

# Bulletin

Institute for  
Employment  
Research

## The Small Firms Sector

The 'small firms' sector is an important employer within the United Kingdom. Approximately 29 per cent of the workforce is employed within organisations with less than 200 employees (Hakim, 1989). Relatively little is known about the people who work in small businesses, the extent and structure of employment in the small firm, and it is difficult to establish the existence of long term trends in small business employment. Volume 1 of the 1990 *Review of the Economy and Employment* (published by the Institute for Employment Research) draws together the available information on employment within the small firms sector for the period 1971 onwards. The extent to which the small firms sector has been a source of employment growth is assessed using a number of different data sources; the Annual Census of Production, registrations for value added tax, and the level and rate of change in self employment. All three sources suggest that small businesses have become an increasingly important component of the UK economy, particularly over the 1980s. This *Bulletin* provides a summary of the main findings of the review of the small firms sector and identifies the likely future trends in small business employment and business formation.

### Trends within manufacturing

The small firms sector is defined as firms with fewer than 100 employees. Since 1971, within manufacturing, there has been a steady increase in the proportion of employees working in the small firms sector, from 15 per cent in 1971 to 24 per cent in 1986.

While the small firms sector has increased its relative share of manufacturing employees, the absolute numbers have remained roughly constant. Over this period the

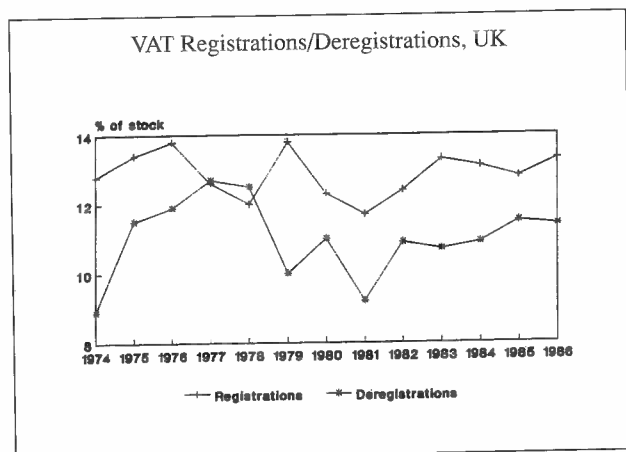
change in the relative importance of small firms has been influenced by changes in the number of new businesses being established or dis-established and changes in the levels of employment in firms remaining within the small firms sector. Principally, however, the growth in the importance of small firms is a result of a decline in the employment levels in medium and large establishments and their shift into the small establishments sector. Thus any observed increase in the relative importance of small firms does not necessarily imply a superior 'performance' on the part of small businesses. (Conversely, a decline in the relative importance of small firms may reflect their growth into medium and large firms, rather than indicating the poor performance of the small firms sector).

The relative importance of smaller businesses has increased within all industry classes and the trend has been particularly marked in those industries in which small firms accounted for a relatively small proportion of employment in 1980. Examples include classes such as **Metal Manufacturing** and **Office Machinery and Data Processing Equipment**. Industries with an historically higher proportion of employment in smaller businesses (for example, **Footwear and Clothing**), have seen a more limited increase in the relative importance of smaller firms.

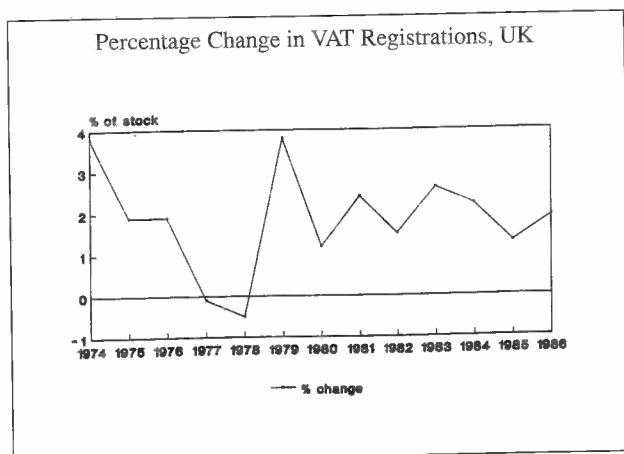
### Trends in VAT registrations

Trends in registrations for VAT show that in every year apart from 1977 and 1978 there has been an increase in the total number of businesses registered for VAT, although the rates of registration and de-registration, and so the growth in total registrations varies quite markedly from year to year.





Registrations have also varied considerably between sectors over the period 1979 to 1987, with the most rapid increases occurring in **finance, property and professional services** (49 per cent), and **'other services'** (63 per cent). At the other extreme, the number of VAT registered, retail businesses fell by 3 per cent over this period, although **retailing** remains the most important sector in terms of the number of registered businesses.



The small business sector is in a constant state of flux, with 'birth' and 'death' rates ranging between 9 per cent and 14 per cent. New firms suffer from very high infant mortality rates with 35 per cent of newly registered firms being de-registered within 3 years of registration, a process currently exacerbated by the economic downturn. The dynamic nature of the small firms sector means that the forecasting of future trends is a hazardous undertaking, as relatively small changes in flows can lead to fairly substantial net changes in the stock of businesses. Calculations indicate that around 65 per cent of the stock of small businesses found at the end of 1989 will not exist by 1995. Around 40 per cent of the 1995 stock will have been created between 1990 and 1995. Thus the current level and structure of employment in small businesses is only an imperfect guide to likely future trends, as firms cease to trade and are potentially replaced by new businesses with entirely different

employment structures and practices. Any forecasts of small business employment must therefore differentiate between employment in surviving businesses and employment in newly created businesses.

### Trends in self employment

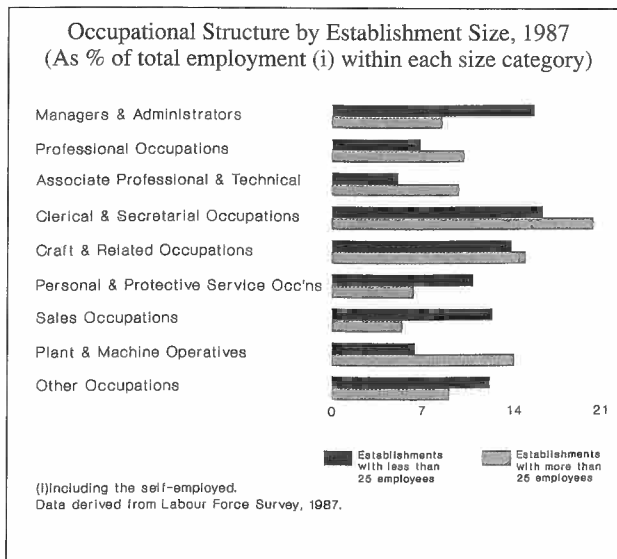
Following the decline in self employment in the 1970s the trend reversed and self employment grew by almost 1 million between 1979 and 1987, and in all industrial sectors save agriculture. The growth in self employment does not necessarily imply an increase in small business formation as many self employed workers do not run a 'business' as such, but rather work in jobs such as labour only sub-contractors in the construction industry, or as commission only sales people. The figures on self employment are, however, supportive of the view that there has been an increase in small scale economic activity in Britain over the last decade.

### The Occupational Structure of Small Firm Employment

There are no strong *a priori* reasons to expect any major variation in the occupational structures of large and small firms. However, it might be suggested that there are some occupations, for example, those concerned with specialist managerial and administrative functions, which might be expected to be less prevalent in smaller businesses. In addition, the scope for a detailed division of tasks between individuals might be expected to be smaller in firms with only a few employees, and hence, for workers to carry out several tasks relating to different occupational groups. This applies in particular to owner/managers of businesses who might perform several different managerial and administrative functions as well as, for example, the tasks of a skilled or semi-skilled operative.

There is relatively little information on the occupational structure of employment by enterprise size in the UK. However, data from both the Labour Force Survey and the New Earnings Survey indicate that small businesses tend to contain a relatively high proportion of **managerial, personal service and sales occupations** and a relatively lower proportion of **professional and associate professional** workers than large firms. There are no obvious trends over time, although it is only possible to examine the period 1983-1987 on a consistent basis.

Although there appear to be clear differences in the occupational structures of small and large establishments, to a substantial extent these occupational differences reflect variations in the establishment size profiles of different sectors, with the average size of service sector establishments being much lower than that of manufacturing plants. Data about the self employed indicates the dominance of two occupational groups; **managerial and professional**, and **craft and related**



**occupations.** The former group accounts for roughly half of all self employed people, and the latter for around a quarter. Clear long term trends in the occupational structure of the self employed are difficult to discern, but it is likely that the proportion of self employed people in the managerial category declined between 1983 and 1987. There are no obvious growth areas.

#### Factors affecting the extent of employment in small firms

Employment trends within small firms are influenced by the general economic climate, by the state of the labour market, by structural/organisational factors and by policies adopted towards the small firms sector. These influences, however, may operate in different ways and to different degrees depending upon whether the focus is upon new firm formation or employment change in existing firms.

New firm formation, self-employment and employment growth within existing firms vary positively with improvements in the overall performance of the economy as measured by variables such as GDP, aggregate demand and company profitability. Labour market changes are also identified as central influences on the new firm formation and self employment decision. For example, high levels of unemployment tend to be associated with high levels of new firm formation. In addition, existing small firms (who tend to pay lower wages and offer 'inferior' conditions of employment) may find it easier to recruit in conditions of high unemployment and slack demand from larger organisations. These labour market factors tend to counteract the more positive effects of cyclical changes in economic activity.

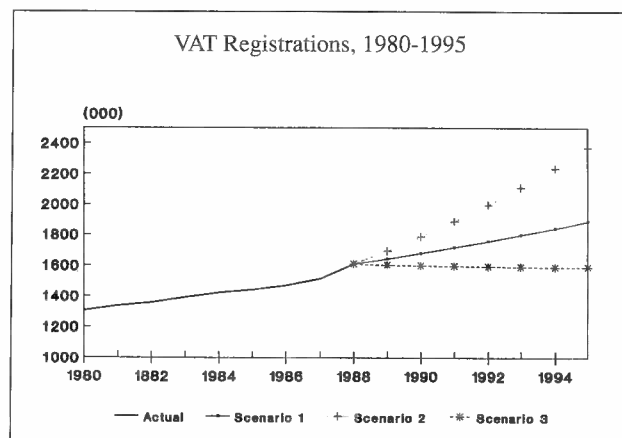
Changes in the distribution of economic activity in favour of sectors in which small firms or the self employed are

relatively important will *ceteris paribus* lead to an overall increase in the importance of smaller businesses in total employment. The growth of activities such as computer services, design and management consultancy, many of which are suited to small firm structures and flexibility, (and where the price and sophistication of supporting technical requirements such as computing facilities are now appropriate) are a component in the employment changes in the small firms sector.

Policies designed to stimulate self employment and support small firms are likely to have a positive effect upon the sector, although it is difficult to evaluate the overall impact of the large number of policies (in excess of 100) which have been introduced in recent years, either in terms of their individual impact or collectively. The relative impact of the 4 main groups of influences outlined above on employment trends is, as yet, unclear.

#### Future trends in small firm formation and employment

The absence of a clear behavioural model, and the lack of suitable data hampers the development of sophisticated forecasting models for small business employment. However, it is possible to build a series of broad medium term scenarios based either upon recent and projected trends in the size distribution of employment or on VAT registrations, and to consider the potential employment trends up until 1995 in the light of three different sets of assumptions.



Using the VAT registrations, one scenario assumes that the average annual rate of registration and de-registration by sector remains at the level found between 1979 and 1987. This would result in a growth of around 15 per cent in total registrations between 1989 and 1995. Around 275,000 new businesses would be created over this period, although some sectors would grow and others experience a small decline. A second scenario is based upon the calculation of the highest likely rates of increase in the total number of VAT registrations and indicates a growth in VAT registrations of approximately 350,000. Growth

would occur in all sectors, with the number of firms in the 'other' category almost doubling. The third scenario adopts the most pessimistic assumptions (assuming a situation characterised by the lowest birth rates and highest death rates found between 1980 and 1987). On this basis, there will be a small decline in VAT registrations over the period 1989-1995, but not in all sectors and new VAT registrations will still approach 190,000.

With regard to employment, a slower growth in the total stock of businesses does not necessarily imply slow employment growth in the sector and vice versa. Growth in total employment depends to a great extent upon the performance of existing small firms rather than on the establishment of new firms. However, not all firms create large numbers of jobs. Substantial employment growth is concentrated in a very small number of firms, with most firms that survive experiencing very modest rates of employment change. A recent estimate by Storey and Johnson (1987) indicates that within the manufacturing sector, over a ten year period, half of the total jobs created will be in 4 per cent of firms which started

trading at the beginning of the period. Further, the rate of job creation is not spread evenly across all sectors. The fortunes of the small firms sector as a whole appears to depend very much on the numbers of and rate of growth of fast growing small firms. While most businesses remain unchanged in terms of employment, or cease trading, it is the fast growing firms which are creating a considerable number of jobs. It is also these businesses that tend to experience the greatest difficulties with issues such as staff recruitment, retention and training as well as management development. While there is a clear role for new enterprise training, the greatest returns in terms of job creation and business development may come from a concentration upon understanding the changing skill requirements and training needs of a comparatively small group of firms.

Hakim, C. (1989) *'Identifying fast growth small firms'* *Employment Gazette*, January, 29-41.

Storey, D. and S. Johnson (1987) *Job Generation and Labour Market Change*. Macmillan.

A full account of the material summarised in this **Bulletin** can be found in the **Review of the Economy and Employment, Vol 1, 1990**.

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### The Institute

The Institute for Employment Research was established by the University of Warwick in 1981. The IER has a diverse portfolio of research projects funded by organisations which include the Employment Department Group, the Economic and Social Research Council, the Department of Social Security, the Commission of the European Communities and a number of local authorities.

Current research includes: forecasting occupational change and skill requirements at the national and local levels, the evaluation of employment policies and programmes, recruitment processes, international aspects of labour markets, and the likely labour market consequences of completion of the European single market.