**Business demography in the Combined Authority**

***A note on the drop in business births in 2017***

***\*Prepared for CPIER\****

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Our 2017 draw analysis of business demography for the Combined Authority and its constituent districts pointed to a substantial drop in the number of business births in the area during 2016-17 compared with earlier years.[[1]](#footnote-1) These results prompted a discussion among the Cambridgeshire and Peterborough Independent Economic Review (CPIER) Commissioners about the extent to which this trend is mirrored at the national level, along with the reasons behind this slow-down in the rate of start-ups in the Combined Authority. This note seeks to shed light on these issues, taking into account the latest figures on business births and deaths in the local sub-region derived from our 2018 draw.

**Business births in the Combined Authority**

Figure 1 plots the number of business births and deaths in the Cambridgeshire and Peterborough area between 2011-12 and 2017-18. The figure is based on data collected by the CBR as part of the 2018 draw and refers to companies that are based in the area (national and foreign companies that are active in the area are not included).

Figure 1 Business births and deaths in the Combined Authority

*Source:* CBR.

While business births and deaths have witnessed an upward trend until 2015-16, there is evidence of a significant decline in the number of newly registered firms in 2016-17. Our data suggest that business births in the Combined Authority have fallen from 3,291 in 2015-16 to 2,228 in 2016-17, with all the districts experiencing a marked reduction in business formations (the largest reduction is found for Peterborough, which has experienced a -55.8% change in business births according to 2017 draw data). A possible explanation behind this reduction in business formations towards the end of the sample period might be the relatively high number of incorporated academies in the years up to 2015-16, which are reflected in larger figures for business births during the first period covered in our analysis. A case in point is 2012-13, during which businesses formed in that year have employed an average of 3.9 people – an unusually high figure for newly formed businesses – compared with an average of 2.3 throughout the whole period.

The fall in business births during 2016-17 has been accompanied by a considerable increase in the number of companies that have died during the same year, with a total of 2,020 companies dissolved or liquidated in 2016-17 compared with 1,764 one year earlier. It is also worth noting that 2016-17 has been the first year (during the period we have examined) when the number of employees at newly formed companies (4,198) has exceeded the number of employees at discontinued companies (4,256), thereby contributing negatively to the total employment base in the area. This is not entirely surprising, since a period of high generation of businesses such as the one until 2015-16 is likely to result in a higher number of business deaths with some lag – given that start-ups frequently fail in the first few years of operation. However, as the number of companies that have been born during the year has exceeded those that have died, the stock of companies that were alive at the end of the period has gone up by 208 companies. Business births and deaths have both recovered during 2017-18, as shown by the two lines in Figure 1 moving away from each other in the last year covered by our analysis.

**What has been the trend in company incorporations for the UK?**

In light of this evidence, it is instructive to examine whether the decline in business births observed in the Cambridgeshire and Peterborough area is confirmed by data at the national level. To this purpose, Figure 2 depicts the number of company incorporations and dissolutions in the UK by year over the period 2011-2018. The underlying data are taken from Companies House, which constitutes the source of accounting information used to produce the corporate database and therefore allows for a meaningful comparison with figures at the sub-regional level.[[2]](#footnote-2)

Figure 2 Company incorporations and dissolutions in the UK by year

*Source:* Companies House.

Company incorporations and dissolutions have grown in tandem until 2016. However, whilst the number of dissolutions has continued to rise in both 2017 and 2018, incorporations have slowed down in 2017 compared with earlier years while increasing again in 2018. According to Companies House data, this has been the first time that company incorporations in the UK have dropped since 2011. In a nutshell, this evidence is consistent with our earlier findings for the Combined Authority, although the drop in business formations in the UK does not appear to be as large as that found for the local sub-region.

Besides yearly data, Companies House publishes data with a quarterly frequency. These data are illustrated in Figure 3, which reports the number of company incorporations and dissolutions in the UK during the period between 2011 Q1 and 2019 Q1. It must be noted that both of these time series appear to exhibit a considerable degree of seasonality, thereby calling for caution in looking at quarter-on-quarter changes rather than year-on-year changes.

Figure 3 Company incorporations and dissolutions in the UK by quarter

*Source:* Companies House.

Between April and June 2018, there have been 166,886 incorporations in the UK, up from 152,411 one year earlier. This result suggests a pickup in company incorporations during 2018, although the number of incorporations has remained somewhat lower than that in the same quarter of 2016. At the same time, one can notice that the number of incorporations has been at one of its highest in the second quarter of 2016 and has subsequently declined until the end of 2017, reaching a relatively low level in the fourth quarter of 2017 and increasing again during 2018. Company incorporations have peaked in the first quarter of 2019, up 15,200 (9.1%) from one year earlier.

Table 1 details the year-on-year changes in company incorporations and dissolutions in the UK based on Companies House data.

Table 1 Year-on-year changes in company incorporations and dissolutions in the UK (second quarter)

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **2012 Q2** | **2013 Q2** | **2014 Q2** | **2015 Q2** | **2016 Q2** | **2017 Q2** | **2018 Q2** |
| Incorporations | 8.6% | 10.9% | 12.9% | 3.4% | 12.7% | -11.9% | 9.5% |
| Dissolutions | 9.7% | -5.8% | 24.2% | -5.9% | 28.6% | 2.5% | 10.3% |

*Source:* Companies House.

It can be seen that the largest drop in company incorporations is found between 2016 Q2 and 2017 Q2, during which incorporations at the national level have fallen from 172,935 to 152,411 (-11.9%). Following this drop, the change in company incorporations has returned positive in 2018 Q2 and largely in line with values observed throughout the period 2012 Q2-2016 Q2.

**What lies behind the drop in business births in 2017?**

Taken together, the results presented above suggest that the decline in newly registered firms that was found for the Combined Authority may not be a phenomenon specific to this area, but may rather be part of a wider trend in business formations that has characterised the whole of the UK. Therefore, it becomes important to uncover what lies behind the trend in business births observed over the recent years. To this end, it is useful to refer to the analyses on business formations in the UK conducted by Inform Direct and the Centre for Entrepreneurs (CFE).[[3]](#footnote-3) Both of these analyses use data drawn primarily from Companies House and find evidence of a drop in business births during 2017. Importantly, the study by the CFE provides data at the local authority district level, which show that the number of business formations in the districts making up the Combined Authority has declined significantly between 2016 and 2017 (with Cambridge witnessing a 15.5% decline).

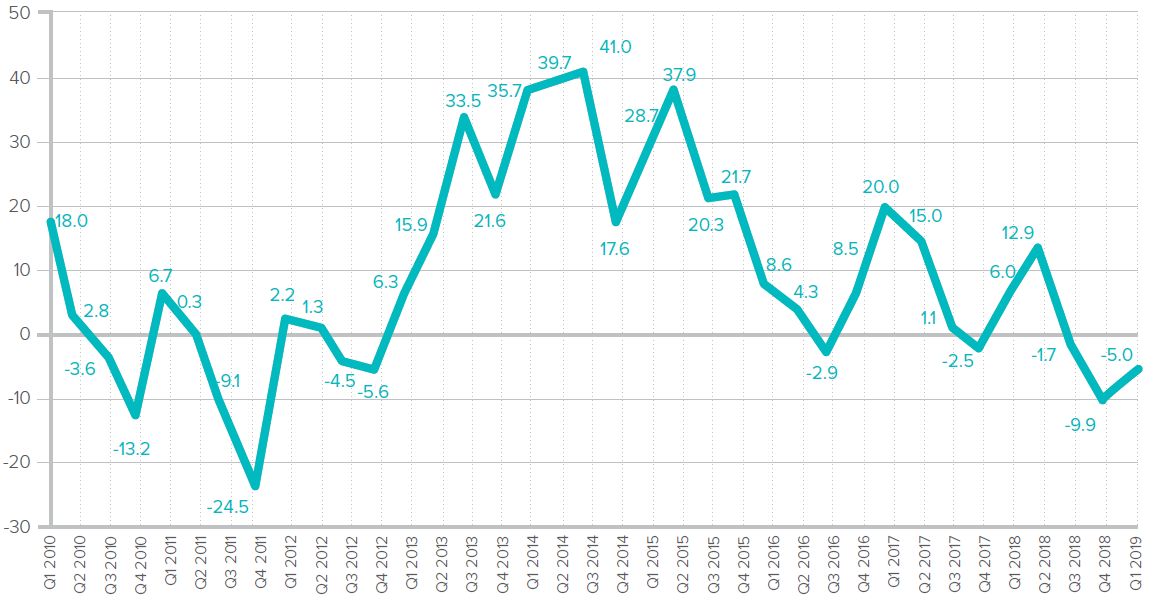
The studies by Inform Direct and the CFE advance two main explanations behind the drop in business births in 2017:

* Reduced confidence amongst entrepreneurs;
* Government’s clampdown on ‘disguised employment’ in contractors to the public sector (and its extension to the private sector as a whole).

***Reduced confidence amongst entrepreneurs***

According to the analysis by Inform Direct, “lower formation numbers may signal reduced confidence amongst entrepreneurs and potential entrepreneurs – with many would be business owners put off from taking the step of forming a company to pursue their ambitions”. This view appears to be largely confirmed by the Federation of Small Businesses’ (FSB) *Small Business Confidence Index*, which shows that confidence amongst UK small businesses has fallen in all of the last three quarters of 2017.[[4]](#footnote-4) The trend in the index is presented in Figure 4.

Figure 4 Small Business Confidence Index for the UK



*Source:* FSB.

The study by Inform Direct points specifically to Brexit as one of the possible reasons underpinning the decline in the number of business births. It is argued that “the lack of certainty about how trade agreements will look post-Brexit makes it difficult for businesses to plan effectively, especially the many companies that trade with countries within the EU. Many will be waiting to see what the final picture looks like before pursuing their next business opportunity”.

Despite the decline in business confidence associated with the uncertainty caused by Brexit, the data from Companies House reported above indicate that there has been a pickup in company incorporations in 2018. As Table 1 shows, incorporations in the UK have gone up during 2018 Q2 compared with one year earlier, while further increasing in the first quarter of 2019.

The pickup in business births in 2018 that is observed at the national level is confirmed by our latest draw of all companies located in the local sub-region. Although the number of business births in the Cambridgeshire and Peterborough area during 2017-18 has been lower than in 2015-16, the last year covered by our analysis has seen 2,509 companies formed compared with 2,228 one year earlier. In terms of employment, newly formed businesses have contributed 4,666 employees in 2017-18, up from 4,198 in 2016-17.

Interestingly, our results also show that the number of companies moving out of the area has been increasing over time and has exceeded the number of companies relocating into the area. For example, in 2017-18 the Combined Authority has lost 368 companies (1,263 employees), while only gaining 109 companies (303 employees). These results might suggest that the area is becoming more expensive, with the cost of premises and labour incentivising companies to move away.

Furthermore, we did not find any sign of a nationality effect behind the change in business births in the Combined Authority between 2015-16 and 2016-17. Our data reveal that the outcome of the Brexit referendum has had a limited impact on the number of businesses started up by foreign-owned companies in the Cambridgeshire and Peterborough area, as there is evidence that these businesses have increased in number relative to the previous year.

***Government’s clampdown on ‘disguised employment’ in contractors to the public sector***

Alongside the rising uncertainty caused by Brexit, the study by the CFE puts forward another explanation behind the drop in business formations during 2017. In November 2016, the government approved new tax rules for limited company contractors working within the public sector, introducing important changes to IR35. Based on the new legislation (Finance Act 2017), the responsibility to prove that public sector contractors are working outside of IR35 shifts from the contractors to the public authority, agency or other third party who are using their services. These rules, which became effective from 6th April 2017, are aimed at tackling ‘disguised employment’ in contractors to the public sector by making non-compliance with IR35 harder. A consultation on extending these rules to the private sector was also conducted by HMRC between May and August 2018.[[5]](#footnote-5) Following the consultation, the government announced at Budget 2018 that the reform will be extended to the private sector from 6th April 2020. A further consultation on the detailed implementation of this reform, which will inform the draft Finance Bill legislation to be published in Summer 2019, was launched in March 2019.[[6]](#footnote-6)

According to the CFE, the tax clampdown on public sector contractors represents the primary driver of the fall in business formations during 2017. For instance, the results by the CFE show that 7,475 new businesses (out of a total of 10,164) formed in Wiltshire during 2016 were registered to an accounting firm that provides payroll solutions to contractors, while only 458 new businesses (out of 3,409) were registered at this address in 2017. Similar drops are found in Wellingborough, Lichfield and Central Bedfordshire, “all areas where contractor accounting firms have significantly outnumbered genuine entrepreneurial business formations in recent years”.

Although legal changes affecting public and private sector contractors might have led to a decline in the number of businesses formed (possibly reinforced by the publicity around these legal changes), the pickup in company incorporations in 2018 at both the local and national level suggests that the impact of the new tax ruling has been less severe than it was feared. Moreover, our 2017 draw analysis of the sectoral distribution of business births in 2015-16 and 2016-17 showed no evidence of the drop in start-ups being driven by particular sectors, which is what one might expect if the government’s clampdown on IR35 were the main factor behind this drop.[[7]](#footnote-7) Conversely, the number of businesses formed in 2016-17 appeared to have decreased in all sectors, including the knowledge-intensive ones. To better assess the impact that contractors to the public and private sectors may have on business births, we plan to carry out further work on identifying these contractors in the local sub-region.

***Concluding remarks***

This note has been concerned primarily with the number of businesses formed and dissolved in the Combined Authority and the UK during the most recent years. The authors believe that a higher churn rate is a symptom of a more entrepreneurial economy. Therefore, the key question to be addressed is what growth do the successful newly formed companies achieve? To this regard, it is worth noting that a report published recently by Tech Nation has placed Cambridge second in the UK (after London and alongside Oxford) in terms of number of $1 billion technology companies created.[[8]](#footnote-8) The report identifies five Cambridge unicorns (i.e. CSR, Arm, Darktrace, Abcam and Autonomy, to which one may add the London-based BenevolentAI as it has a research facility on the Babraham Research Campus), out of a total of 72 unicorns created in the UK until 2019.

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**Appendix A**

Table A.1 Business births by sector in the Combined Authority

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |
| Companies based on 2017 draw | **2016-17** | | | | **2015-16** | | | |
| **BIRTHS** | **Number of companies** | **%** | **Total employment** | **%** | **Number of companies** | **%** | **Total employment** | **%** |
| **KNOWLEDGE INTENSIVE SECTORS** |  |  |  |  |  |  |  |  |
| Information Technology and Telecoms | 204 | 12.1% | 287 | 8.7% | 347 | 10.7% | 610 | 10.2% |
| Life science and healthcare | 23 | 1.4% | 105 | 3.2% | 64 | 2.0% | 216 | 3.6% |
| High-tech manufacturing | 55 | 3.3% | 80 | 2.4% | 78 | 2.4% | 106 | 1.8% |
| Knowledge intensive services | 21 | 1.2% | 26 | 0.8% | 36 | 1.1% | 47 | 0.8% |
|  |  |  |  |  |  |  |  |  |
| **TOTAL KI SECTORS** | **303** | **18.0%** | **498** | **15.1%** | **525** | **16.2%** | **979** | **16.4%** |
|  |  |  |  |  |  |  |  |  |
| **OTHER SECTORS** |  |  |  |  |  |  |  |  |
| Primary | 29 | 1.7% | 86 | 2.6% | 42 | 1.3% | 177 | 3.0% |
| Manufacturing | 42 | 2.5% | 124 | 3.8% | 128 | 3.9% | 212 | 3.6% |
| Wholesale and retail distribution | 170 | 10.1% | 441 | 13.4% | 310 | 9.6% | 560 | 9.4% |
| Construction and utilities | 222 | 13.2% | 297 | 9.0% | 354 | 10.9% | 499 | 8.4% |
| Transport and travel | 71 | 4.2% | 79 | 2.4% | 281 | 8.7% | 303 | 5.1% |
| Property and finance | 209 | 12.4% | 374 | 11.4% | 266 | 8.2% | 515 | 8.6% |
| Other business services | 323 | 19.2% | 666 | 20.3% | 596 | 18.4% | 989 | 16.6% |
| Other services | 251 | 14.9% | 452 | 13.7% | 602 | 18.5% | 1,145 | 19.2% |
| Education, arts, charities, social care | 62 | 3.7% | 271 | 8.2% | 142 | 4.4% | 590 | 9.9% |
|  |  |  |  |  |  |  |  |  |
| **TOTAL NON-KI SECTORS** | **1,379** | **82.0%** | **2,790** | **84.9%** | **2,721** | **83.8%** | **4,990** | **83.6%** |
|  |  |  |  |  |  |  |  |  |
| **TOTAL ALL SECTORS** | **1,682** | **100.0%** | **3,288** | **100.0%** | **3,246** | **100.0%** | **5,969** | **100.0%** |
|  |  |  |  |  |  |  |  |  |

*Source:* CBR.

1. The full analysis is presented in the note titled *Business Demography and Growth Composition Analysis* that was released in June 2018. [↑](#footnote-ref-1)
2. The latest data on incorporated companies in the UK that were published by Companies House are available at the following link:

   <https://www.gov.uk/government/publications/incorporated-companies-in-the-uk-january-to-march-2019/incorporated-companies-in-the-uk-january-to-march-2019>. [↑](#footnote-ref-2)
3. The analysis produced by Inform Direct is available at the link below:

   <https://www.informdirect.co.uk/company-formations-2017/>.

   The data prepared by the CFE can be downloaded at the following link:

   <https://centreforentrepreneurs.org/cfe-releases/business-formations-fall-tax-clampdown/>. [↑](#footnote-ref-3)
4. The latest report published by the FSB can be accessed via the link below:

   <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-sbi-q1-2019-final.pdf?sfvrsn=0>. [↑](#footnote-ref-4)
5. The consultation document is available at the following link:

   <https://www.gov.uk/government/consultations/off-payroll-working-in-the-private-sector>. [↑](#footnote-ref-5)
6. The policy paper and consultation document can be accessed at the link below:

   <https://www.gov.uk/government/consultations/off-payroll-working-rules-from-april-2020>. [↑](#footnote-ref-6)
7. The results of our analysis are summarised in Appendix A. [↑](#footnote-ref-7)
8. The report published by Tech Nation is available at the following link:

   <https://www.slideshare.net/WeAreTechNation/unicorn-update-london-tech-week-2019/WeAreTechNation/unicorn-update-london-tech-week-2019>. [↑](#footnote-ref-8)