

INTERNATIONAL WORKSHOP HIGH-GROWTH FIRMS: LOCAL POLICIES AND LOCAL DETERMINANTS

SUMMARY REPORT

Background information

The OECD Local Economic and Employment Development (LEED) Programme and the Danish Business Authority (DBA) organised on 28 March 2012 a workshop on the theme of “High-growth firms: local policies and local determinants”. This is the result of the new interest of policy makers towards high-growth firms, i.e. firms that grow rapidly over a short period of time, because of the number of jobs they are estimated to create. Most evidence, indeed, points to most job creation taking place in a small percentage of especially fast-growing firms.

The OECD is currently engaged in measuring high-growth firms and gazelles (the younger variant of the former) in selected countries and understanding their main characteristics and drivers. Recent publications on the topic include, for example, *High-growth firms: What governments can do* and *Financing high growth firms: The role of angel investors*. As part of this in-house effort, the LEED Programme has started a project on high-growth firms at local level, with a view to determining the geographical distribution and scoping local policies and determinants.

The Danish government, on his hand, keeps a comprehensive approach to entrepreneurship support, where high-growth firms are located at the top of the pyramid of public support and primarily receive venture capital, skills development, and tailored advice. Part of their approach consists in the regionally based “Growth-houses”, which are one-stop shops located in each of the five regions of the country and which provide companies with the identification of market opportunities and with signposting to relevant business development services available externally.

Given this shared interest on the role and potential of high-growth firms, the workshop was set to understand determinants and policies of high-growth entrepreneurship, especially at sub-national level.

Determinants

High-growth firms are a recent topic of interest at academic level. Thus, much of the available literature concerns determinants of business growth more in general. The presentation by **David Audretsch** brings out that the original framework to study the phenomenon of business growth was Gibrat’s Law, which postulated that this was normally distributed across the range of firm sizes and firm ages and thereby occurred randomly. An important implication of this theoretical framework is that high

growth firms would not only be a small number, but would also be independent of firm-specific characteristics. Early empirical evidence originally brought considerable support for Gibrat's Law, as there was no firm-specific variable systematically linked to firm growth.

These first empirical studies, however, were essentially based on US datasets of large companies. As studies began to include a broader set of firm sizes and firm ages, evidence began to shift. In particular, firm growth was found in most studies to be associated with certain characteristics such as the dimension, age, and sector of the enterprise. In particular, the prevailing evidence suggests that growth rates are higher for firms that are small, young and in technology-intensive industries.

But do firms with these characteristics reflect the reality of high-growth firms? Whilst it seems uncontested that job creation is concentrated in few fast-growing firms, the prevailing features of the latter are more of a controversial issue. For example, Birch and Medoff (1994) find that what they call gazelles are a very small share of the total firm population, have a mean size of only 61 workers, and can be found across all economic sectors. A more recent study by Acs et al. (2008), however, finds that high-impact firms defined in terms of both sales and employment are rather larger and more mature firms, but it confirms that they can be found across all industries.

That high-growth firms are not necessarily technology-based is corroborated also by studies presented at the workshop. For example, in the Swedish region of Scania, **Åsa Lindholm-Dahlstrand** finds that high-growth firms are distributed across a wide range of industries and only a handful are in technology-intensive sectors. Unsurprisingly, only a few of them keep relationships with higher education institutions and even fewer are university spinouts. They are also more often than not mature firms rather than newly established enterprises. **Suzanne Mawson** from Scottish Enterprise similarly reports in another presentation that the approximately 1 500 high-growth firms of Scotland are generally innovative but not necessarily technology-based and are found across many sectors, including some traditional industries such as construction, food processing, and beverages. Scottish Enterprise detects them mainly in services and in business-to-business activities.

Especially when looking at firm age and firm size as determinants of business high-growth, it appears important to control for possible Mergers & Acquisitions (M&A) and spin-off effects. Fast growth can, indeed, be the artificial outgrowth of an M&A, where additional turnover and jobs are not created but simply inflated through integration of a previously independent company. Similarly, spinoff effects can lead to an overestimation of the role of small and young firms in fast growth and related job creation.

Most of the literature on business growth has, therefore, focused on three firm-specific determinants: firm age, firm size, and industry. A different strand has, however, looked at personal features to determine what makes an entrepreneur successful. Variables taken into consideration encompass the age and gender of the entrepreneur, his/her prior work experience, etc. Previous work experience in a related industry, past experience as entrepreneur, and growing up surrounded by business owners in the family or in the social milieu, are all factors affecting positively the chances of success of an entrepreneur, although the latter is measured as survival or growth in general, rather than as specific high growth (Adragna and Lusardi, 2008; Djankov et al., 2007; Lazear, 2005). A policy implication of this would be to look at the characteristics of the entrepreneur rather than those of the company when giving support to firms with growth potential, although the risk for policy makers could be to fall in some sort of social discrimination.

Locational factors

The literature on geographical determinants is much less generous and has primarily concentrated on clustering and knowledge spillovers as main drivers of business growth (**David Audretsch**). Knowledge spillovers decay with distance, which implies that especially in knowledge-based sectors there will be a

tendency toward clustering. Clustered firms are then expected to outperform similar enterprises in non-cluster environments, in spite of the congestion costs with which the former are faced. Clusters, however, can be located pretty much everywhere, as shown by the large anecdotal literature on the topic (e.g. Rosenfeld, 2002; Nadvi and Schmitz, 1999).

With regard to high-growth firms there is also limited evidence that they can be found in different places. The study by Acs et al. (2008) highlights, for example, that i) high-impact firms are not only found in metropolitan area or in their proximity; ii) the attractiveness of metropolitan areas has, indeed, been decreasing over the last decades; iii) nonetheless, geography still plays a role, for the most prevalent location of high-impact firms is still between 6 and 15 miles from a central business district.

The location of FDI can also become a driver of local business growth, especially in countries where FDI accounts for a significant share of national GDP. The point is made in the presentation by **Pawel Chorazy** from Poland's Ministry of Regional Development. Fastest-growing regions in Poland have been those able to attract most FDI and embed it with local cluster development. Based on findings from the Ministry, inward FDI has positively impacted on local economies through both job and business creation (a 33% increase in the average number of firms). Based on the Ministry's own calculations, high-growth firms (OECD employment-based definition) were a considerable 8.6% of the total firm population in Poland in 2009, down from 13.1% in 2008 and 12% in 2007.

Much less evidence is available in the extant literature on possible local explanatory variables of business high-growth such as educational attainment (e.g. percentage of the labour force with tertiary education), industry structure (e.g. weight of knowledge-intensive sectors in the local economy, predominance of services, etc.), factor conditions (e.g. labour cost and land costs), labour market vitality (e.g. participation rate and unemployment rate), business vitality (e.g. start-up rate and business density), etc. A partial exception is represented by the preliminary findings of **Werner Hözl**'s work from the Austrian Institute of Economic Research (WIFO). In his presentation, he claims that the incidence of high-growth firms is higher in Austrian regions which have higher aggregate growth rates, higher labour turnover and higher unrelated variety (across 2-digit industries). By contrast, the business churn-out rate and the specialisation of the local economy do not have an impact on the local incidence of high-growth firms.

Establishing the impact of locational variables on the preponderance of high-growth firms at local level is the main scope of the OECD project in collaboration with Aston University and presented by **Yama Temouri**. The project looks at local distributions and local determinants of high-growth firms (OECD employment-based definition) in selected OECD countries, drawing on the firm-level database ORBIS. Preliminary results on the distribution of high-growth firms in Belgium, Denmark, Germany, Italy, and United Kingdom were presented at the workshop, while more conclusive results on both local distributions and local determinants will be available by the end of the year.

Policies

An interesting evolution has interested SME and entrepreneurship policies over the last decades. In the 1980s and part of the 1990s the interest was mainly on existing SMEs and, namely, in creating a level playing field for small enterprises so that they would not be disadvantaged in the face of large corporations because of, for instance, higher fixed costs. Later in the 1990s the attention of policy makers shifted towards entrepreneurship, although the focus was mainly on encouraging new business creation *tout court* in the belief that increased productivity would stem from the entry of new more efficient firms and by the contraction, exit or upgrading of inefficient incumbent enterprises. The rationale was clearly the Schumpeterian view of entrepreneurship as a process of 'creative destruction'. Much more recently the glance has turned towards high-growth firms as a special subset of both new and existing small enterprises.

The main rationale of policy intervention concerns the number of jobs high-growth firms are estimated to create, although other motives involve more traditional market failures (e.g. limited supply of growth capital and suboptimal public investment in R&D) and system failures (e.g. poor inter-firm linkages and relationships between research organisations and business enterprises). **Niels Bosma** and **Erik Stam** from Utrecht University, however, argue that it is difficult to determine whether high-growth policies result in net job creation or simple labour re-allocation from declining firms to fast-growing ones. They also maintain that programmes for high-growth firms seem to be driven by benchmarking, bringing evidence by which the launch of business incubators in one region is positively affected by the presence of incubators in neighbouring regions (Ingram et al., 2010).

Concerning the geography of business high-growth policies, the Utrecht University's paper reports that programmes are mainly at the national and regional level, with very limited scope for the municipal level. Large countries such as the United States and Canada or smaller ones with remarkable internal cultural differences such as Belgium adopt quite a regionalised approach, whereas the Netherlands, Finland and Sweden mainly present national programmes.

The paper also makes a distinction between virtual and location-based business accelerator programmes. The former “most often target gazelles (young firms) that want to make the transition towards high-growth firms, while location-based business accelerator programmes most often target ambitious (budding) entrepreneurs that aim to develop their nascent business into a gazelle” (Bosma and Stam, 2012).

Denmark and Scotland are two examples of governments – national the first, regional the second – which have developed specific programmes for high-growth firms. In Denmark, as mentioned, high-growth firms are at the top of the pyramid of entrepreneurship support and are mainly catered for through venture capital, skills and individualised advice. **Anders Hoffman** from the Danish Business Authority (DBA) reports the presence of a dense business support infrastructure that includes local business support centres, trade centres, technology institutes, etc. However, the policy tool that is more closely geared towards the needs of high-growth firms is the network of regional Growth-houses. Located in each of the five regions of Denmark, Growth-houses are tasked with the support of a restricted number of firms that show growth potential. They mainly act as a signposting for business advice, which is concretely delivered by local business service providers. They can also lead projects tendered by regions for EU funding. Some early evaluation evidence indicates that job creation is stronger among customers of Growth-houses than among comparable non-customer enterprises (Danish Business Authority, 2012).

Scotland has also an important tradition of support of high-growth firms. **Suzanne Mawson** from the regional development agency Scottish Enterprise argues that until recently policy support was oriented towards small, young and technology-based companies, in the conviction that enterprises with these features were those most likely to grow fast. Programmes were then concentrated on “transactional” forms of support such as R&D grants and soft loans. Recent research by Scottish Enterprise has, however, convened towards findings in line with those highlighted in the session on determinants of the workshop: i) high-growth firms are generally innovative, but not necessarily technology-based; ii) and they are generally mature firms rather than newly established ones.

The Scottish experience also shows that growth is a rare moment in a company's life, with 55% of fast-growing firms exhibiting an average of two moments of growth over a ten year period, generally followed by times of modest growth. To define these moments, Suzanne Mawson comes up with the new concept of ‘trigger points’, which are “systemic changes to the structure and workings of a firm which provide a critical opportunity for altering the firm's growth trajectory”. Trigger points can be exogenous, endogenous, or co-determined.

An implication of the ‘trigger point’ theory is that timing is a crucial element in policy support. Presently, Scottish Enterprise backs enterprises both when they experience a ‘growth trigger’ and in the subsequent post-growth phase. An example of action is the ‘Companies of Scale’ programme, which helps enterprises during a period of transition (e.g. management change) with a focus on long-term strategies that include the management of ownership succession and acquisitions. This also implies that, at more general level, Scottish policies have partly turned from ‘transactional’ (see above) to ‘relational’, focusing on individualised advice and mentoring.

The case of France, discussed by **Nadine Levratto**, is also interesting because it represents an example of country where support for high-growth firms has followed an opposite path, losing importance during the last years. For a few years in the mid-2000s high-growth firms were highly ranked in the national political debate. In 2007, the “Gazelle Plan” was announced, with a view to boosting the scant presence of medium-sized companies in France through innovation contests, tax rebates (i.e. for firms whose payroll rose more than 15% per year) and enhanced supply of equity capital. Mainly due to the economic crisis, however, since 2008 policy makers have prioritised employment creation rather than business growth. In the field of SME and entrepreneurship policies, this change is epitomised by the large emphasis given to the new legal status of *auto-entrepreneur*, a form of self-employment benefitting from tax exemptions and tax rebates up to a certain turnover threshold. In the field of high-growth enterprises, the action of the national government is today restrained to equity participation in promising SMEs (approx. 1 100 by the end of June 2011) and participation in private investment funds to raise the amount of equity finance in the country. The retreat of the national government from more active support is only partly compensated by *pôles de compétitivité*, a regional policy approach fostering the development of business clusters.

Policy-relevant issues

The presentations and debate on policies for high-growth enterprises at the workshop raises two key issues for policy makers: the timing of the intervention and the evaluation of the same.

Firstly, many of the studies presented at the workshop bring up the fact that fast growth is a rare occurrence in the life of a company and that, as a result, persistent growth is extremely rare and sustainable growth is a challenge. Though in different nuances, the point has been reiterated in the presentations by **Åsa Lindholm-Dahlstrand** (Lund University), **Suzanne Mawson** (Scottish Enterprise) and **Björn Falkenhall** (Sweden’s Growth Policy Analysis Agency). What are the policy implications? Should policy support accompany firms as they experience high-growth? Or should support be consequent to fast-growth and help companies manage the ‘creative disorder’ provoked by the previous period of growth, making growth ‘sustainable’? A completely different strategy would be trying to anticipate fast-growth, based on some company’s metrics or entrepreneur’s characteristics, but this option is at best marred with the well-known inability of governments to pick winners.

Secondly, testing additionality in the evaluation of programmes for high-growth firms is made complex by the nature of the target group, i.e. firms that at a glance are not in need of help as they are experiencing or have recently experienced high growth. The key question is therefore: how should policy makers assess additionality in interventions targeting enterprises that have already a performance much better than the average? The question seems to be especially relevant when the support intervenes in the post-growth phase. Similarly, the possible roles of M&A and spin-off effects in business growth call for special attention on re-allocation effects, especially when measuring the impact of high-growth programmes on job creation.

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