

# New firm formation and development



## **Introduction**

The reasons that lead policy-makers and practitioners to promote firm creation and development may not always be the same. However, at a certain point in time, the result of interests that may not be exactly the same nor be exactly aligned, eventually converge. Policy-makers are a body of people ' with power to influence or determine policies and practices at an international, national, regional or local level' and have in general macro-economic, broad views. The government of a country is an example of a policy-maker whose views have an impact on society. Practitioners, on the other hand, are people who ' practice a learned profession', e. g. an executive of a firm. They look for more micro-economic aspects which benefit their own personal interests and/or the interests of smaller groups.

## **WHY?**

In order to analyse why policy-makers and practitioners intervene in the creation of new firms and their development, we must first examine some data: In 2004, for instance, 580, 900 new firms were created in the United States, generating 2, 207, 420 jobs or, in other words, 7% of the total number of jobs created in that year. These figures demonstrate that new businesses are responsible for the creation of an increasing number of jobs, which in turn reduces unemployment and results in economic growth in certain areas. Some of these regions, especially rural areas and inner cities, may be declining, and the formation and development of new firms might regenerate these, reducing regional inequality and preventing the younger - innovative- generation from moving away (by creating jobs, reducing unemployment and therefore creating wealth for the area and it's people).

The Scottish Birth Rate Strategy launched by Scotland Enterprise (sEn) in 1993 is an example of an enterprise-creation policy which focused on regenerating a rural region- lowland Scotland. In order to do so, the strategy was split into 6 aims: persuading more people in Scotland to set-up businesses, improving the environment so as to make the area a more encouraging place for entrepreneurs, improving access to finance by helping potential entrepreneurs with funding to develop their businesses, widening the entrepreneurial base in order to remove social exclusion (getting ethnic minorities and women involved, for example), increasing new firm formation in industries such as manufacturing and increasing the number of fast-growing new firms.

Another reason why policy-makers and practitioners encourage new firm formation and development is in order to promote innovation. New businesses coming into an industry bring new, radical ideas with them, enabling markets to respond to constant changes in the technological, economic, and social environment. Furthermore, innovation generates choice and diversity in markets, which leads to competition amongst firms. Existing businesses in the market are faced with new entrants, who come armed with technological advances (innovative products and services, for example) which provide them with a competitive advantage. Existing businesses are then forced to increase efficiency in order to stay in the market and if they are unable to match their productivity to that of new firms, they are forced to leave the market, thereby boosting productivity in the market, as a whole. This leads to the formation of more competitive markets.

## HOW?

However, it is not always easy for a new firm to enter a market. Far from it, entry barriers, such as capital, control of resources and economies of scale, prevent most new businesses from coming in. Therefore, it is very common for most entrepreneurs to give up on the idea of ever owning a business. Market intervention by policy-makers and practitioners is thus deemed necessary in order to address attitudinal, resource, operational and strategic barriers to firm formation and growth.

In the U. K. as well as the U. S., a wide variety of measures have been introduced, resulting in a collection of policies ranging from macro policies to ‘hard’ and ‘soft’ support measures. ‘Hard’ support measures are those which have a tangible content and are probably the most important incentives of firm formation since without financial assistance, equipment and premises most businesses would never be born. Grants, subsidies and reduced-rate loans are provided by the government (which acts as an economic agent) with the intention of reducing the cost of inputs into the business. The major governmental financial aid package for new small businesses in the United Kingdom is the Enterprise Finance Guarantee Scheme. Loans are given to firms or individuals who cannot obtain financial assistance from elsewhere and 75% of the loan is usually covered. However, this scheme is only provided for companies who are more than two years old and most loans are below £70, 000.

Macro policies, on the other hand, involve reducing interest rates, taxation and inflation in order to stabilise the economy and reduce uncertainties. This encourages new firm formation and development because there is a smaller

risk involved with entering the market. An example of a macro policy is the Home Office Tax Deduction in the United States. Since half of all new businesses in the U. S. are based at home, the government deducts some costs from people using their houses for their firms, instead of working for someone else, which gives them an incentive to start their own company. Furthermore, at a micro-economic level, practitioners promote new firm formation and growth through ‘ soft’ support measures; those which encourage an increase in the flow of information. This keeps businesses aware of trends in markets and in government policies. Examples of ‘ soft’ support measures would be providing specialist advice (counselling) as well as helping with training, educating and mentoring entrepreneurs on the best way to create a business.

## **Conclusion**

In conclusion, benefits to society and the wellbeing of citizens can be seen to arise from new firm formation and development although this doesn’t necessarily mean that every new firm created will generate all, if any, of the benefits mentioned above. Especially since the typical start-up company is usually dead within 5 years. So the question to be posed is whether policy-makers and practitioners should provide ‘ blanket support’ to all new firms or if they should support ‘ winners’ only. In my opinion, ‘ blanket support’ should be given for macro-policies that affect new firms (reduction in taxation, for example). However, there may be a need to provide targeted support based on business plans presented by firms. In any case, each situation is different and there is no guarantee that policies that work in a certain context work in a different context.