Study raises questions over entrepreneurship policies

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Policymakers who try to boost the economy by creating a more favourable environment for entrepreneurs “can’t have their cake and eat it”, a new study has warned.

Such initiatives may well lead to new businesses but will also bring about more closures, according to major research into tax policy’s effects on entrepreneurship.

The study, carried out by the University of Nottingham, questions the wisdom of efforts to rebalance the economy towards manufacturing.

It also describes stories of a 'High Street apocalypse' as 'nonsense', arguing that business entry and exit rates actually change little between good times and bad.

Risk-takers and go-getters

The findings come as the UK government continues to stress entrepreneurship's role in aiding economic recovery in the wake of the global financial crisis. David Cameron has repeatedly signalled his support for 'risk-takers and go-getters' and last year described entrepreneurs as Britain's 'only strategy' for growth.

Research co-author Professor Richard Kneller, of the Nottingham School of Economics , said: "Entrepreneurship has been identified as a crucial factor in driving future growth and employment in many countries.

"But there remains the question of whether fiscal retrenchment might itself reduce the level of entrepreneurship that takes place, so undermining its role in recovery.

"Our study confirms that some of the patterns relating to entrepreneurship are as might be expected – but there are others that are altogether more surprising."

The research set out to examine the links between policies on corporate and personal income tax and entrepreneurs' decisions to open or close businesses.

Covering more than 20 countries and the period from 1998 to 2005, it drew on entry and exit data in the OECD-Eurostat Structural Demography Business Statistics.

Measuring entrepreneurship

Professor Kneller said: "The rate at which new firms open and old firms close is one of the more commonly employed methods of measuring entrepreneurship.

"Using this, we first find entrepreneurship is everywhere, not just in the high-tech sector. Old companies die and new ones are created in every industry in every country.

"We also find that policies that are aimed at creating more entrepreneurs will inevitably lead to higher rates of closure. In other words, more entry means more exit.

"Policymakers really need to get their heads around this idea. It's a lesson to them that they can't have their cake and eat it when it comes to encouraging entrepreneurship.

"Most of the exits are of firms that opened just a few years earlier. That might be no bad thing, as it suggests consumers didn't value those firms' products or services."

The research found more companies die in manufacturing than are opened, with the decline more pronounced in the UK than in other countries in the sample.

In addition, rates of entry and exit as a whole were discovered to be higher in Britain than in other major European economies such as Germany and France.

Professor Kneller said: "What we don't know is whether this is because the UK is more entrepreneurial or because it does less to support new and small businesses.

"We tend to classify someone as an entrepreneur only if they're successful, but the reality is that there are all sorts of unsuccessful entrepreneurs out there."

Because most entrepreneurs actually earn less than the average wage, increasing the marginal income tax rate for poorer individuals reduces entrepreneurship.

By contrast, increasing the marginal income tax rate for higher earners leads to more entrepreneurs and a rise in business entry rates – but only to a small extent.

High street apocalypse 'nonsense'

The study says one possible explanation for this is that such a move encourages the rich to become self-employed in an attempt to reduce their overall tax bill.

In general, the study shows taxation policies mostly affect those who want to open a business, with lower marginal corporate tax rates encouraging new enterprises.

But the research suggests the effect is small and that reducing the corporate tax rate by one percentage point would lead to only a few thousand new businesses.

Professor Kneller, a professor of economics, said: “One pattern evident from the data is that the rate of entry and exit really doesn’t change much over time.

“The entry rate might go down a bit while the exit rate goes up a bit, which is sufficient to generate the boarded-up shops and derelict factories that we all see.

“But the rates during the ‘bad’ times are generally the same as the rates during the ‘good’ times. The stories of an apocalypse on the High Street are nonsense.”

Provided by University of Nottingham