Open for Business:

The shape of business, enterprise and entrepreneurship across UK cities

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“The Centre for Cities is a research and policy institute, dedicated to improving the economic success of UK cities.

We are a charity that works with cities, business and Whitehall to develop and implement policy that supports the performance of urban economies. We do this through impartial research and knowledge exchange.”

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Executive summary

The return of the UK economy into recession underlines the political and economic imperative for growth. The UK economy is 4.4 percent smaller than it was at its pre-recessionary peak and, in terms of total output, the economic clock has been turned back to 2006. Because of this, now more than ever commentators are asking where future growth in the UK economy is going to come from.

Private sector growth in cities can come from two main sources – either through **growth of the existing business base** or through the **attraction of businesses** from elsewhere. Economic theory suggests that competition and openness foster growth of an economy. This paper attempts to categorise cities according to their levels of local competition and their openness to external investment.

"Cities with the highest levels of local competition and the most open economies are also some of the UK's strongest performing city economies"

Our research finds that those cities with the highest levels of competition – estimated based on the number of businesses and business start-ups - and the most open economies – those with the largest proportions of "branch" businesses (i.e. businesses with headquarters elsewhere) - are also some of the UK's strongest performing city economies.

Meanwhile those cities that have fewer branches and low levels of competition tend to perform more poorly – they tend to be closed economies.

The strength of these two factors has implications for the magnitude of future economic growth for cities. In order to encourage future growth, all cities should look to strengthen the basic principles underpinning their economies – better transport, more highly-skilled labour and making the planning process more responsive to business needs. Each city should also focus on addressing the specific deficiencies in its business base, whether this is by supporting enterprise – from start-ups to existing businesses – or through taking steps to make the city more attractive to external investment, and showcasing what the city has to offer investors.

Introduction

The return of the UK economy into recession means that the imperative for economic growth is clearer than ever. Unemployment is at its highest rate since 1995. The real value of take-home pay has fallen for 44 of the last 46 months. And four years on from the beginning of the downturn, the output of the UK economy is still 4.4 percent below its pre-recessionary peak.[1]

But despite the imperative for the UK economy and its cities to grow, and the importance for the UK as a whole of having policies that support economic growth, very little is understood about where city economies are starting from in terms of the types of businesses they have, the size of their overall business base and their reliance on foreign businesses. Without this understanding it is difficult to tailor policies to support the required expansion of city economies.

"Growth will need to be primarily driven by private sector investment, be this from businesses within a city or from external businesses choosing to invest in a city"

Economic growth in a city can come from three main sources – the public sector; organic growth of the private sector through business start-ups and growth of incumbent businesses, and; relocation of businesses from elsewhere. The requirement to reduce public spending over the current parliament and beyond means that the public sector is very unlikely to be a net direct contributor to overall economic growth over the coming years.[2] Given this, growth will need to be primarily driven by private sector investment, be this from businesses within a city or from external businesses choosing to invest in a city.

This paper explores the prospect for the latter two sources of economic growth in our cities. It aims to categorise cities according to the make-up of their private sectors to help inform the policy choices that cities and central government will invariably need to make to support future economic growth. It asks whether cities need to have high levels of local competition to be economically successful, and it looks to categorise UK cities according to their dependence on "branch" businesses (businesses with headquarters elsewhere, for example companies such as Boots or Barclays) and the strength of their local business base.

This exploratory research opens up as many questions as it provides answers. But by flagging the gaps in our current understanding of the dynamics of the private sector, it identifies possible avenues of future research both for the Centre for Cities and other research organisations. We will look to explore some of these issues further in a second paper that will look in more detail at the role of small and medium-sized businesses in cities.

1. As of Q1 2012. Source: ONS
2. This does not preclude the potential for productivity growth in the public sector.

Sources of private sector growth in cities

Growth in the private sector of a city can come from two main sources:

1. **Growth of the local business base**
2. **Relocation of businesses from elsewhere.**

1. Growth of the local business base

An obvious source of growth within a city economy is through the activities and expansion of its indigenous businesses. Competition is a driver of innovation – in order to remain in business, businesses need to find either a better or cheaper way of doing what they do.[3] So businesses in cities with higher levels of competition are likely to face greater pressures to innovate,[4] which in turn has implications for economic growth.[5] It is important to note here that economic growth and employment growth are not the same thing. Box 1 discusses the relationship between innovation, job creation and economic growth.

"Businesses in cities with higher levels of competition are likely to face greater pressures to innovate, which in turn has implications for economic growth"

Box 1: Innovation, productivity and jobs growth

Innovation in this report is used to refer to any process that makes the activities of a business either faster or cheaper to do or creates a new market. This could range from a business creating a new idea itself to copying it from another business. And it could include anything from introducing a faster way to serve customers in retail to patenting a new plastic electronics product.[6]

Economic theory is clear about the impact that this will have on economic growth, which this paper will focus on.[7] The link between innovation and jobs growth is less clear. In the short term it could mean that jobs are lost in a business or sector as greater efficiency means that fewer workers are required. But in the long term a more innovative economy leads to more productive businesses, and in turn a more productive economy, which is likely to create more jobs in new areas than an economy that is less innovative.

This means that those cities that have a greater number of firms should have greater pressures to innovate within their economies. Of course, not all businesses operate solely in local markets. For some businesses in certain industries this competition takes place at a national or international level. In this instance cities play host to the firm only. But other businesses have a much greater focus on a local market. In the analysis below we look at the number of local-facing or "non-tradable" firms in a city as a measure of "local competition". Box 2 discusses measures of local competition.

3. Blundell R, Griffith R & Van Reenen J (1995) 'Dynamic Count Data Models of Technological Innovation', *Economic Journal* 105 (March): 333-44
4. Van Stel A & Suddle K (2005) The Impact of New Firm Formation on Regional Development in the Netherlands, Erasmus Research Institute of Management (ERIM) Research Paper; Davis S, Haltiwanger J & Jarmin R (2008) *Turmoil and Growth: Young Businesses, Economic Churning, and Productivity Gains*, Kansas City: Ewing Marion Kauffman Foundation
5. Joseph Schumpeter set out this process in his theory of "creative destruction". Competition invariably creates losers as well as winners, as competition from more productive businesses forces less productive businesses to close. But this frees up resources to be put to better use, which in turn has positive implications for long run economic growth. See Schumpeter J (1942) *Capitalism, Socialism and Democracy*, New York: Harper, 1975 (original published 1942) pp 82-85
6. McKinsey found that retail was responsible for nearly a quarter of the increase in productivity in the US economy between 1995 and 1999. See McKinsey (2002) *What's right with the US economy*, San Francisco: McKinsey
7. For example, see Romer PM (1994) 'The Origins of Endogenous Growth', *Journal of Economic Perspectives* 8 (1): 3

New business start-ups should also increase competition - they disturb the status quo by challenging incumbent businesses with new ideas and innovations. While business start-ups will vary in their quality and survival, previous work has shown that new business start-ups account disproportionately for productivity growth in an economy,[8] suggesting that cities with higher levels of business start-ups are more likely to see stronger productivity growth.

Box 2: Defininig competition and local-facing businesses

Competition: We measure competition within a city in two ways. Firstly, we use the number of existing businesses per head in a city as a proxy for competition between existing businesses. Secondly, we use the number of business start-ups in a city to estimate competition from new entrants.

Local-facing businesses: Local firms are those businesses that serve only a local market. A classic example of this is a hairdresser, who can only sell his or her services to local customers. But while the example of a hairdresser is clear cut, attempting to define local-facing business more generally using Standard Industrial Codes is difficult. For example, some accountancy businesses may only serve the local business base, whereas others may have a national or international reach.

A list of the sectors we have used to define local-facing firms can be found in our online appendix: www.centreforcities.org/openforbusiness

Due to issues of data availability, business starts are not split according to sector.

"A high level of enterprise is not the only potential route to a city's success – instead city economies could grow by attracting external firms in to their economy"

2. Relocation of businesses from elsewhere

Economic growth in a city is not just driven organically. As well as growth through business start-ups and expansion of incumbent businesses, growth can also occur and innovation be fuelled through the relocation of or expansion of businesses from elsewhere. This suggests that a high level of enterprise is not the only potential route to a city's success - instead city economies could grow by attracting external firms in to their economy. This can have important implications for innovation too - these firms could help "import" new ideas which in turn spread to domestic firms through supply chains.[9]

So it is possible that cities that can be characterised as "branch" economies – i.e. have a higher proportion of firms in their economies which have headquarters elsewhere - could still see strong economic growth even if levels of enterprise are weak. We note however that there is likely to be some trade-off - some of the profit made by the activities of branch business is likely to return to their headquarters. Box 3 looks at the varying role that a branch business can have in a local economy.

8. Barnes MJ, Haskel J & Maliranta M (2001) OECD Firm-Level Study: Notes on the Decomposition of Labour Productivity Growth, mimeo.
9. Fu X (2008) 'Foreign Direct Investment, Absorptive Capacity and Regional Innovation Capabilities: Evidence from China', *Oxford Development Studies* 36 (1); BIS (2011) *International Trade and Investment - the Economic Rationale for Government Support*, London: The Stationery Office; MIER (2009) *Growing inward and indigenous investment*, Manchester: MIER. Note the impact of productivity spillovers are found to be dependent on the ability of indigenous businesses to absorb new innovations from branch businesses. MIER also find that productivity spillovers are unlikely to occur when foreign firms are primarily export orientated and can steal the market from domestic firms.

"The ability of a city to make use of innovations that originate from outside its economy is likely to vary across cities"

Box 3: The role of branches in a city economy

We use the percentage of branch businesses in a city as a proxy for the opportunity that a city has to import innovations from elsewhere, assuming that businesses will apply their practices through their subsidiaries. But there are many factors that mean that "absorptive capacity" – the ability of a city to make use of innovations that originate from outside its economy - is likely to vary across cities. These include the migration of workers from elsewhere, the interaction of branch businesses with local businesses and the ability of local businesses to use new innovations.[10]

The impact that a branch business has on a local economy will also vary according to the activities that it undertakes. A good example of this is the operations of Airbus in the UK. The company has two sites in the UK – a plant at Broughton, North Wales, which employs 5,600 and a plant in Bristol which employs 4,500 workers.

The functions of the two sites are very different. The Broughton plant is principally an assembly site only, with little of the firm's innovative activity occurring on site. There are a much wider range of activities that occur at Bristol, such as design, procurement and finance.[11] Not only does this activity provide more skilled jobs but it is also likely to have a greater amount of "spillover" benefits for the rest of the economy through its local interactions. This means that while the Broughton site has a very important role to play in the local economy in terms of the large number of people that it employs, its wider productivity benefits for the rest of the economy are likely to be much more limited than the Bristol plant.

Box 4: Defining branch and independent businesses

Independent businesses are classed as those that have **no parent company**. **Branch businesses** are those that have a **parent company** operating above it. In the following data the ultimate parent company of a business, rather than its immediate parent, is used to identify its ownership status. This approach was taken because using the location of an immediate parent of a branch may under-represent the number of foreign owned businesses in the UK because some companies set up UK arms to control their subsidiaries in the country. An example of this Cater Allen Ltd. (a private bank), whose immediate parent is UK based company Santander Private Banking UK Ltd. but whose ultimate parent is Banco Santander SA - based in Spain.

10. NESTA (2008) *Innovation by Adoption: Measuring and mapping absorptive capacity in UK nations and regions*, London: NESTA
11. Source: www.airbus.com/company/worldwide-presence/airbus-in-uk/, accessed 12 April 2012.

Levels of competition & openness in UK cities

We now look at how the strength of local competition and the location of branch businesses vary across UK cities.

There is significant variation in nature of local competition across cities

Figure 1 shows the cities that have the highest and lowest levels of local-facing businesses per 10,000 population. **Aberdeen**, **London** and **Brighton** had the highest number of local-facing businesses relative to their populations in 2010, while **Sunderland**, **Middlesbrough** and **Hull** had the lowest.

"Aberdeen, London and Brighton had the highest number of local-facing businesses relative to their populations"

Figure 1 also shows that the total number of local-facing businesses is reflected in the patterns of business start-ups – **those cities that have fewer businesses that serve a local market also tend to have lower levels of business start-ups**. While noting that some of this variation will be driven by demand – there is a positive relationship between these two measures of enterprise and wages – using these proxies for competition suggests that competition between businesses is likely to be weaker in cities such as Mansfield than cities such as Aldershot.

Figure 1a: Measuring the size of local competition

Top 10

Rank	City	Local-facing businesses per 10,000 population (2010)	External-facing businesses per 10,000 population (2010)	Business start-ups (2010)
1	Aberdeen	324.4	67.4	47.7
2	London	314.5	68.6	65.0
3	Brighton	300.2	62.6	52.1
4	Bournemouth	299.0	61.7	40.8
5	Edinburgh	293.7	60.2	42.6
6	Aldershot	274.7	75.8	44.5
7	Cambridge	271.9	75.9	35.8
8	Blackpool	265.6	49.3	29.6
9	Worthing	265.3	55.8	33.9
10	Bristol	255.5	58.5	36.7

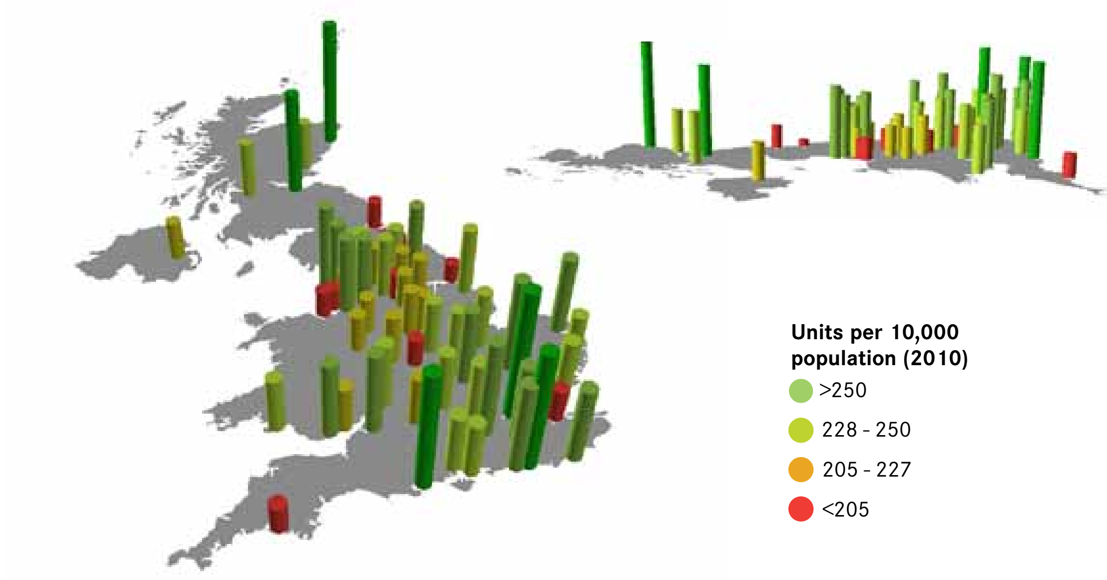
Bottom 10

Rank	City	Local-facing businesses per 10,000 population (2010)	External-facing businesses per 10,000 population (2010)	Business start-ups (2010)
55	Barnsley	192.8	42.8	24.8
56	Coventry	192.7	47.5	30.6
57	Birkenhead	192.4	35.3	26.4
58	Luton	191.4	41.3	32.2
59	Plymouth	190.9	34.4	21.3
60	Mansfield	188.7	45.6	21.7
61	Liverpool	187.7	37.4	26.0
62	Hull	182.6	44.2	23.5
63	Middlesbrough	168.8	34.7	22.1
64	Sunderland	158.9	30.0	16.8

Source: ONS 2012, Business Demography; TBR Observatory, 2012

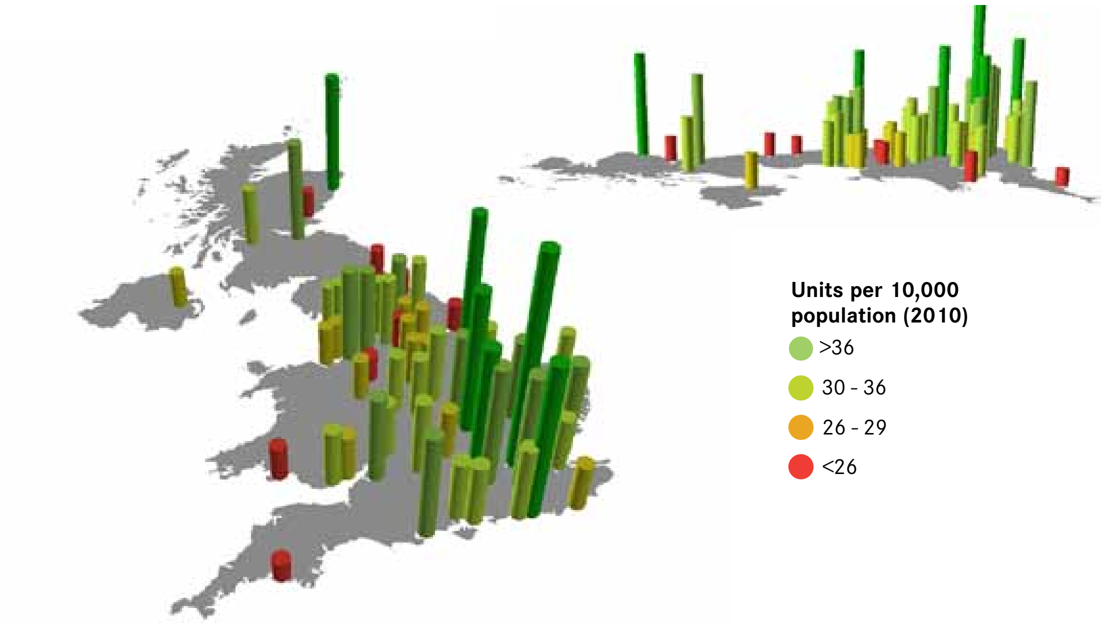
Figure 1b: Mapping the size of local competition

Internal facing businesses per 10,000 population (2010)



"Cities that have a smaller number of local-facing businesses have a lower number of external-facing businesses too"

Start-ups per 10,000 population (2010)



Source: Contains Ordnance Survey data © Crown copyright and database right 2012, TBR Observatory 2012, 2010 data

Cities that have a smaller number of local-facing businesses also have a lower number of external-facing businesses, meaning that they have a smaller pool of businesses overall. For the purposes of assessing local competition, this makes the distinction between local and external-facing businesses less important. The overall size of the business base is a good indicator of the strength of the business base in a local economy. What drives this link between the number of local and external-facing businesses is unclear. But it does suggest that the strength of the local business base is an important factor for businesses that have a wider market as well as those that are local-facing – a conducive business environment is important in encouraging business creation and expansion.[12]

12. Given that smaller cities such as Cambridge, Aldershot and Worthing appear in the top ten it appears that the overall population size of a city is not a principle driver of the strength of its business base.

Cities in the Greater South East tend to have larger branch economies

As with levels of competition, the proportion of branch businesses (defined in Box 4) relative to the overall number of businesses varies strongly across our cities. Figure 2 shows that the largest branch economies tend to be concentrated in the South East. And this is most marked in cities to the west of London, such as Reading and Aldershot, which are close to Heathrow Airport.

Aberdeen – principally because of the oil and gas industry - and Warrington are notable exceptions to this trend. **Aberdeen has the most branches out of all UK cities:** more than one in five businesses in the city are owned by parents either based elsewhere in the UK or abroad.

"Aberdeen has the most branches out of all UK cities: more than one in five businesses in the city are owned by parents either based elsewhere in the UK or abroad"

Cities in Yorkshire and the North West of England, on the other hand, tend to have more closed economies. In Burnley, 88.5 percent of businesses were independently owned in 2010, while in Barnsley this figure was 89.1 percent. Hastings, Brighton and Southend provide an exception to this spatial pattern. **Despite being in the South East, Southend has the highest proportion of independent firms out of all UK cities.**

Figure 2a: Percentage of businesses that are branches and the subset that are foreign owned

Top 10

Rank	City	Percentage of businesses that are branches (2010)	Percentage of businesses that are foreign owned (2010)
1	Aberdeen	23.7%	7.1%
2	Milton Keynes	21.4%	7.0%
3	Crawley	21.0%	5.9%
4	Swindon	20.5%	7.2%
5	Ipswich	20.3%	4.8%
6	Cambridge	19.9%	5.1%
7	Oxford	19.7%	6.0%
8	Reading	19.5%	6.7%
9	Gloucester	19.4%	5.9%
10	Dundee	19.1%	4.3%

Bottom 10

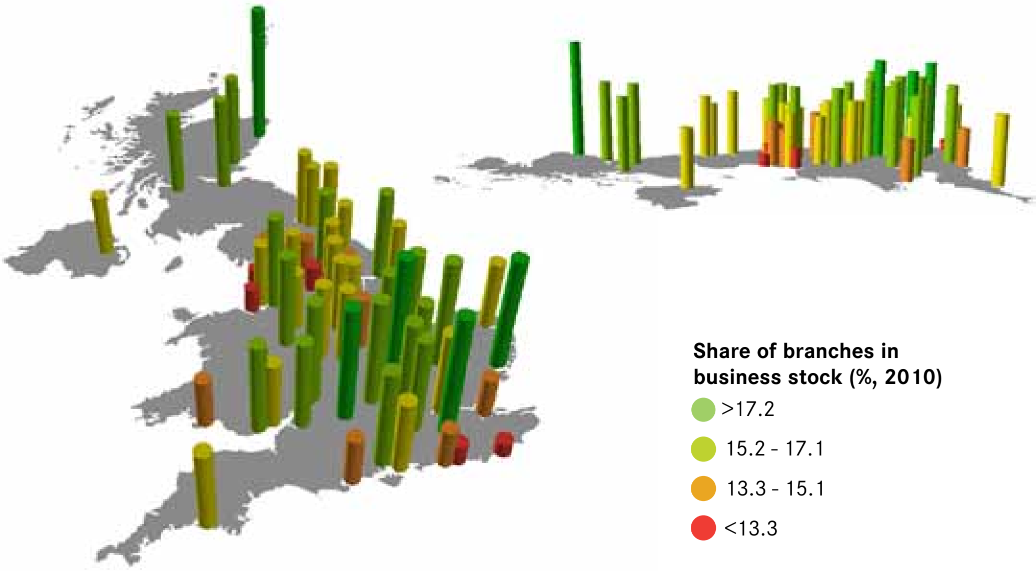
Rank	City	Percentage of businesses that are branches (2010)	Percentage of businesses that are foreign owned (2010)
55	Chatham	13.2%	3.2%
56	Worthing	13.0%	2.7%
57	Huddersfield	12.0%	2.5%
58	Birkenhead	11.8%	2.7%
59	Burnley	11.5%	2.7%
60	Brighton	11.3%	2.6%
61	Barnsley	10.9%	2.6%
62	Blackpool	10.8%	2.1%
63	Hastings	10.8%	2.3%
64	Southend	9.4%	2.0%

Source: ONS 2012, Business Demography; TBR Observatory, 2012

"Almost one in three foreign owned businesses in the UK are based in cities in the Greater South East"

Figure 2b: Mapping branch economies and foreign ownership

Share of branches in business stock (2010)



Share of foreign owned firms in business stock (2010)

Source: Contains Ordnance Survey data © Crown copyright and database right 2012, TBR Observatory 2012, 2010 data

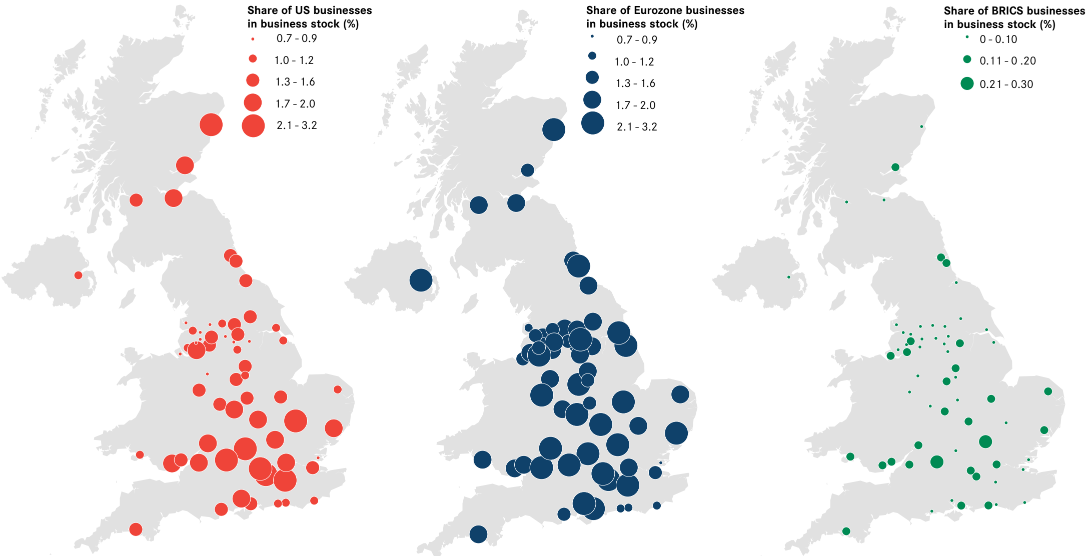
These trends are reinforced when looking at the percentage of businesses that are foreign owned (Figure 2). Although there is much less variation between cities (ranging from two percent of total businesses in Southend to 7.2 percent in Swindon), there is an even stronger concentration of foreign owned firms in and around London – **almost one in three foreign owned businesses in the UK are based in cities in the Greater South East**, compared to one in four businesses overall.[13]

13. These cities are Aldershot, Brighton, Cambridge, Chatham, Crawley, Hastings, Ipswich, London, Luton, Milton Keynes, Norwich, Oxford, Peterborough, Portsmouth, Reading, Southampton, Southend and Worthing.

Businesses from the USA dominate the total number of foreign firms in our cities. With the exception of Belfast, businesses whose ultimate parent is based in the USA account for the most foreign owned firms in every city in the UK. **Reading has the highest share of US owned businesses** – 2.8 percent of its total stock had an ultimate parent from the USA in 2010. French, German and Dutch firms also have a strong presence across all cities. Meanwhile **there are very few businesses from BRICS[14] countries in UK cities** – Luton had the most in 2010, but they accounted for just 0.2 percent of its total stock (see Figure 3).

"There are very few businesses from BRICS countries in UK cities - Luton has the most at 0.2%"

Figure 3: Foreign ownership



Source: Contains Ordnance Survey data © Crown copyright and database right 2012, TBR Observatory 2012, 2010 data

In the short term, the large share of Eurozone owned businesses across UK cities could increase their exposure to the Eurozone crisis as the probability of these businesses struggling to access credit or looking to consolidate increases. Cities such as Milton Keynes, Coventry and Swindon have the largest share of Eurozone owned businesses in their economies, and as such their business bases are most exposed to the ongoing troubles within the currency union.

But in the longer term the ability of these cities to attract businesses from elsewhere is likely to be a benefit to growth. Those cities with a larger share of branch businesses are likely to be better placed to import innovations from elsewhere than those that do not. This means that the open nature of their economies is likely to be a benefit to economic growth, rather than a hindrance. But it also means that some of the UK's most closed city economies, such as Southend, Hastings and Blackpool, may be less well positioned to benefit from this second source of private sector growth.[15]

14. Brazil, Russia, India, China and South Africa
15. See footnote 9.

Which types of city economy are best placed to grow?

The analysis above shows that while there is significant variation in levels of local competition and the proportion of branch businesses across UK cities there is no clear geographical pattern between the two. This poses the question, which types of city economy are best placed for growth – **does it contribute more to economic success to have strong local competition, an open branch economy, or both?**

More entrepreneurial, open cities are best placed to grow

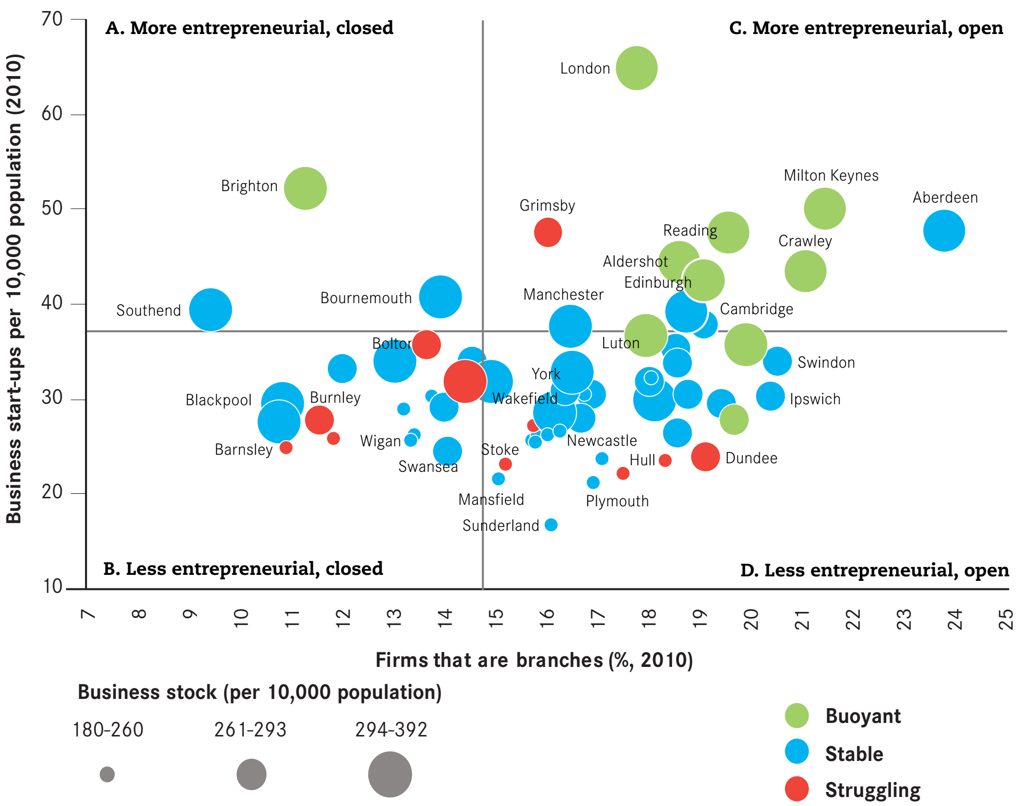
"More entrepreneurial, open cities are best placed to grow"

Placing cities into four categories by combining data in Figures 1 and 2 allows the economic policy priorities for each type of city to be identified. These categories are:

- More entrepreneurial and open economies
- More entrepreneurial but closed economies
- Less entrepreneurial but open economies
- Less entrepreneurial and closed economies

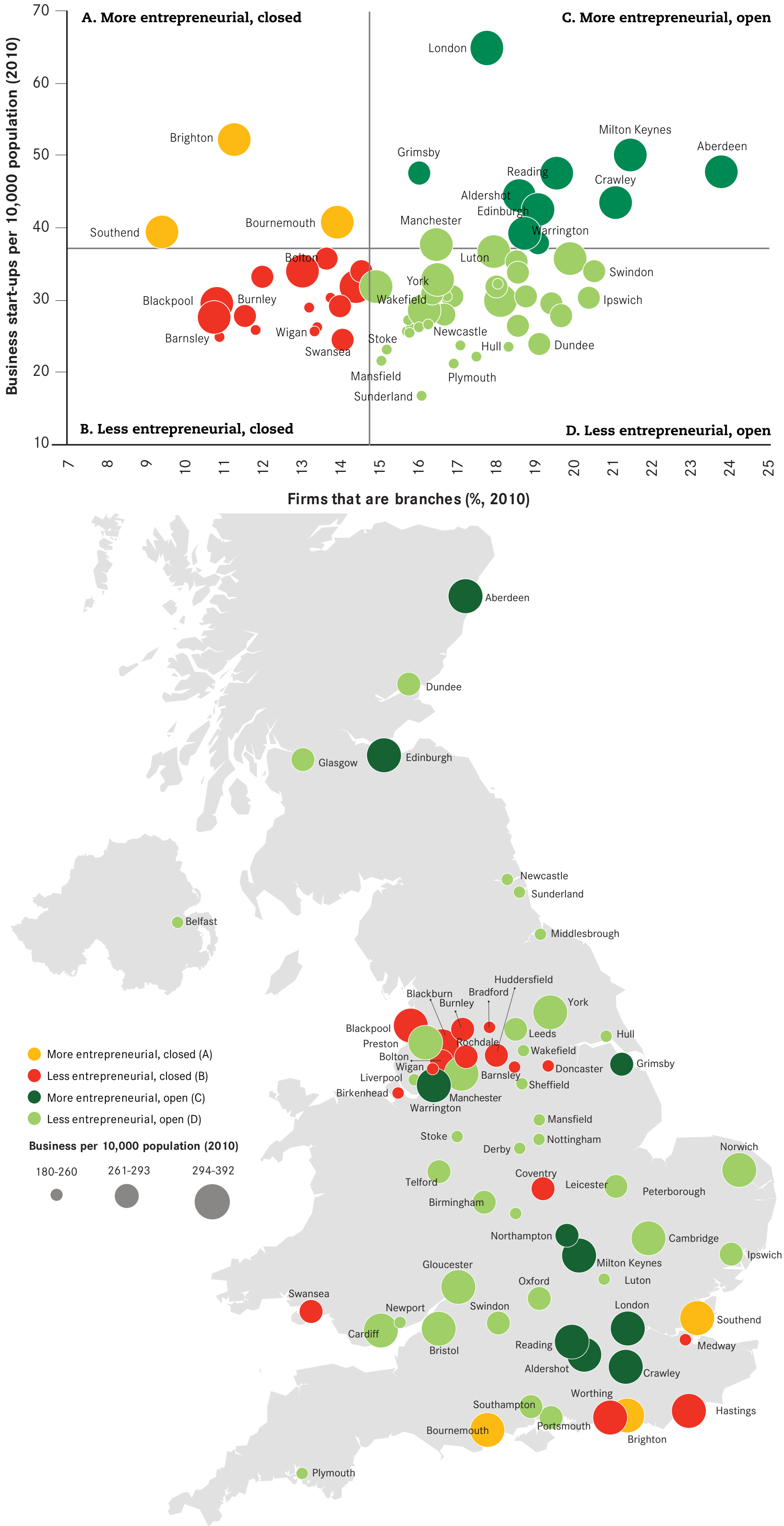
Figure 4 splits cities into these categories using the UK averages for business start-ups per 10,000 population and the percentage of all businesses that are branches. Those cities that had business start-up rates above the UK average in 2010 are classed as being more entrepreneurial, while those that had a share of branches above the UK average are described as being open economies. The size of each data point shows the total number of businesses in a city.

Figure 4a: Typology of the business base across cities



Source: ONS 2012, Business demography, 2010 data; TBR Observatory 2012, 2010 data

Figure 4b: Typology of the business base mapped



"The majority of the cities that have high levels of enterprise and are open are also some of the UK's strongest performing economies"

Source: Contains Ordnance Survey data © Crown copyright and database right 2012, TBR Observatory 2012, 2010 data

Six key findings emerge from allocating cities into these categories:

1. The majority of the cities that have high levels of enterprise and are open are also some of the UK's strongest performing economies (quandrant C).

Those cities with both high numbers of businesses and business start-ups and a larger share of branch businesses also tend to be those cities with the strongest economies, as measured by a range of indicators.[16] This further suggests that a high proportion of branches is a sign of strength – external businesses are attracted to strong city economies, most likely because of the strength of demand and access to skilled labour that they offer. In turn this complements the strong business base that these cities already have and creates opportunities for these businesses to feed into the supply chain of national or international businesses.

"Cities with smaller business bases, such as Wakefield and Plymouth, have tended to see more mixed economic performance"

2. Those cities with closed economies and lower levels of enterprise tend to be some of the UK's weaker economies (quadrant B).

The 16 cities that fall into this category tend to have smaller business bases coupled with fewer business start-ups, meaning that they are likely to have lower levels of competition within their economies.[17] And they are less likely to import innovation because of their low number of branches. So unlike more entrepreneurial closed economies, they are less likely to see growth from their independent businesses.[18] And unlike less entrepreneurial but more open economies, they are less likely to be able to import ideas from elsewhere and appear to be less attractive to external investment.

3. The majority of the UK's cities are open but have low levels of enterprise i.e. few businesses and few business starts (quadrant D).

While the majority of UK cities – 35 in total – appear to have been successful in attracting external investment, this is not reflected in the strength of their business base. This means that while these cities are in a good position to import growth into their economies through their branch businesses, they are less likely to generate growth organically.

A further distinction can be made within this category based on the size of the overall business base in these cities. Those cities that have larger business bases, such as Bristol, Cambridge and York, have tended to perform more strongly in recent years, and tend to be the more entrepreneurial of the cities within this category.[19] Cities with smaller business bases, such as Wakefield and Plymouth, have tended to see more mixed economic performance. While these cities experienced private sector jobs growth between 1998 and 2008, they have tended to perform less strongly than other cities across a range of indicators, and tend to be less entrepreneurial.[20]

16. For an assessment of city economic performance see Webber C & Swinney P (2010) *Private sector cities: A new geography of opportunity*, London: Centre for Cities. The methodology was extended to include Scottish and Welsh cities for the purposes of this research.
17. These cities also tend to have lower levels of GVA per capita, suggesting they are relatively less productive.
18. As discussed above, this is because there is likely to be smaller competitive pressures to grow.
19. These cities also have business start-up rates that are above the city average even though they are below the UK average.
20. Webber C & Swinney P (2010) *Private sector cities: A new geography of opportunity,* London: Centre for Cities

The openness of the city economies in this category to external investment is an asset. But their over-reliance on branch businesses and their dependence on external decision makers could hinder their long run economic growth prospects. Although they are in a relatively better position to import ideas from elsewhere, poor levels of enterprise undermine their ability to develop their own innovations and make the most of those innovations that are imported. This could have a negative impact on their longer term economic performance. Box 5 looks at the differing ways that Detroit and Boston have adapted to changing economic conditions in recent decades.

"Although Brighton, Southend & Bournemouth all have strong levels of competition, this does not seem to be reflected in the attractiveness of their city economies to external investment"

Box 5: The case for entrepreneurialism – Boston & Detroit[21]

Detroit and Boston provide a good contrast for the importance of enterprise for long run economic growth. Both cities declined between the 1950s and 1980s after a period of strong economic growth, but the trajectories of the two cities have diverged since. Whilst Boston has reinvented itself, Detroit has continued to struggle. The differing fortunes of these cities have been studied extensively by urban economist Ed Glaeser and his findings are summarised here:

Detroit was once renowned for its entrepreneurial nature and was home to many entrepreneurs – like Henry Ford and The Dodge Brothers – who competed and collaborated to develop the first mass produced car. But according to Glaeser, the invention of mass production turned Detroit from a city of entrepreneurship to one dominated by large vertically integrated firms with a requirement for low skilled labour. The dominance of a few large firms in a single industry made it difficult for Detroit to restructure when the car industry moved elsewhere – levels of entrepreneurship, innovation and competition had reduced and the city's labour force was mainly made up of low skilled factory workers. Today, the city continues to struggle with population losses of 25 percent between 2000 and 2010.

Boston on the other hand recovered from the decline in manufacturing by diversifying out into high technology, knowledge-intensive industries. And, as a result, the population in the metropolitan area has grown. Boston's more skilled population and more diversified business base were key factors in the city's successful response to deindustrialisation.

In the UK, London and Liverpool have undergone similar trajectories to Boston and Detroit respectively. Our forthcoming report *Cities Outlook 1901* will show that London and Liverpool were very similar in terms of their entrepreneurial activity at the turn of the 20th century, and were both some of the most enterprising cities in the UK.[22] But this no longer holds today. While London has the highest level of business start-ups and overall number of businesses out of all UK cities, Liverpool has among some of the lowest levels.[23] A similar story is seen in terms of skills – London has a very skilled population, while Liverpool has one of the highest proportions of people with no formal qualifications out of all UK cities.

21. Glaeser E (2005) 'Reinventing Boston: 1630-2003' *Journal of Economic Geography* 5: 119-153; Glaeser E & Ponzetto (2007/08) Did the death of distance hurt Detroit and help New York?; Glaeser E (25 March 2011) Detroit's decline and the folly of light rail; Glaeser E (2011) 'Unleash the entrepreneurs' *City Journal* 21 (4)
22. This is measured using the number of enterprises registering as joint-stock companies. Although this data will only capture a subsection of total starts, it should still act as a reasonable proxy for entrepreneurship.
23. Liverpool's industrial structure also became dominated by large firms. In the mid-1970s it was estimated that half of the workforce in Merseyside was employed in factories employing more than 1,000 people. See Wilks-Heeg S (2003) 'From World City to Pariah City? Liverpool and the Global Economy' Published in *Reinventing the City? Liverpool in Comparative Perspective*, Liverpool: Liverpool University Press

4. Very few cities have high levels of enterprise but a small number of branches (quadrant A).

Although Brighton, Southend and Bournemouth all have strong levels of competition within their economies, this does not seem to be reflected in the attractiveness of their city economies to external investment. Brighton in particular has surprisingly few branches, despite being one of the UK's strongest performing cities in recent years. Externally owned businesses make up just 11.3 percent of the overall business base. This suggests that while the strong local business base of these cities is likely to encourage growth driven by indigenous businesses, their lack of branch businesses is likely to hinder their ability to import ideas and growth from elsewhere.[24]

"More entrepreneurial and open economies also tend to have more foreign migrants"

5. More entrepreneurial and open economies also tend to have more foreign migrants.

As well as having more branch businesses, more entrepreneurial, branch economies also have a higher number of foreign born residents in their working age population (see Figure 5). This suggests that these cities are also relatively more attractive to migrants as well as businesses, and as such supports the finding that they are more open than other UK cities.

Figure 5: Migration and skills

Typology		Proportion of working age population non-UK born (2010)	Proportion of working age population with NVQ4+ (2010)	Proportion of working age population with NVQ1 or less (2010)
More entrepreneurial	Open economies	19%	34%	21%
	Closed economies	12%	31%	24%
Less entrepreneurial	Open economies	13%	28%	26%
	Closed economies	11%	25%	28%

Source: NOMIS 2012, Annual Population Survey, 2010 data
Note: This table presents the non-weighted averages for each city group. The presence of London in the more entrepreneurial, open economy group skews the data when weighting the averages by population, but the choice between methodology makes little difference for the other groups.

This could have important implications for long run economic growth. Recent research on businesses in London found that diverse management teams are particularly important for ideas generation.[25] Although any links between businesses

24. Fu X (2008) 'Foreign Direct Investment, Absorptive Capacity and Regional Innovation Capabilities: Evidence from China', *Oxford Development t Studies* 36 (1); BIS (2011) *International Trade and Investment - the Economic Rationale for Government Support*, London: The Stationery Office; MIER (2009) Growing inward and indigenous investment, Manchester: MIER.
Note the impact of productivity spillovers are found to be dependent on the ability of indigenous businesses to absorb new innovations from branch businesses. MIER also find that productivity spillovers are unlikely to occur when foreign firms are primarily export orientated and can steal the market from domestic firms.
25. Nathan M & Lee N (2011) *Does Cultural Diversity Help Innovation in Cities? Evidence from London Firms*, SERC discussion paper 69

in London and other UK cities should be made with caution, this suggests that the open nature of these cities is likely to further improve their ability to both absorb existing innovations and generate new ones.

The same cannot be said about the less entrepreneurial and closed economies. As well as having a low proportion of branch businesses, they also have a low percentage of foreign born migrants in their populations.[26] This further reinforces the finding that they have relatively closed economies.[27]

6. More entrepreneurial and open economies also tend to have stronger skills profiles

"More entrepreneurial and open economies also tend to have stronger skills profiles"

They have a higher number of graduates and a lower number of people with few or no formal qualifications. Figure 4 shows that the opposite is the case for less entrepreneurial and closed economies. They have the poorest skills profiles of the four categories. These differing skills profiles are likely to be able to provide some explanation of the difference in the percentage of branches in these to groups of cities.[28]

26. Although cities in this category tend to have smaller populations, there is no correlation between the number of non-UK born residents and city size, suggesting that this finding is not merely a function of their scale.
27. This analysis does not include the impact of universities on importing ideas from elsewhere. See Swinney P (2011) *Starter for ten: Five facts and five questions on the relationship between universities and city economies*, London: Centre for Cities, which questions the scale of the economic impact that universities have on the local business base.
28. Whyman P & Baimbridge M (2006) *Labour Market Flexibility and Foreign Direct Investment*, London: The Stationery Office

Policy implications for different city economies

Encouraging enterprise

The analysis above shows that the entrepreneur has a very important role to play in the success of city economies. The challenge however is identifying policies that are successful in encouraging enterprise at a city level. The problem however is that it is much less clear as to what policy should do to directly encourage enterprise at a city level. Successive Governments have tried to encourage business start-ups in particular, through schemes such as the Enterprise Allowance Scheme, which supported the unemployed to set up a business, and the Local Enterprise Growth Initiative (LEGI), which aimed to boost enterprise in deprived areas. But despite the stream of enterprise related initiatives business start-up rates have remained very stable across cities - suggesting that public policy in this area has had little impact.[29]

"There is little evidence either for or against the benefits of cities directly targeting and approaching businesses, states or countries to encourage external investment"

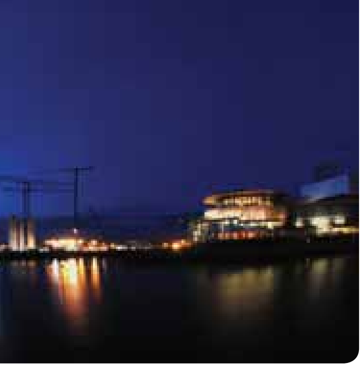
The current Government has also been busy creating specific policies to encourage enterprise. As well as setting up the New Enterprise Allowance, a reincarnation of the original scheme from the Thatcher and Major Governments, the Enterprise Finance Guarantee Scheme is guaranteeing 75 percent of loans to new businesses and a national insurance holiday is in place for all new businesses set up outside of the Greater South East. And the new StartUp Loans initiative aims to encourage young people to start a business. It is too early to tell whether these policies will have more of an impact than evaluations suggest that previous initiatives have had. But early indications show that there was a disappointing take-up of the national insurance holiday in its first four months – just 1,500 businesses applied to a scheme that hopes to attract 400,000 businesses over three years.[30]

Our research suggests there are two areas where public policy could play a role in supporting enterprise:

First, all cities should look to tailor support to the specific needs of their business base. Examples of this might include providing focused management advice for local independent businesses and supporting better linkages between local independent businesses and branch businesses to provide a market for local entrepreneurs. That said, more work is required to better understand how cities can encourage greater interaction between branch and local businesses.

A second way to potentially encourage enterprise is through Government procurement. There has been much focus in this area in recent years.[31] Some cities, such as Sunderland, have moved to improve the way they tender work for smaller local businesses to ensure that they have an equal opportunity to apply for public sector tenders.[32] This is a sensible approach – having a procurement process that tips the scales in favour of large firms limits the degree of competition for such contracts. But this needs to be balanced with the need for the public sector to get value for money for the tax payer – levelling the playing field is different to biasing the

29. Swinney P (2010) *UK cities: Do they mean business?* London: Centre for Cities
30. '*Osborne plan for regional jobs boost flops*', Financial Times, 6 February 2011
31. For example see *'Government procurement too complex for SMEs'* Guardian Professional, 5 March 2012
32. See www.buysunderlandfirst.co.uk. A similar approach has been used by CompeteFor to encourage smaller businesses to compete for contracts for the 2012 Olympic Games.



selection process towards local businesses. Limiting the degree of competition that a local firm faces would reduce the pressure to innovate.

That said, a key message from the analysis above is how an indirect approach to enterprise policy appears to have a big bearing on the levels of enterprise in a city - namely those to improve the business environment. Those cities that have more local-facing businesses also have more external-facing businesses and more business start-ups. This suggests that cities should look to improve the business environment that their businesses operate in. **This includes strengthening transport links, improving skills and making the planning process responsive to business needs.**[33]

"Currently very little is understood about the potential of public sector procurement to encourage entrepreneurship"

Skills in particular should be a key focus of less entrepreneurial and closed economies given their weak skills profiles. More specifically they should focus on improving Maths and English attainment of its residents that have few or no formal qualifications, regardless of whether they are in or out of employment. Focussing on these skills is likely to be the most beneficial for both individuals and business.[34]

Encouraging external investment

There are two main ways that cities can aim to attract external investment. Firstly they can externally market their cities. Secondly they can improve the fundamentals of their economies to make them more attractive to invest into.

Most cities appear to have channelled more of their efforts into the former while paying much less attention to the latter. Local Enterprise Partnership (LEP) submissions to the Government in 2010 underlined the attention that local government gives to having an inward investment function. Of the 50 submissions the Government received to set up a LEP, 41 identified inward investment as a key local priority. But tellingly only seven out of the 41 submissions set out a rationale for holding inward investment powers at a local level.[35]

If cities are campaigning to attract investment, it is important that the city itself is an attractive location for investment. There is little evidence either for or against the benefits of cities directly targeting and approaching businesses, states or countries to encourage external investment, and more work in this area would be welcomed. But such touting for investment is likely to be ineffective if a city suffers from some fundamental weaknesses. Surveys on the factors that drive business location decisions consistently cite the importance of qualified labour, good transport links, good telecommunications and the value for money of office space, rather than how well a city has marketed itself.[36]

To complement efforts to strengthen the fundamentals of their economies, cities should also focus on making it easier for businesses to locate in their city. This can

33. Work by the Manchester Independent Economic Review (MIER) showed that proximity to a large city, skills and transport explain much of the variation in the productivity performance of firms in the UK. See MIER (2009) The case for Agglomeration Economies, Manchester: AGMA
34. Swinney P & Clayton N (2011) *Learning Curve: Schooling & skills for future jobs*, London: Centre for Cities
35. SQW (2010) *Local Enterprise Partnerships. A new era begins?* Cambridge: SQW
36. Cushman & Wakefield (2011), *European Cities Monitor,* London: Cushman and Wakefield; DTI (2006) *Labour Market Flexibility and Foreign Direct Investment,* London: The Stationery Office

be done by focusing on three main areas. Firstly each city should submit a list of the key assets that it has that can be used by UKTI to better inform the location decisions of potential investment from abroad. Secondly cities should create a visible single point of contact for potential investors to communicate with and an online presence to give businesses key information that they would require.[37] And finally they should look to make the planning system as flexible and expedient as possible to lower the costs of investing within the city.

"There are lessons to be learnt from London's approach to attracting external investment"

There are lessons to be learnt from London's approach to attracting external investment. The city does undertake direct marketing through organisations such as London and Partners. But this is not the central focus of its activities. The language of the Mayor and the Greater London Authority is built around making London the "most competitive business environment in the world". And much of this focuses on attempts to support innovation, skills and transport infrastructure to foster "an open and competitive business-friendly environment".[38] In other words, London's success in attracting external investment is based on a two-pronged approach; both ensuring the world knows about how business-friendly and enterprise-ready the city is, and ensuring that the city is as supportive an environment as possible in which to do business.

37. A good example of this is the Manchester Investment Development Service (MIDAS), which last year reached an agreement with UK Trade and Investment (UKTI) to act as the sole point of contact for Foreign Direct Investment in Manchester. The aim of this agreement is to co-ordinate its efforts with those of UKTI.
38. LDA (2010) *The Mayor's Economic Development Strategy for London,* London: LDA

Conclusion

This report has shown that there is large variation in the strength of the business base and the size of the branch economy across UK cities. It highlights two important areas of focus for policy as it attempts to support future economic growth, and emphasises how it should vary according to the nature of the private sector in each city.

Firstly it has shown the importance of the entrepreneur to a city economy. Cities that have higher levels of competition because they have more businesses and more business start-ups are more likely to see growth because of the innovation that competition necessitates. Specific policies to encourage enterprise, such as making it easier for smaller businesses to compete for government contracts, are to be encouraged. But cities should not lose sight of the importance of having a conducive business environment. They should view improvements to planning, transport and skills as key tools for supporting enterprise.

"Cities should not lose sight of the importance of having a conducive business environment. They should view improvements to planning, transport and skills as key tools for supporting enterprise"

Secondly the paper has shown the important role that external investment has to play in a city economy. Those cities that have a larger number of branch businesses are better placed to import innovations from elsewhere. So cities should aim to encourage external investment into their economies through better communication with UK Trade and Investment, creating a single point of contact for investors to communicate with and through making the planning system as flexible and expedient as possible.

There is still much work to do to understand the relationship between levels of enterprise in a city and that city's ability to attract external investment. But in splitting cities into four categories using data on these variables this paper hopes to further the understanding that cities have about the make-up of their business bases in the hope that it can better inform policy designed to support future economic growth in their cities.

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