Missing Firm Creation in the UK During the Covid-19 Lockdown

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We use near real-time data on business creation in the UK to assess the effect of Covid-19 lockdown policies on business creation. We find that, relative to the same period last year and up until 30 April, business creation decreased 32% since the lockdown. This amounts to over 27,000 fewer businesses than if the 2019 trend had continued. The construction and retail trade sectors suffer the largest decline in business creation with close to 40% falls in weekly incorporations. This decline in the creation of new firms can have important consequences for long-run productivity and employment performance.

Business creation is an informative measure of real economic activity. During exceptional events such as the Covid-19 pandemic, it is important to develop tools that allow us to measure in real time the effect of social distancing policies on the economy. The data available from the UK's Companies House allows us to measure new daily company incorporations.[1] The main advantage of this data is in its near real-time nature. In this short note, we present the first results of our analysis of new companies' incorporations in the UK since the start of the lockdown measures up until 30 April 2020. Our analysis is purely descriptive. We aim to quantify the extent of supply-side disruption caused by social-distancing measures.

Business creation is also important for deeper economic reasons. First, it is important for productivity dynamics. New firms grow to compete with existing firms, putting pressure on established firms to continue to innovate and keep prices low as consumers have alternative choices. Additionally, successful new firms grow faster than existing firms and have higher levels of productivity (Foster, Haltiwanger and Krizan 2001). In fact, evidence for the US suggests a small number of high-growth startups account for large portions of aggregate productivity, output and employment growth (Haltiwanger, Jarmin, Kulick and Miranda 2016). Secondly, new firms are important for employment creation. A fall in business creation directly reduces the number of jobs created. But this has a long-lasting effect as the firms created during a crisis age (Sedláček 2019). Furthermore, surviving new firms create more jobs than they destroy, so they are net job creators.[2]

Entering the crisis, the UK had record high levels of employment, but suffered from weak productivity growth. The fall in business creation will decrease UK employment levels and productivity growth will take a further hit. The productivity point should be a major concern for UK policymakers who were already grappling with the UK's so-called "productivity puzzle".

Aggregate Company Incorporations

Figure 1 shows weekly company incorporations in the UK since January 2020 relative to the same week in 2019 where we have aggregated daily data by week for visual ease and to smooth out inter-

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[1] The full data file can be found on the Companies House website (available here). The full list of variables is available here.
[2] See Sedláček and Sterk 2020 for a deeper analysis of these points with reference to the US.

day volatility. For comparison, we take two benchmarks. The mean number of new companies for the pre-lockdown period relative to the same period in 2019 (blue line), and the mean relative to 2019 since the lockdown began (red line). In the UK, social distancing measures had several stages. On March 16 all non-essential travel was prohibited. On March 20 the closure of pubs, restaurants, and other social contact businesses was announced. The full lockdown was announced on March 23, which is the date that determines our pre- vs post-lockdown comparison.

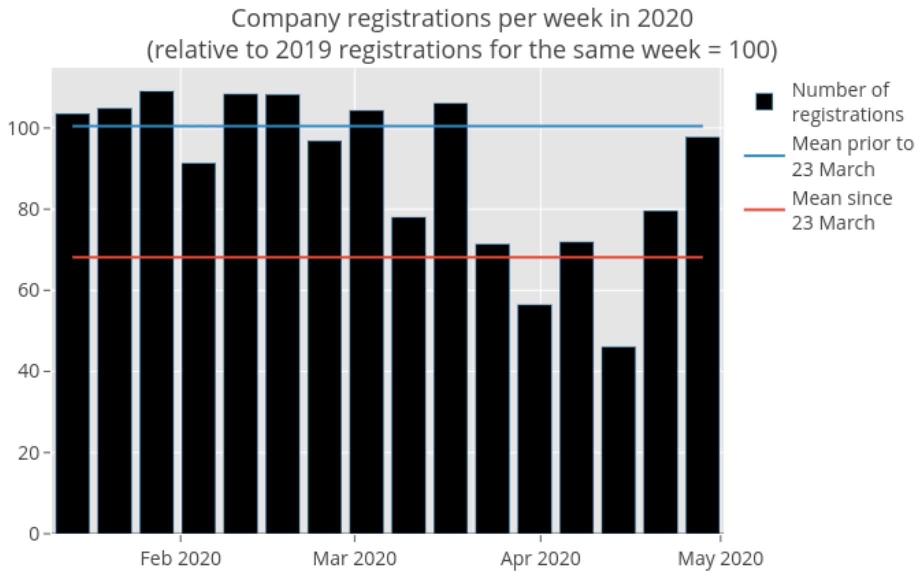

Figure 1. UK weekly new company incorporations 1 Jan to 30 April 2020

Before the lockdown period, the number of new firms created in 2020 was very similar (almost the same) to the same period in 2019. The number of new incorporations declines sharply after the third week of March (week ending Fri 20th March), which is when lockdown measures were implemented strictly. The fall relative to the same period in 2019 is 32%. To put these numbers into perspective, this would imply 27,518 fewer incorporations during the lockdown period if we take the same period in 2019 as a benchmark. The decline is sharpest in the second week of April, recovering towards the end of the month. This, however, may be driven by different dates for the Easter holiday, with Easter Sunday falling on 21 April in 2019 and 12 April in 2020. The decline if we compare pre- and post-lockdown periods in 2020 is similar given that the pre-lockdown number of new incorporations is very close to that in 2019.

This is less than the comparable figures for the US. John Haltiwanger (US Census Bureau) shows a 42% decline in new business applications in the US for the week ending March 28 relative to the same week in 2019 (Haltiwanger, 2020). They use BFS data, which allows them to focus on *business applications with planned wages*. This is an important distinction because it identifies "genuine" firms as opposed to entities created for accountancy purposes. Our data does not provide this distinction. We focus on all business incorporations regardless of their intended purpose.

Sectoral Change in Company Incorporations

Figure 2 shows the effect of the lockdown on business creation across the sectors defined in the Companies House data. It shows the percentage change in weekly average incorporations against 2019 in the pre-lockdown (grey bars) and the post-lockdown (black bars) periods. In the pre-lockdown period, perhaps surprisingly, both wholesale and retail trade were enjoying a substantial increase in new incorporations, followed by manufacturing. Other services, construction, and agriculture were experiencing a decline. After the lockdown, construction and retail sales suffer the sharpest declines relative to 2019 (close to 40%). The decline is sharpest for retail trade if we take into account the increase pre-lockdown relative to 2019. Public administration and finance-related incorporations also suffer a strong contraction. By contrast, agriculture, manufacturing, and mining experience less severe reductions in new company registrations. This conforms with these sectors having a larger proportion of essential workers. Nevertheless, the shock is global as we observe a significant contraction in all sectors relative to the same period in 2019.

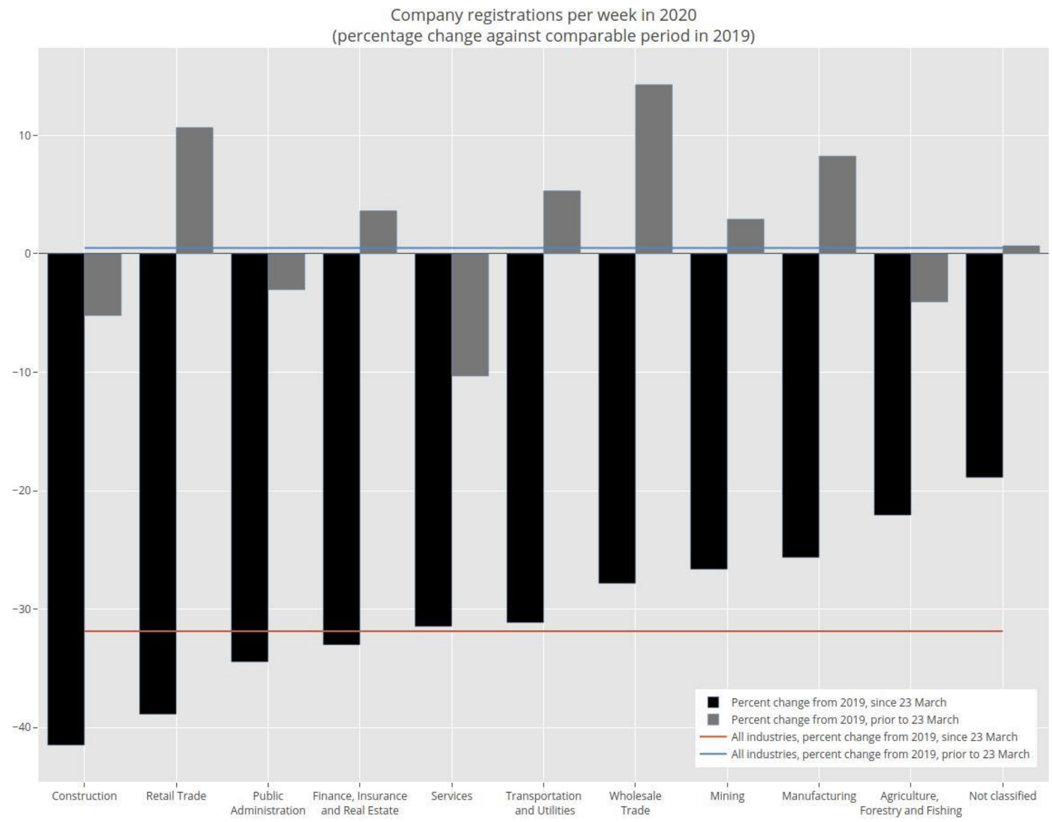

Figure 2. Change in new firm incorporations by sector

The results above paint a bleak picture for the dynamics of firm entry during the lockdown period with potential medium-term effects as a consequence of an unprecedented contraction of economic activity. There is not only a dramatic reduction in new company incorporations, but also a substantial redistribution of firm creation between sectors. Extending the series in the future will provide a clearer picture of the effect of the social distancing measures on firm dynamics. Unfortunately, data on firm exit is much harder to come by, as the register does not provide information on when companies ceased their economic activity. Only on the date in which the cessation is registered at the Companies House.

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