally-separate business ventures (generally from their formation) to add to those who already had developed such interests prior to the original survey, thereby confirming the view that many founder-owners of small firms are responsible, in partnership or by themselves, for the creation of more than one new enterprise in their lifetime. Whereas traditionally this process has been conceived in sequential terms (if accepted at all; see Cross, 1981, p.220 for a dissenting view) with a founder-owner setting up a second (or subsequent) business after his first (or earlier) venture(s) had either failed or been acquired by another company (Oxenfeldt, 1943), in fact the more common process would appear - on this evidence - to be for a founder-owner to set up another business while continuing to own and manage his existing enterprise.

4.2 Finance and Investment

Despite the adverse economic conditions, the majority of surviving new firms (78%) had succeeded in improving on their level of gross turnover during the past three financial years (1980/81 to 1982/83). Moreover, in most cases the increase in sales was well above the rate of inflation⁵; indeed, nearly 60% of firms achieved a growth in turnover of over 50% while 11 firms (30%) managed to double their turnover. (The best performer increased from less than £200,000 worth of sales to £1.2m in three years.) The largest two firms in the panel had achieved turnovers in excess of £2m by 1982/83 and a further two firms had exceeded £1m of sales; the oldest of these firms was only seven years old and the youngest just three years. The increased turnover of most of the firms in the panel is reflected in the median turnover value which rose from £105,000 in 1980/81 to £172,000 in 1982/83, with over two-thirds of this increase occurring between 1981/82 and 1982/83 (Figure 4).*

Of more significance is that this general increase in turnover over the three years has been accompanied by a much greater spread around the average value, especially in the top half of the distribution. This is reflected in the inter-quartile range which increased from £156,000 to £335,000 (+ 226%) over three years, primarily as a result of the much greater rise in the upper quartile value (£198,000 in 1980/81 and £417,000 in 1982/83 - an increase of 111%) compared with the lower quartile value (from £41,000 to £62,000, + 49%). As a result, the upper quartile value was almost two-and-a-half times larger than the median in 1982/83 compared with less than twice as large in 1980/81. This greater dispersion in turnover values has occurred without significant changes in the rank order of firms in the panel according to their turnover in 1980/81 and 1982/83 ($r_s = 0.89$, significant at $p > 0.01$). Indeed, only one of the ten surviving firms with the largest turnovers in 1980/81 did not maintain this position in 1982/83 and there was only one significant change in ranking within the top ten, with a firm moving from 10th to 3rd position. The much greater dispersion in turnover values which has occurred in the period between the two surveys is therefore due to the better performing firms in the panel, that is those with above average turnovers, pulling further

*The data in Figures 4 to 7 inclusive are presented by means of 'box and whisker' diagrams which provide a graphic description of the broad features of a distribution by using the median, inter-quartile range and extreme point values. The 'boxes' provide an indication of the spread of the data by describing the inter-quartile range, the 'cross bar' depicts the median value and the 'whiskers' mark the extreme values.

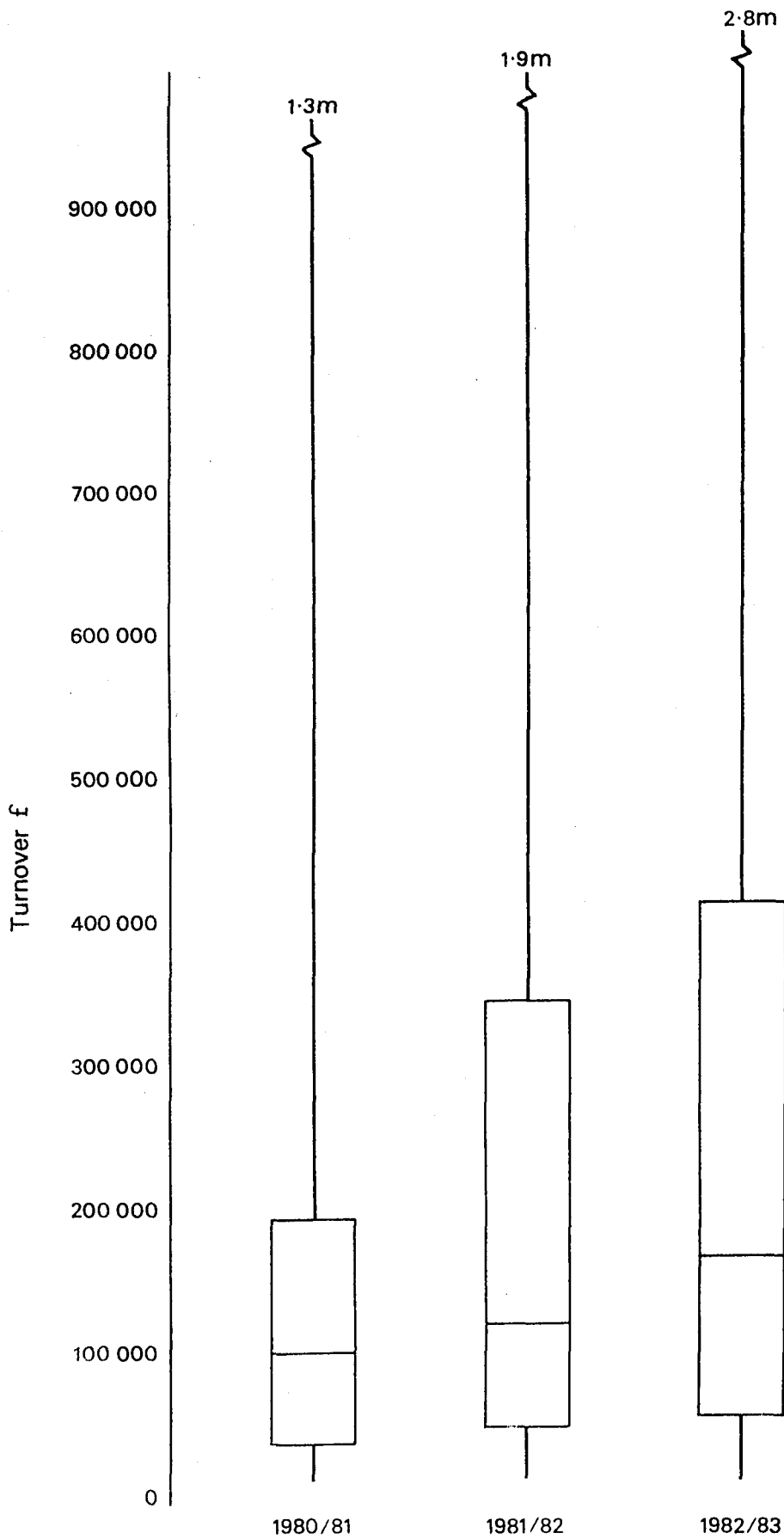


Fig 4. Gross Turnover in Surviving New Enterprises 1980-81 to 1982-83



away in relative terms from the majority which are clustered around and below the average.

Investment in the two years between the original interview and the follow-up study was, in most cases, directed towards plant and equipment rather than for buildings, continuing the pattern established in the years immediately after start-up (Mason, 1982, p.22). The median value of investment in plant and equipment was £10,000, although the skewed distribution (the upper quartile was £75,000) indicates that a sizeable minority of firms did invest substantially larger amounts (Figure 5). For many of the firms in the panel this investment in plant and equipment represented a significant increase in their capital assets. For example, eight firms (24%) undertook expenditure between 1981 and 1983 which exceeded the value of the plant and equipment which they possessed at the time of the original interview. This group comprised two 'high tech' enterprises (with turnovers of £2m and just under £1m) which required to invest substantial amounts of capital in order to keep abreast of the latest technologies, and seven smaller firms which each installed up-to-date machinery (e.g. CNC machines) to enhance their capabilities. A further 10 firms (29%) purchased machinery whose cost was equivalent to between 50 and 99% of the value of their 1981 stock of plant and equipment. This group comprised the remaining three companies with turnovers in excess of £1m, each of whom was engaged in less technologically intensive activities (pvc windows, polythene film and smoke detectors) and seven smaller firms.

For the panel as a whole, investment in plant and equipment was largely designed to improve the existing stock (55%) and to provide additional capacity or extend the firm's capabilities (32%) rather than simply for replacement purposes. Preference was generally for new machinery: firms which directed 90% or more of their expenditure towards new machinery comprised 64% of the total while those spending less than half of their total plant and equipment expenditure on new machinery comprised less than 15% of the panel. As only one-third of the surviving firms had a stock of plant and equipment in 1981 in which over 75% was purchased new, this pattern of investment during the two years since the original survey therefore indicates that there has been a general tendency for firms to modernize their capital stock. The preference of owner-managers in all but one case has been to buy rather than lease machinery, continuing a feature which was established at start-up.

The median investment on premises in the two years since the original survey

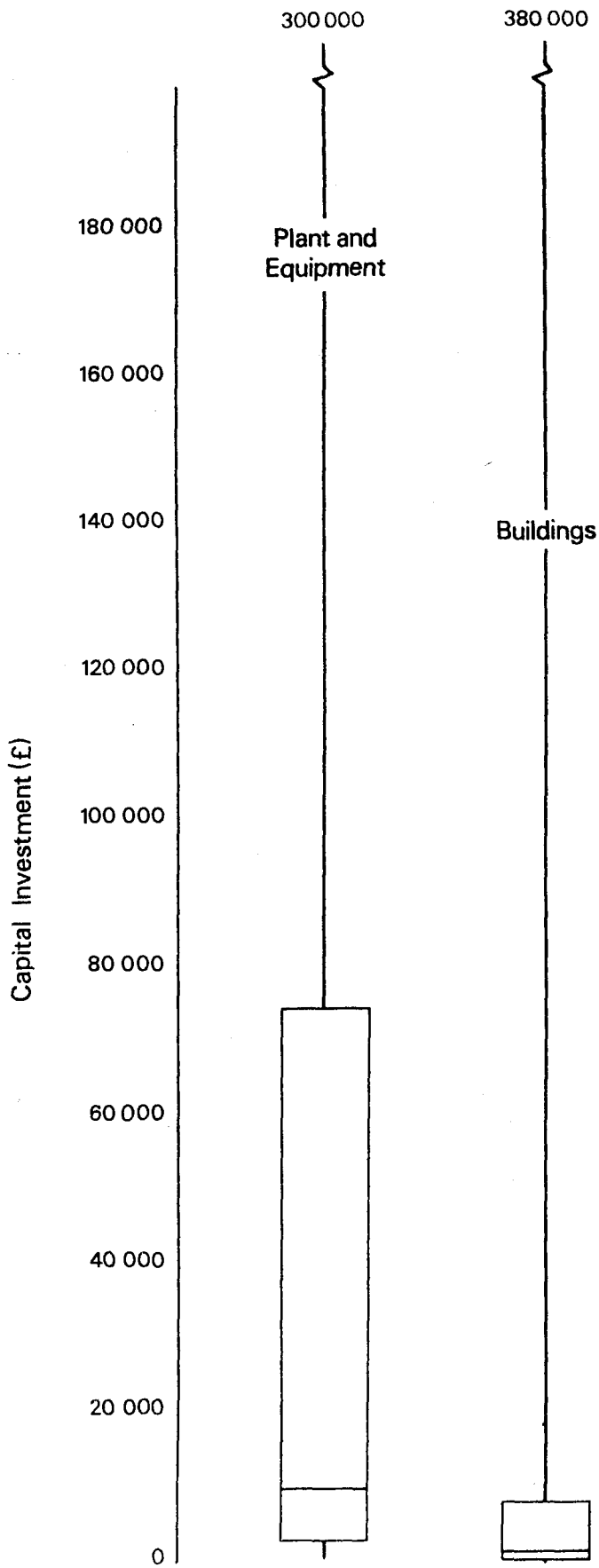


Fig 5. Capital Investment by Surviving New Enterprises 1981-1983

was just £1500 - substantially less than the equivalent figure for plant and equipment - while the upper quartile value was just £8000. Indeed, almost one-quarter of firms incurred no expenditure at all under this heading. Only a small proportion of firms in the panel have therefore undertaken substantial investment in connection with their premises, and in the majority of these cases this has been linked to a major adjustment in either tenure or location - or both. Hence, of the seven firms (21%) which invested over £20,000 on premises, all but one incurred the expenditure either by expanding their existing (freehold) premises, by opening an additional establishment or through relocation. In two of these cases firms moved from leasehold to freehold premises and a third purchased the freehold of its existing factory.

Sources of finance were dominated by the use of retained profits (utilized by 76% of firms). External sources were used to a much lesser extent, the most significant being finance houses (35%), bank loan (28%) and bank overdraft (21%). Only two firms made any use of less conventional methods of raising finance, namely a share issue to an investment trust (which was already a shareholder) and ICFC. Retained profits was also the single most important (or only) source of finance for exactly half of the panel, while external sources (bank loan, bank overdraft, finance house) fulfilled this function in only 38% of cases. Government grants were used by four firms (12%) but never as the single most important source of finance. Two of these firms had benefitted under the original Small Engineering Firms Investment Scheme (two other firms had also been awarded SEFIS grants but had not yet used it to purchase machinery), another obtained finance under the micro-electronics industry support programme and one had received funding from both the NRDC and under a Department of Industry support scheme for innovation. In terms of other sources of government financial assistance, three firms had benefitted under the Loan Guarantee Scheme, two firms had received help through the Microprocessor Application Project (MAP) while four of the major exporters had used the Export Credit Guarantee Scheme. When compared with the start-up and early post-start-up stages, the use of government grants and other forms of financial support by firms in the panel has been much more prevalent, reflecting the recent increase in the number of government measures to assist small businesses. Nevertheless, the majority of firms have made no use of government financial (or non-financial) assistance either before or since start-up.

Raising outside finance was a problem which affected only a very small minority of firms, primarily because the panel were now established and had

a 'track record' but also as a result of the general improvement in the supply of finance for small businesses. Indeed, only four firms (12%, but 16% of those which attempted to obtain external funding) encountered difficulties in raising outside finance, in two cases because of the lack of security, a third which was turned down under the Loan Guarantee Scheme and a fourth which despite being quickly accepted for the Loan Guarantee Scheme by the Department of Industry nevertheless encountered a long delay before gaining its own bank's approval. A fifth company, one of the most successful in the panel, was constrained in raising outside finance because of the way in which it was financially structured at start-up rather than due to any unwillingness of the financial community to lend.

There was no general tendency amongst the surveyed firms for stock levels to be reduced. Indeed, only one-quarter of firms underwent a de-stocking exercise while 20% of businesses actually increased their stock levels. But less encouraging was that just under three-quarters of firms reported excessive increases in the cost of particular inputs, although this created severe financial problems in only a very few cases. Raw materials - notably aluminium and steel - was the most frequently mentioned item to record a large increase in price (41% of firms) while petrol and associated transport costs, imported items, wages and rents were each highlighted by approximately one in every eight firms as items whose costs had risen particularly fast during the past two years.

Cash flow remained a serious problem for the majority of surveyed firms. Indeed, there was a slight deterioration in the position compared with two years earlier, with 56% of firms in the panel reporting that they had cash flow problems, a slightly higher proportion than in 1981. However, there have been considerable changes in the cash flow situation of a number of individual firms in the panel, with seven firms (21%) suffering from cash flow problems in 1983 but not in 1981 while four firms (12%) had overcome their difficulties in the two years between interviews. For a further 12 firms (35%) cash flow problems were prevalent in both 1981 and 1983. But if the identity of some of the firms with cash flow problems had changed in the period between the surveys, the general causes remained largely the same, namely slow payers (42% of firms with cash flow problems) and bad debts (26%). Less widespread causes included the seasonality of the business (aggravated by the poor summer weather in 1982) and a rapid growth in orders, each identified by 16% of firms as the reason for their cash flow problems. The most common responses to the problem were to seek an extension to their

overdraft (47% of firms) and, more positively, to make greater efforts to chase up slow and defaulting customers (21%). However, approximately 20% of firms with cash flow problems made no attempt to alleviate the situation and were prepared to accept it fatalistically. Given that slow payers and defaulting customers are the main cause of cash flow difficulties amongst the panel, it is significant that a number of the firms which have not suffered from this problem ascribed the reason to their careful choice of customers whereby they avoided those (generally large) companies which had a reputation as slow payers (or else only undertook small amounts of work for them) and carefully investigated potential new customers.

In summary, despite the recession most firms had been able to increase their turnover, in many cases quite substantially, between 1981 and 1983. In addition, a majority of firms had undertaken substantial investments in new plant and equipment while a much smaller group had made major premises-related investments, either by purchasing and in some cases improving and extending freehold premises or in fitting-out costs following relocation to modern leasehold property. Outside finance for these investments was raised with little or no difficulty by all but a small number of companies, although most of the funding came from internal sources. However, this relatively favourable financial outlook is tempered by the continued cash flow difficulties which plagued a majority of enterprises in the panel, caused in large part by the need to pay suppliers promptly - within 30 days - while waiting for upwards of 60 days for their customers to settle their accounts. In addition, some firms - especially those engaged in subcontract engineering and metal industries - encountered financial difficulties as a result of steep increases in the cost of raw materials which, because of severe competition, were difficult, or even impossible, to pass on in their entirety in the form of higher prices. But in the final analysis, perhaps the most noteworthy feature to emerge from this financial profile is the increasing variation in the performance of the surveyed firms (reflected in the highly skewed turnover and investment distribution), with the rapid growth of the small number of 'high fliers' pulling them further away from the majority of the panel.

4.3 Products, Customers and Markets

The panel continued to be dominated by the engineering and metal industries (orders 7 to 12) which accounted for 41% of the surveyed firms. Smaller concentrations of firms occurred in electronics (15%), plastics (12%) and boatbuilding (9%) industries. Nine firms also undertook

non-manufacturing activities, the most significant being repair and refurbishment (3 firms) and consultancy (2 firms). Five of these firms (i.e. 15% of the panel) generated 50% or more of their turnover from non-manufacturing activities, in contrast to the situation in 1981 when non-manufacturing, although still significant, accounted for no more than half of the turnover in any of these enterprises.

Innovation continued to be a characteristic of only a minority of firms in the panel. Indeed, just 10 firms (29%) were regarded by their owner-managers as innovative (seven with a new product and three with a new process or design). Moreover, the identities of the innovative firms in the panel were almost identical in both 1981 and 1983; hence, there was little evidence of previously non-innovative firms developing innovative characteristics in the two years between surveys. In fact, evidence from the two surveys suggests that most innovative new companies display such characteristics from their formation; in the limited number of cases where a non-innovative new company develops a new product or process, this transition is likely to occur within a very short time (a maximum of two to three years) of their formation.

Firms which were involved in licensing also remained very much as exceptions, with only one firm licensing out any products (in this case it was regarded as an alternative to exporting and was on a very limited scale) and three firms which manufactured products under licence, although in only one case (where the licensor was a West German company) was it significant. Moreover, in this case the availability of the licence had been the factor which prompted the formation of the firm. However, another firm in the panel had just commenced the manufacture of a new product under licence (from a U.S. company) because it was felt to represent a cheaper method of gaining access to the technology than undertaking their own research and development.

Slightly over half of the surveyed firms claimed that their activities had changed during the past two years, although in few cases did this represent radical departures. For the remainder, the period between the surveys had simply involved 'more of the same'. The changes reported were of four types, the most frequent being an increase in the range of products/processes on offer (56% of firms reporting changes) and shifts in the balance of their activities (22%). In addition, two firms reported a reduction in their range of products manufactured and two others shifted from volume work to small scale batch production. Half of the firms also reported qualitative changes in their activities, involving improvements in the level of technological sophistication of their products or processes, generally associated with a more 'up market'.

In most cases this increase in technological sophistication was achieved by the purchase of new machinery (e.g. four of the 14 mechanical engineering and metals firms invested in CNC machines), although two firms undertook more intensive research and development and two others re-focussed their marketing efforts on more technologically-oriented customers.

Firms which increased the technological sophistication of their products and processes did so basically for one of two reasons. For some the motive was related to 'competitive push' where the purpose of investing in new and more sophisticated machinery was in order to enhance their competitiveness. For example, firms investing in CNC machines did so in order to reduce their production costs, increase their output and enhance their versatility. The alternative motive was linked to 'market pull' where the increase in technological sophistication was associated with the aim of seeking out more profitable and less competitive markets.

The majority of firms in the panel continued to depend largely or exclusively on sub-contract work. For 19 firms (56%), sub-contract work accounted for 98% or more of their output while a further four firms (12%) undertook some sub-contract work although this comprised no more than 50% of their turnover. Moreover, the proportion of turnover accounted for by sub-contract work has displayed a high degree of stability over the past two years in every firm in the panel.

The manufacturing sector, and especially the electronics and mechanical and electrical engineering industries, maintained their position as the main market for the surveyed firms. Nearly 80% of the panel listed manufacturing enterprises amongst their customers whereas the next most significant market outlets - non-manufacturing firms and the general public - each were served by 26% of firms. Again the tendency amongst the panel was against change, with under one-third of firms reporting changes in the composition of their customer base. These comprised five firms which entered additional markets as an expansion strategy, four firms which switched to different types of customers (notably those which moved 'up market') and three firms which changed the balance amongst their existing customer base.

In the context of the demand by small firm lobby groups that small firms should have a greater share of government purchasing, it is significant that only four firms (12%) in the panel had any public sector organizations as customers. Three of these firms (9% of the panel) directly supplied the Ministry of Defence (but in each case this accounted for less than 20% of their turnover). However, 15 firms (44%, but including two of the direct

suppliers) were engaged in work for the Ministry of Defence indirectly by undertaking sub-contract work for prime defence contractors such as Plessey and Racal. This also represented a fairly limited source of demand, accounting for less than 20% of turnover in all but two cases and generally substantially below this figure. There was a slight tendency for the amount of defence-related work undertaken by these firms to have risen slightly in the past two years, with five firms reporting an increase against only two which reported a decline in their military work. Nevertheless, given the concentration of both Ministry of Defence establishments and military equipment manufacturers in Hampshire and adjacent counties (Law, 1983), and notwithstanding the youthfulness of the panel, the spin-off in terms of direct and indirect demand from the defence sector is surprisingly low.

Dependence on key customers also persisted as a feature of the panel, with 21 firms (65%) indicating that they felt themselves to be reliant on a small number of dominant customers, although extreme dependence, where only one or two firms accounted for upwards of 60% of their turnover, was a characteristic of only 10 firms (29%). Moreover, there was little evidence that those surviving firms which depended on a small number of key customers in 1981 had been able to numerically increase their customer base over the last two years, even though in some cases the identity of the key customers had changed. Indeed, only one firm considered itself to be less reliant on dominant customers compared with two years earlier whereas four firms indicated that their dependence on key customers had increased since 1981, either because these firms had continued to place orders or else as a result of the reduction in work from other customers.

The panel of firms also continued to depend on the local and regional market, with 12 firms (35%) contracting 75% or more of their sales within Hampshire while 21 firms (62%) undertook upwards of three-quarters of their sales within the South East Region (including Hampshire). In contrast, only 8 firms (24%) made any sales overseas; moreover, only four could be regarded as significant and regular exporters, with overseas sales accounting for over one-third of their turnover. (Infact, two of these firms derived 80% of their sales through exports). Changes in market areas between 1981 and 1983 were relatively frequent but generally fairly modest in magnitude, with 15 firms (44%) indicating that the geographical distribution of their sales had altered during the past two years. However, whereas 10 of these firms increased the geographical extent of their sales territory, either by extending it northwards into the Midlands (3 firms), by increasing their exports (3 firms) or by reducing their dependence on the local market and increasing sales in the rest of the South East (4 firms) - a further five firms became more dependent

on the local market, often because of the loss of more distant customers but in some cases by deliberate action (e.g. to reduce transport costs).

The original survey reported that the majority of new firms operated in very competitive market environments. The follow-up study indicated that this situation had continued unabated, with the owner-managers of only three firms (9%) considering that the level of competition had fallen, ascribed in each case to the effect of closures. In contrast, 14 firms (41%) claimed that the level of competition had increased during the past two years, primarily as a result of new entrants into the industry (mentioned by nearly two-thirds of the firms in this category). Start-ups which occupy low cost premises, use cheap machinery, undertake little or no investment and minimize their expenditure on labour (generally by not costing the time of their owner-manager properly) in order to keep their overheads to a minimum were singled out by many owner-managers in the panel, especially those in the engineering and metalwork industries, as being the main source of the increased competition. A general reduction in demand was identified as a further significant cause of the increased competition (cited by one-third of firms), while the increased competition from bigger companies which not only undertook a greater proportion of work 'in house' but also competed for outside work, in some cases by artificially undercutting small firms, in order to help keep their workforces occupied was also noted. A further three firms (9%) considered that although there had been no change in the level of competition it was possible to discern changes in its nature, with customers placing a much greater emphasis on price. The remaining 14 firms (41%) identified no change in either the level or nature of competition despite large numbers of factory closures and bankruptcies. However, the owner-managers of these firms claimed that the closures were largely concentrated at the bottom end of the industry in terms of quality and sophistication of work and therefore had no impact on their market niche.

In terms of marketing efforts, the panel of firms continued to rely on word of mouth and repeat orders as the main methods of obtaining work (76%) although generally in conjunction with some advertising and 'knocking on doors'. Nevertheless, 21% of firms undertook no marketing at all and relied exclusively on word of mouth and repeat orders from customers. The most frequently used active method of marketing was advertising (53%), but this was generally restricted to entries in 'Yellow Pages' and a trade directory. Just under one-third of firms undertook 'knocking on doors' while mail shots and exhibitions were each used by one-quarter of the firms surveyed. The continued low emphasis given by most of the panel to marketing is further underlined by the fact that only seven firms (21%) had their own sales representatives.

However, 12 firms (35%) had stepped up their marketing efforts over the past two years, notably by increased advertising (four firms) or by the appointment of a sales representative (five firms plus one other about to do so). The most dramatic example of increased marketing efforts was by one firm (with the largest turnover in the panel) which opened an overseas sales office. In contrast to these cases of increased sales effort, four firms (12%) actually reduced their range of marketing activities, by ceasing either to advertise or to 'knock on doors' because of serious doubts about their effectiveness.

In summary, neither the activities of the surveyed firms nor the sectoral and geographical pattern of their markets and the extent of reliance on a narrow customer base have displayed much in the way of radical change over the past two years. Instead, changes - where they occurred - were both modest and incremental. There was, for example, an attempt by half of the firms in the panel to increase the technological sophistication of their activities, generally in conjunction with investment in new machinery, in order to seek out less competitive market niches with opportunities for greater profit. Indeed, one of the most significant changes in the external environment facing the panel of firms during the past two years has been the increased competition, caused by falling demand, new firm formation, the activities of some larger companies and the much greater emphasis which customers now place on price. Yet, despite this, only a minority of firms in the panel responded by increasing their marketing efforts. However, this paradox can be at least partially understood by reference to the CATCH 22 position of some of the smallest and most vulnerable firms in the panel where the owner-manager accounts for one-third or even one-half of the 'shopfloor' workforce. If he withdraws his contribution to production in order to seek out new customers it may result in a lack of productive manpower to service new orders, yet if he devotes his efforts to production at the expense of marketing the firm may suffer from a shortage of orders.

4.4 Premises

The firms in the panel continued to display a high degree of locational change with six firms (18%) having relocated and a further two firms opening additional premises⁶ sometime in the period between interviews. Indeed, 16 of the surviving 34 firms (47%) had relocated at least once since start-up and a further four (12%) had opened additional premises, underlining the

high degree of mobility characteristic of recent start-ups. As was the case with firms which had relocated prior to 1981, so the most recent moves have generally been over short distances, with four firms moving a distance of less than 3 km while the longest move was 13 km. Similarly, the branch plant creations were located 2 km and 18 km respectively from their parent factory. Nor surprisingly, the reasons for undertaking short-distance moves were in order to retain both staff and customers.

Both relocation and branch plant creation were undertaken in response to the unsatisfactory nature of the firm's existing premises which in each case was regarded as being too small. Additional 'push' factors included the substandard nature of the property (which in turn created a poor image to potential customers) and actual or potential lease problems. By moving, these firms were able to expand production, introduce a new product or process and improve both their image and the working conditions of their employees. In marked contrast to the difficulties encountered by the majority of firms in the panel when searching for start-up premises (during the second half of the 1970s), finding suitable premises in order to relocate or to open a branch plant presented few problems; indeed, each firm found premises which met their requirements and only one encountered any problems primarily because of its specialised requirements.

Unlike many of the relocations which occurred soon after start-up, those moves undertaken since 1981 - when the businesses had passed the 'infant' stage - have clearly been linked to an upgrading in the quality and tenure of accommodation. In six of the eight post-1981 moves the destination premises were either newly constructed or else less than five years old. The two exceptions involved firms which moved into freehold premises; in both these cases the property was slightly older, having been constructed during the 1960s. For those firms which moved to leasehold property, the length of lease varied according to the type of premises and the type of landlord. Hence, the three firms which moved to privately-rented industrial premises each took out initial leases of 25 years, a fourth firm took out a five year lease for an office, while the remaining two firms both moved to local authority constructed nursery units where the lease was also five years. The mobile firms were generally well-satisfied with their new premises although there continued to be some disquiet about the scope for future insitu expansion, suggesting that further relocation is likely should such firms embark on a further stage of development. Moreover, both of the firms which moved to freehold premises had a slightly less

favourable evaluation of their accommodation than their counterparts in leasehold property.

This focus on firms which either relocated or opened an additional establishment should not obscure the fact that non-moving enterprises also made adjustments in the nature of their accommodation. With respect to changes in tenure, one firm bought the freehold of its factory and two owner-managers personally bought the freeholds of their firms' property. As a result, only 28 of the 34 surviving firms were in leasehold premises at the time of the follow-up study (82%) compared with 51 of the 52 firms interviewed in the original survey. Turning to the length of lease, five of the non-moving firms in rented premises increased the length of their lease (as did all of the relocating companies), indicating a general increased commitment to the future. Hence, whereas only one-third of the original 52 firms had leases extending beyond ten years in 1981, this proportion had risen to 46% amongst the surviving firms; similarly, only 27% of surviving firms had leases of less than three years compared with 36% of the original group. There was also a tendency for firms to increase their space requirements; five of the six relocating firms plus the two firms which opened additional establishments each increased the amount of floorspace which they occupied as did seven of the non-movers which each expanded insitu, generally by occupying vacant neighbouring premises. The overall result was to increase the median floorspace occupied by the surviving firms from 2500 ft² in 1981 to 3400 ft² in 1983 (Figure 6).

These changes in the characteristics of the accommodation occupied by the panel of firms confirm the pattern revealed by other indicators, namely of a gradual upgrading in quality. There was an upward movement in the typical length of lease of firms in rented premises, while a small group of firms either moved from leasehold to freehold property or else bought the freehold of their existing premises. In addition, there was a slight increase in the average floorspace occupied by firms in the panel. Although some non-moving firms were able to expand their floorspace and renegotiate the length of their lease, it was those firms that either relocated or else opened additional premises that were able to make the most significant improvements to their accommodation in terms of size, length of lease, tenure and quality. However, it was noticeable that firms which moved into freehold premises did not achieve as substantial an upgrading in the quality of their premises as did those firms which moved into leasehold property, indicating that they have had to trade-off the advantages of owning their own property against some loss in the potential quality of their accommodation.

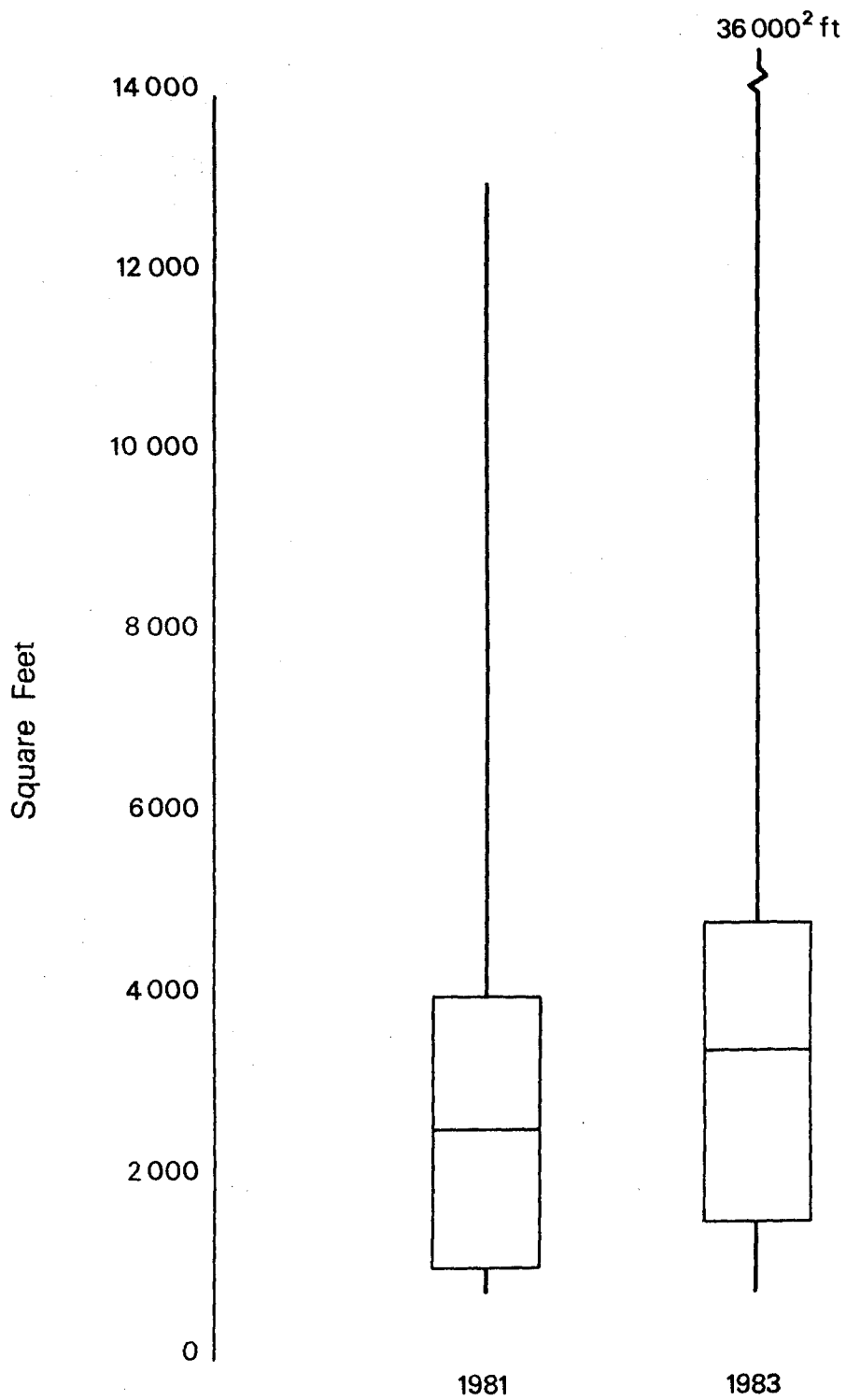


Fig 6. Floorspace Occupied by Surviving New Enterprises 1981 and 1983

4.5 Employment

The role of new and small firms in job creation continues to be of great interest to both policy-makers and academics. Of the 37 surviving new firms in South Hampshire, just over two-thirds recruited additional staff between 1981 and 1983, leading to the creation of 171 new jobs, whereas only 11% of firms shed labour, involving a loss of 12 jobs. As a group, surviving new firms in South Hampshire therefore increased the size of their workforce by 159 employees (+ 40%) in the two years between surveys to employ a total of 559 people in mid-1983. This increase in aggregate employment is reflected in a rise in the median size of workforce from 6.5 to 8.5 (Figure 7). However, looking behind this aggregate upward trend in employment reveals two much less sanguine features. First, just two fast-growing firms (both in electronics) who together took on almost 100 extra workers between 1981 and 1983 were responsible for 56% of the gross new jobs created by expanding firms in this period. Second, and even more significant, is that the 12 firms out of the original group of 52 which closed between 1981 and 1983 employed a total of 177 workers in 1981; the net new jobs created by the 37 surviving firms in the two years since 1981 have therefore failed to offset the employment loss which has resulted from firm failures.

Problems of recruiting additional labour - a feature which was identified in the original study - continued to persist through to 1983, with over half of the panel encountering difficulties in this area. The primary difficulty was the inability to find sufficient skilled staff (six firms) and technical workers (two firms). Problems in recruiting semi-skilled and unskilled workers was much less of a problem, affecting just two firms (whose owner-managers both identified what they regarded as the high level of unemployment and social security benefits as the cause); however, complaints amongst firms about the attitudes and competence of shopfloor workers was quite widespread (eight firms). Nevertheless, the adverse impact of such recruitment problems were relatively limited; only four firms (12%) reported that it had caused them to turn away orders or constrain their growth, while for another four the impact was felt in terms of the expense and cost of training workers who turned out to be unsuitable.

This study therefore provides further depressing empirical evidence to demonstrate the very limited job creation impact of new firms. Not only is substantial employment growth confined to a very small number of firms, a point which Storey (1981) has also demonstrated with aggregate data sources,

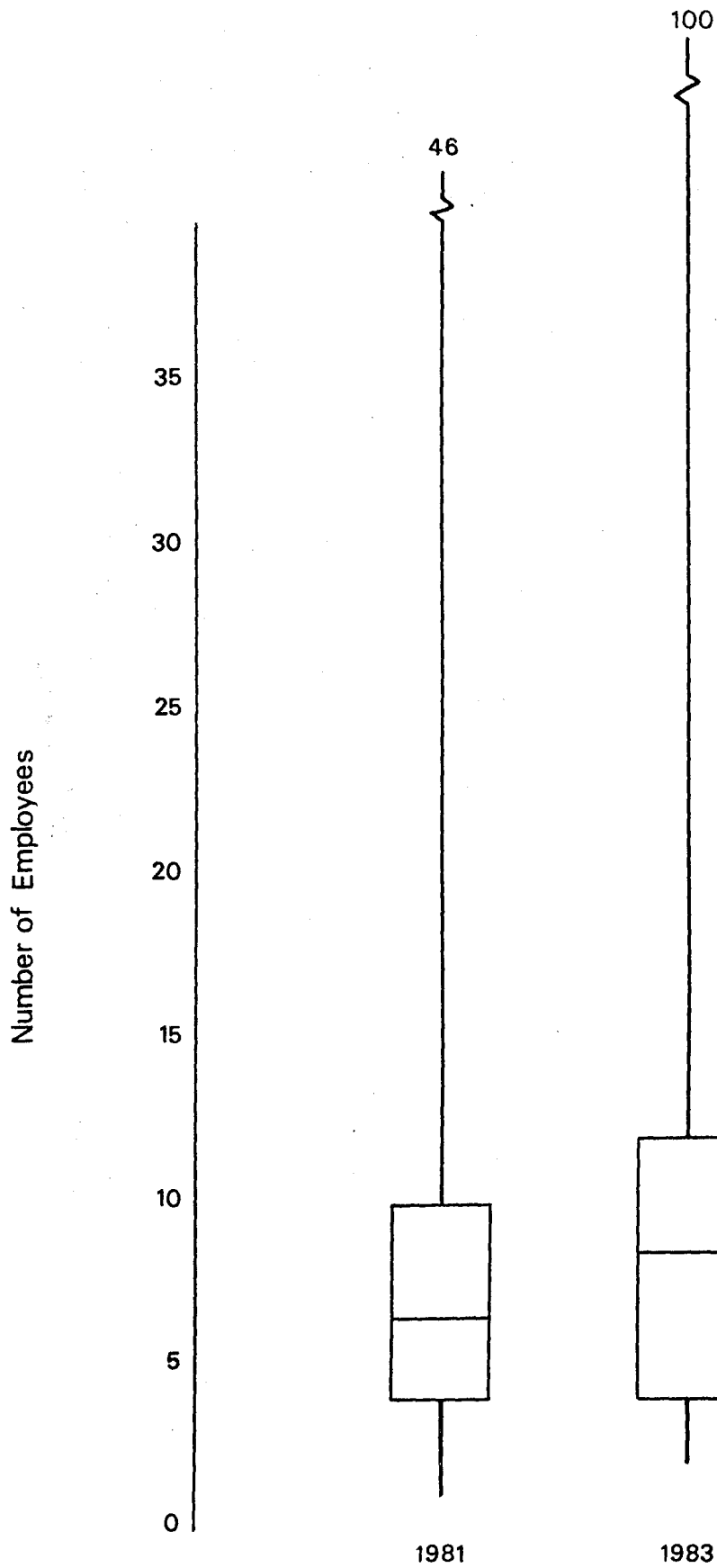


Fig 7. Employment in Surviving New Enterprises 1981 and 1983

but in any time period the additional employment created by surviving firms in a cohort of new enterprises is more than offset by the job losses in those businesses which fail. The only crumb of comfort is that some firms do have the capacity and willingness to take on extra staff but are constrained from doing so by shortages of workers with the appropriate skills and attitudes. If small businesses are to make any impression on job creation, then one element in any policy package must involve measures to enable those firms who wish to increase their workforce to do so, for example by public assistance with their training costs and improvements in the channels of recruitment, such as between universities and small firms.

5. CONCLUSION

The follow-up study of new manufacturing firms in South Hampshire has failed to confirm the most pessimistic views about the effect of the recession on small firms. Admittedly, nearly one-quarter of the panel closed between mid-1981 and mid-1983; however, although there is no way of precisely gauging the role played by the external economic environment, it would seem valid to conclude on the basis of the information collected from these firms in the original study that some would have closed even without the recession because of internal problems such as low labour productivity and under-capitalization, while others which gave no sign of internal problems in 1981 may well also have failed for reasons unconnected with the recession.

Similarly, the recession has not had a uniformly adverse impact on surviving firms (Table 2). Indeed, the owner-managers of 20 companies (59%) considered that the recession had not affected their business detrimentally, primarily because they served recession-free markets (e.g. home improvements, agriculture, aerospace, leisure, fire detection) or, in the case of sub-contractors because either their customers were in recession-free industries (e.g. pharmaceuticals, nuclear) or else their customer-mix was sufficiently diversified to enable those in decline to be offset by others which were expanding. For those firms which had been adversely affected by the recession, the main impact has been to lead to a shortage of work (8 firms: 24%), while a less widespread effect has been a lack of continuity in work and 'last minute' ordering by customers (3 firms: 9%). Two owner-managers (6%) considered that the effect of the recession has been to create insecurity about future prospects, despite the fact that both were still able to find sufficient orders.

Table 2. What has been the main effect of the recession on your business?

<u>response</u>	<u>no. of firms</u>	<u>%</u>
Adverse effect:		
shortage of work	8	24
lack of continuity in work/ 'last minute' ordering by customers	3	9
insecurity/uncertainty	2	6
slower growth	1	2
Sub-Total	(14)	(41)
No effect	20	59
	—	—
	34	

The follow-up study provides some support for the notion of a development sequence or 'life cycle' model - as proposed in the business literature - and involving an upward progression in both quantitative and qualitative indices over time. The average firm in the panel has become larger: median turnover increased from £105,000 in 1980-81 to £172,000 in the latest financial year; median employment increased from over 6 to over 8 between 1981 and 1983 while floorspace increased from 2500 ft² to 3400 ft² over the same period. Moreover, there was a fairly widespread tendency for firms to make improvements to the qualitative aspects of their accommodation, notably in terms of the length of lease, or less often, the acquisition of freehold property, while relocating firms also upgraded the quality of their premises in terms of its age, physical condition and image. Investment behaviour similarly supported a development sequence model; the panel of firms mainly directed investment towards plant and equipment rather than to premises, the purpose being to improve and expand their capabilities, while the general preference to purchase new rather than secondhand machinery has meant an upgrading in the quality of their capital stock. With this investment in new machinery, firms have been able to make incremental improvements in the technological sophistication of their activities and thereby move 'up market'. However, changes in the type and scale of output have been very limited. There was, for example, no tendency for sub-contractors to develop their own proprietary products. Similarly, there has been little change in the types of customers or market areas served by the panel of

firms, although some sign of greater marketing efforts was observable. Moreover, there has been little development in management style or organisational structure except in a very small number of firms in the panel. In summary, the growth trajectory of the panel has been upwards in direction although gradual, while change has been both incremental and modest rather than revolutionary and radical, and confined to certain dimensions of business development. But given the short period of time between surveys - just two years - it is probably not surprising that change has been limited and that the prevailing tendency amongst the panel has been 'more of the same'.

In terms of the recent model of small business development proposed by Churchill and Lewis (1983) it would appear that the majority of firms in the panel have progressed from the existence stage to the survival stage (Figure 8). At most, six firms have progressed further, either into the success stage, or beyond into take-off. However, it is this small minority of 'high fliers', by no means exclusively engaged in high technology activities, that have made the greatest contribution to direct (and probably also indirect) employment creation, with four firms responsible for 45% of the total employment provided by the 37 surviving companies, and have had the most significant impact on regional and national economic growth. Indeed, the innovative characteristics and exporting activity of the 'high fliers' results in few displacement effects either within South Hampshire or in the rest of the country.

For the most part, current small firms policies attempt to assist the entire sector. Clearly, this approach is indiscriminate since it supports intra-marginal and marginal firms and both the deserving and underserving (Mitchell 1980), while the high failure rate amongst small firms means that much of the costs incurred in providing aid is wasted. In addition, as Storey (1983) points out, policies which are designed simply to maximise the number of new businesses created will result in massive displacement. The policy implication from the South Hampshire study (also see Storey, 1983), is that assistance to the small firm sector would be much more cost-effective if it attempted to increase the number of 'high fliers' because it is these enterprises which make the greatest contribution to job generation, wealth creation and the balance of payments. Moreover, even a relatively small increase in the number of such firms could make a quite considerable contribution to economic development at the sub-regional and regional scales.

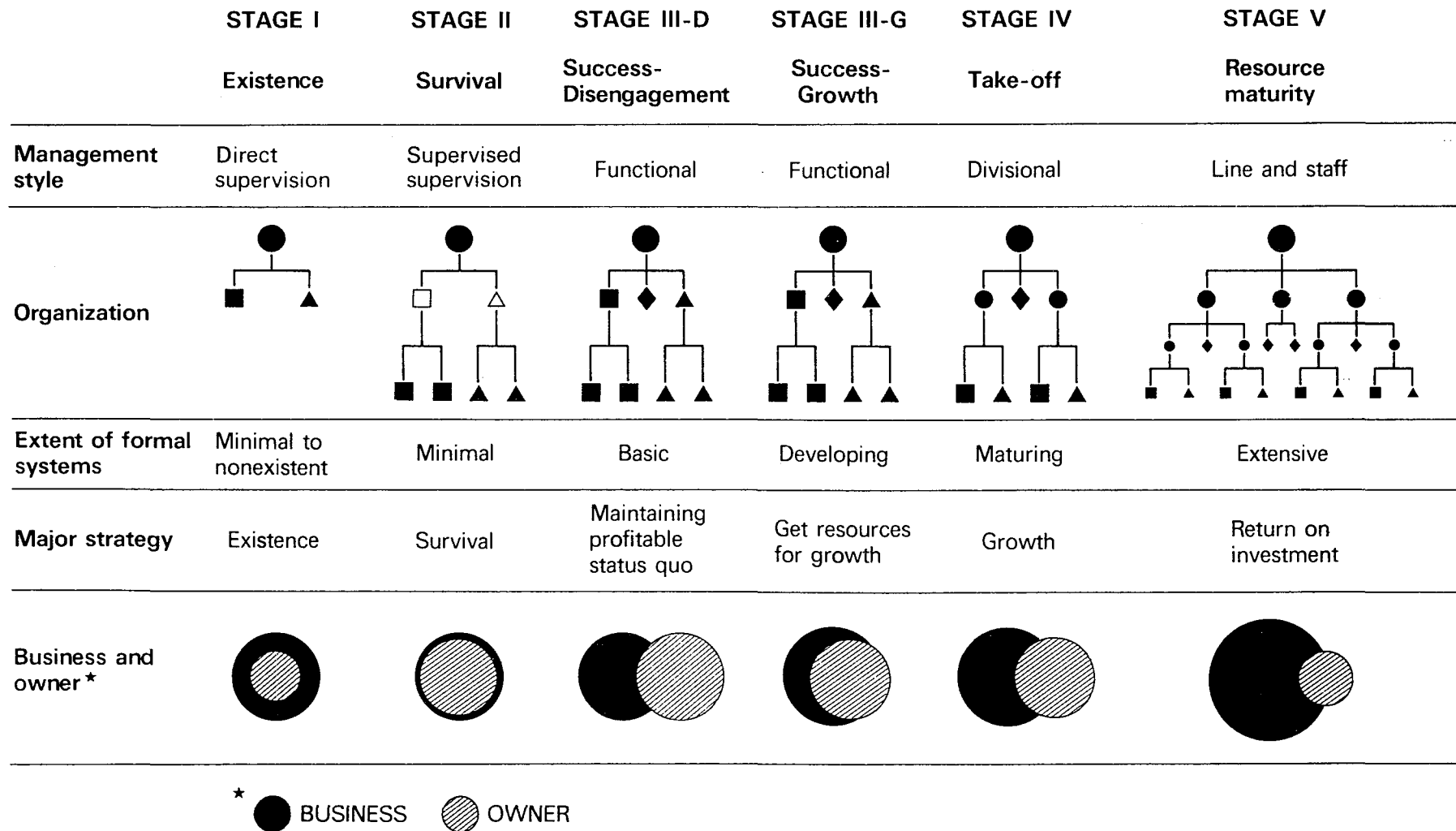


Figure 8 Evolution of Small Companies: characteristics at each stage of development
 (source: N. C. Churchill and V. L. Lewis (1983). The five stages of small business growth, *Harvard Business Review*, vol. 61, May / June, p. 38)

But if the direction in which new and small firms policy should go is clear, it remains less obvious how the objective of producing a larger number of 'high-fliers' is best achieved. However, simply encouraging more new firms in high technology sectors, while a very important element in industry policy, is certainly not sufficient for a number of reasons. First, Storey (1983) suggests that there is no evidence for the more rapid growth of new manufacturing firms in high technology sectors. Second, high technology enterprises are inherently risky. As Oakey (1983) points out, the products of high technology firms have a short life cycle and it is therefore essential for such firms to undertake research and development to ensure medium term survival and growth. However, because the cycle of R and D costs does not correspond to the revenue cycle periods of financial stress occur, in some cases leading to the demise of the company. Finally, by no means all of the 'high-fliers' in South Hampshire were in high technology sectors. Indeed, it would appear from both this and other studies (eg Nicholson and Brinkley, 1979; Fothergill and Gudgin, 1982) that management ability is the key factor in the creation of rapid growth enterprises, with the most successful new firms formed by people who have held management positions in large firms, and probably with experience of working in a number of different departments (with sales or marketing experience particularly significant) and for more than one employer.

Policy must therefore address itself to the task of encouraging more people in management positions in large companies to set up in business for themselves. Appropriate measures are of two types. On the one hand, tangible improvements to the 'entrepreneurial climate' are necessary, including the introduction of 'portable' pensions to ensure that an individual does not lose his accumulated pension rights by leaving his employer in order to set up a new firm, and the creation of more acceptable share buy-back schemes to enable founders who accept equity investments at start-up to retain full ownership of their firm at a later date, if they so wish. The Economist (23.7.83) also argues that Britain's top managers suffer from a combination of low incomes which leave them with too little to save and high perks which bind them to their employer: it argues that this system of remuneration should be changed. But in addition, measures are required to remove the perceptual barrier to self-employment, which Cross (1982) regards as the main constraint on new business formation by

managers in large companies. This must involve the presentation of business formation as a viable option for individuals who are considering a change in career, for example by creating greater awareness of successful firms started by former management employees in large firms and by replacing the prevailing myths concerning the high failure rate of new businesses with better quality information in order to enable individuals to more accurately assess the prospects of self-employment. The alteration of current attitudes to business formation cannot be legislated but instead requires cultural changes, achieved through education, which inevitably occur over a long period of time. Nevertheless, some concrete steps can be taken by large companies to promote the idea of business formation amongst their employees, particularly where they wish to make redundancies amongst their management staff, for example by re-settlement schemes, training courses, material assistance (premises, machinery, orders, etc), help in identifying business opportunities and secondment schemes to small firms (Cross, 1982; Johnson and Rodger, 1983).

NOTES

1. This includes one case where the owner-manager put his company into voluntary liquidation but immediately set up a new company with a slightly different name in the same premises to undertake the same line of business. In the analysis this firm is regarded as a survivor but clearly could be classified instead as a 'death' and a 'new firm'. It therefore represents another situation where the definition of a new firm is unclear (see Mason, 1983).
2. One of the firms in the survivors category was acquired by a public company less than a month after the managing director had been interviewed in the follow-up study. It had the fourth largest turnover in the panel.
3. One of these firms also subsequently went into liquidation, but before doing so the directors set up another firm (with a slightly different name) to buy the assets in order to continue in the same line of business and in the same premises.
4. Confirmation that closures were genuinely the result of firms going out of business rather because of relocation were obtained through site visits, checks with neighbouring firms and a special search of their records by British Telecom. In addition, the Official Receiver indicated that two of the firms had gone into compulsory liquidation.
5. The index of input prices (materials and fuel) stood at 124 in June 1983 while the index of output prices stood at 127.8, 1980 = 100. (British Business, 14 October 1983, p 370).
6. This excludes one firm (a brewery) which opened a pub and another which opened an overseas sales office.

REFERENCES

- Binks, M. (1983) Is phoenix of industry rising or still burning? The Guardian, 22 June.
- Binks, M., Atkin, T. and Vale, P. (1983) The dole queue creates reluctant entrepreneurs, The Guardian, 25 March.
- Binks, M. and Jennings, A. (1983) New firms as a source of industrial regeneration, paper to the 6th National Small Firms Policy and Research Conference, University of Durham, 1 to 3 September.
- Churchill, N.C. and Lewis, V.L. (1983) The five stages of small business growth, Harvard Business Review, 61, May/June, 30-50.
- Cross, M. (1981) New Firm Formation and Regional Development (Gower, Farnborough).
- Cross, M. (1982) The entrepreneurial base of the large manufacturing company, in J. Stanworth, A Westrip, D Watkins and J Lewis (eds.) Perspectives on a Decade of Small Business Research (Gower, Aldershot), 143-156.
- Dickson, T. (1983) Why companies go bust, Financial Times, 8 March.
- Elliot, J. (1982) UK industry: problems of an upturn, Financial Times, 3 August.
- Fothergill, S. and Gudgin, G. (1982) Unequal Growth: urban and regional employment change in the UK (Heinemann, London).
- Ganguly, P. (1983) Lifespan analysis of businesses in the UK, 1973-1982, British Business, 12 August, 838-845.
- Harrison, R.T. and Hart, M. (1983) Factors influencing new business formation: a case study of Northern Ireland, Environment and Planning A, 15, 1395-1412.
- Johnson, P. and Rodger, J. (1983) From redundancy to self-employment, Employment Gazette, 91, 260-264.
- Law, C.M. (1983) The defence sector in British regional development, Geoforum, 14, 169-184.
- Leigh, R., North, D., Gough, J., and Sweet-Escott, K. (1983) Monitoring Manufacturing Employment Change in London 1976-81 (Middlesex Polytechnic, London) 2 vols.
- London Chamber of Commerce and Industry (1982) 23rd Trend Survey of Manufacturing in London and the South East.

- Mason, C.M. (1982) New manufacturing firms in South Hampshire: survey results. Department of Geography, University of Southampton Discussion Paper No 13.
- Mason, C.M. (1983) Some definitional difficulties in new firms research, Area, 15, 53-60.
- Mason, C.M. and Lloyd, P.E. (1983) New firms in a 'prosperous' sub-region: a case study of new manufacturing enterprises in South Hampshire, paper to the 6th National Small Firms Policy and Research Conference, University of Durham, 1st to 3rd September.
- Mitchell, J.E. (1980) Small firms: a critique, Three Banks Review, 126, 50-61.
- Nicholson, B. and Brinkley, I. (1979) Entrepreneurial characteristics and the development of new manufacturing enterprises, mimeo.
- Oakey, R.P. (1983) Research and development cycles, investment cycles and regional growth in British and American small high technology firms, University of Newcastle-upon-Tyne, Centre for Urban and Regional Development Studies, Discussion Paper No 48.
- Oxenfeldt, A.R. (1943) New Firms and Free Enterprise (American Council on Public Affairs, Washington DC).
- Storey, D.J. (1981) New firm formation, employment change and the small firm: the case of Cleveland County, Urban Studies, 18, 335-345.
- Storey, D.J. (1983) Regional policy in a recession, National Westminster Bank Quarterly Review, November, 39-47.

