

# TOP FLOOR

News from the Centre for Business Research, University of Cambridge

Issue 4: Winter 2002

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## CBR News

### From X-Rays to Brain Waves

There were celebrations at the end of January as the Centre for Business Research officially opened its offices on the top floor of the Judge Institute of Management building - Cambridge's business school. Joining CBR director Prof Alan Hughes at the party to celebrate the transformation from an old hospital ward to a new office suite were Sir Alec Broers, Vice-Chancellor of the University of Cambridge, and Sir Paul Judge, whose generous benefaction helped the creation of the magnificent Judge Institute building on the site of the old Addenbrookes Hospital.

The CBR's move into the building brings under one roof one of the largest concentrations of interdisciplinary business and management research activity in Europe. Indeed another research institution has recently arrived in the building - the new Cambridge Endowment for Research in Finance. CERF was launched by Lord Eatwell - President of Queens' College, Cambridge and leader of the CBR project on the World Financial Authority.

Prof Hughes says: "We are delighted at the exciting opportunities which the creation of specialist research laboratory space in the Judge Institute building provides for all of my colleagues in the CBR and the Judge Institute. It greatly strengthens our ability further to develop the fruitful research interactions which the CBR has generated between the many University faculties and departments which collaborate in our research programme."

*The picture shows, from left to right, Sir Alec Broers; Prof Alan Hughes; David Clarke from HEFCE (the Higher Education Funding Council for England); Lord Eatwell; Sir Paul Judge; and Prof Sandra Dawson, Director of the Judge Institute.*



### Editor's note

The new CBR research project featured on page three - which studies how businesses respond to economic shocks to the system - happens to be focusing on Britain's civil aerospace firms at a turbulent time for them. Like their counterparts elsewhere in the world, UK aerospace manufacturers were hit hard by the terrible events of September 11th last year. When passenger numbers suddenly tumbled in the wake of the terrorist attacks, orders for new planes were cancelled, resulting in job losses.

What the new research will reveal is a picture of how these firms are really faring in the wake of these events - and how what happens to them impacts on the wider economy. For in a novel 'real-time' study, researchers will follow aerospace (and also biotechnology) firms for the next two years, interviewing them every two months, and tracking the effect of economic changes on their businesses as and when they happen. This is an intriguing project, and TOP FLOOR will carry updates on its findings in future issues.

Elsewhere in this issue, there are reports on the product development performance of UK and Japanese car makers; and Stephen Rubin, chairman of sports goods company Pentland Group, discusses how his firm is responding to the challenge of tackling child labour in the Third World. Mr Rubin was a speaker at the CBR's Business Ethics Conference in December, and here airs his views on how companies can and should exercise social responsibility when operating, for example, in Third World countries. This is a theme that will be developed further at the

next Business Ethics conference, which takes place in September. Meanwhile the centre pages of this issue are devoted to a round-table event held in March. This seminar put venture capital funding for small businesses under the microscope, comparing US and UK practice, and asking whether current company laws are helping or hindering its supply. The day gave academic researchers, practitioners and policy-makers a chance to engage in high-level debate about the problems and challenges of ensuring a healthy venture capital supply to the UK's innovative small firms.

We always welcome feedback, so if you have comments or queries about any of the articles in this issue, please contact us.

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# Shocks to the System

CLOSE UP

By David Primost and Michael Kitson

Firms from the aerospace and biotechnology industries are being used in a highly novel study of the ways companies react to changes in the UK economy.

In a project just beginning at the Centre for Business Research, David Primost and Michael Kitson are conducting a "real time" survey of the way businesses respond to macroeconomic changes and shocks. The researchers will interview a cross-section of firms from both industries every two months over the next two years. These interviews will show how the firms are weathering changes in the economy, and in interest rates, exchange rates and tax policy.

The aim is to build up a picture as events unfold of how short-run changes and developments in the macroeconomy affect individual firms. David Primost, CBR Junior Research Fellow, says, "The key aspect of this research is the micro/macro linkages. It gives us an opportunity to see how changes in the wider economy affect firms - and their ability, for example, to generate jobs - and how the actions of those firms in turn affect competitiveness and the long-term growth of the UK economy."

The research will focus on how changes in the wider economy affect employment, and firms' decisions to invest; how companies respond to the ups and downs of exchange rates, and whether these affect their market share and/or profit margins; and how managers deal with macroeconomic variability, and the way it affects their corporate strategy. (Historically, the UK has had one of the most volatile growth rates of the major industrialised countries.)

Project leader Michael Kitson says: "The most common approach to studying the macroeconomy is through analysing aggregated data about firms' behaviour. But macroeconomic variables reflect the outcomes of the



decisions and actions of *individual* agents in the economy. So far, however, there is little detailed analysis of how individual agents perceive changes in macroeconomic conditions and how they respond."

The project, funded by the Economic and Social Research Council (ESRC) as part of its programme on 'Understanding the Evolving Macroeconomy', focuses on two very important industries. The UK leads Europe in the area of biotechnology, although our industry still lags behind that of the US. And the UK's aerospace industry is the largest in Europe: it employs over 150,000 employees and has a turnover of £18 billion, two thirds of which comes from exports.

Both industries have a high degree of innovation, and research and development (R&D) activity, and are therefore key players in the 'knowledge-based' economy, which is considered important for the UK's competitiveness and long-term growth.

The research will help inform upon the linkages between macro-economics, industrial organisation and strategic management. It aims to fill an important gap in the knowledge necessary to design appropriate tools for managers and policy makers. Research findings will be reported in future issues of TOP FLOOR.

► **For more information about the research, please contact David Primost on Tel: +44 (0)1223 765329, or e-mail: [d.primost@cbr.cam.ac.uk](mailto:d.primost@cbr.cam.ac.uk)**

## Macroeconomic instability kills!

A new study concludes that macroeconomic instability, such as exchange rate volatility and surges in inflation, has a significant detrimental impact on quoted firms in the UK, leading in many cases to bankruptcy or acquisition, particularly for newly listed firms.

The study found evidence that newly listed companies are more likely to go bankrupt during years when the value of the pound depreciates sharply. Meanwhile uncertainty – in the form of sharp increases in inflation – also makes newly listed firms more prone to go bankrupt. Acquisition activity is subdued in such years and offers little 'competition' to bankruptcy.

The research was undertaken by Arnab Bhattacharjee, Chris Higson, Sean Holly and Paul Kattuman of the Department of Applied Economics (DAE) at Cambridge. It is part of a wider study programme on "Business Failure, Business Organisation and Macroeconomic Instability" conducted jointly by the DAE and the CBR, and sponsored by the Leverhulme Trust. The research was presented at the Royal Economic Society's Annual Conference in late March.

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# Funding small firms: does the law help or hinder?

**The UK's strict personal insolvency laws may be affecting innovation, because they deter entrepreneurs from setting up high-risk businesses. Is this reducing demand for venture capital finance, particularly among start-up firms?**

**This was a question posed by John Armour, CBR Senior Research Fellow, at a round-table seminar in Cambridge in March. Discussing the issue were policy makers and practitioners involved in the financing of entrepreneurial firms in the UK.**

## Law matters

The event was organised jointly by three University organisations: the Centre for Business Research, the Cambridge Entrepreneurship Centre, and the Centre for Corporate and Commercial Law. "As researchers, we want to identify ways in which the legal regime makes a difference to the supply of, and demand for, venture capital finance," John Armour said. "But as academics, we operate at one stage removed from the practice. Hence this event, at which we hope to learn from key players in the market, and they can have an influence on our research." "Entitled, "How does Law Matter for Venture Capital Finance?", it was sponsored by law firm SJ Berwin, whose Head of Knowledge Management, Simon Witney, described it as "a very worthwhile contribution to the debate about the impact of law on venture capital."

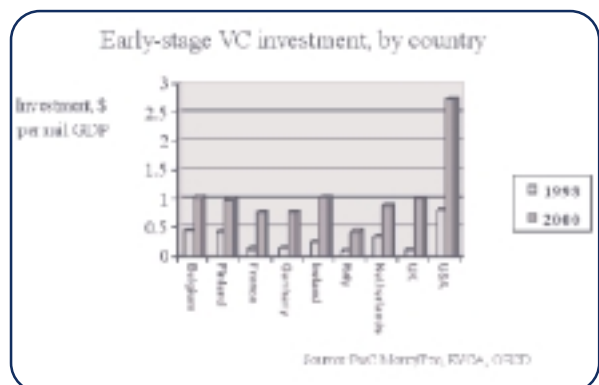
Insolvency law was a frequent theme. Dr Hermann Hauser - who founded Acorn Computers, has been involved with 25 other start-up firms, and now runs the Cambridge venture capital firm Amadeus Capital Partners - argued that the UK should adopt insolvency laws like the US Chapter 11 bankruptcy process. (This allows insolvent firms a period of protection from their creditors while they try to rescue the firm.) This, he said, would save some innovative small UK firms from collapse.

"The people with the most vested interest in rescuing the firm are the management," Dr Hauser argued, "but the UK process of administration is very rigid, and takes the rescue process out of their

hands. I don't think this benefits the company or the shareholders or, ultimately, the economy."

And John Armour also covered insolvency laws in his review of research on "Law, Innovation and Finance", a study of issues like changes in capital gains tax, and the provision of government subsidies, and how they impact on the supply of venture capital.

He explained that personal insolvency laws are more liberal in the US than in the UK. A US bankrupt is immediately discharged from most of his debts, in return for handing over all his non-exempt assets to his creditors; the legal proceedings are quick (they can take just three to four months); and in some states, there is no limit on the value of property a bankrupt can retain. But in the UK, a bankrupt's estate is taken over by a trustee and sold for the benefit of his creditors.





Does the law help or hinder?  
Conference speakers (left)  
Professor Edward B Rock  
and John Armour (right).

And the bankrupt himself is subject to several legal disabilities for the next three years, including being barred from running a limited liability company.

### Bankruptcy

John Armour said: "Given the UK's stricter personal insolvency law we might expect this would lead to a reduced demand for venture capital finance, particularly amongst start-up firms. And there is support from a recent US study which showed a significant correlation between the number of owner-managed businesses in a state, and the total

value of property which could be exempted from bankruptcy under that state's law."

After receiving feedback from the professional community as to the importance of these factors in practice, he is now planning to conduct a detailed study of insolvency laws and the demand for venture capital across Europe.

**For more information, please contact John Armour at the CBR. Tel: +44 (0)1223 765320. Or e-mail: [j.armour@cbr.cam.ac.uk](mailto:j.armour@cbr.cam.ac.uk)**

At the seminar Professor Edward B Rock, from the University of Pennsylvania Law School, gave a presentation about US laws on "corporate immigration policy". Changes to these laws over the last 20 years have made it easier for foreign firms to list on US exchanges, and this has had the unforeseen effect of luring many companies from the venture capital and high-technology hot-spot of Israel to the US's high-technology market, the NASDAQ. This worries Israeli commentators, who see a resulting drain of entrepreneurs, jobs and tax revenues from Israel to the US.

Professor Rock explained that the US Securities and Exchange Commission, aware of the increasing globalisation of stock markets, relaxed the rules about the way and the amount of information foreign companies have to disclose. "The goal of the new regulations was to allow US investors access to the Daimlers of the world who, without some regulatory relief, would simply not enter the US market, while protecting US investors from unscrupulous foreign firms," he said.

"But an interesting and largely ignored result of this," he added, "is that it provides an extremely

easy way for a firm to self identify as a 'regular' US firm, so long as it is willing to assume the burdens that come with that choice. If a company chooses early enough, it is quite easy to do by incorporating in Delaware (which actively encourages foreign firms to do so); identifying the US office as the headquarters; keeping the accounts in accordance with US accounting standards from day one; drafting major documents in English; going public on NASDAQ as a regular (i.e. US) company; and de-emphasising foreign connections in the investor relations effort. The regulatory structure not only permits, but rather encourages this."

# Tackling Child Labour

Stephen Rubin takes the floor.

Any notion that using child labour is in the business interests of a company has to be ridiculous. We require a quality product and, if our business is going to exist in twenty years' time, our customers will be in India and China. It is therefore in our interests that these countries develop, which they cannot do on the back of child labour.

The question arises, what can companies reasonably do to tackle child labour in their supply chains? Where large companies are involved – which in the sporting goods industry includes Nike, Adidas, Reebok and ourselves – there is a capacity (developed over the last few years) to analyse and deal with the issue. (Though even we can get it wrong.) However, most companies in the apparel or sporting goods industry are much smaller and do not have the personnel or the resources to act.

That is why Pentland has invested an incredible amount of time and effort to mount collective action in programmes in Pakistan and India on child labour. These partnerships (which include both small companies supplying and small companies buying and NGOs and INGOs such as UNICEF) take time to set up, and inevitably come up with long term and complex programmes to address the issues. Our role therefore becomes one of facilitating the local institutions and the wider civil society to take on the problem and, with our help, improve the situation.

We cannot do it on our own; we cannot do it quickly. We have to take account of a wide range of views. We must also be careful about interfering in the customs of others. In Pakistan, the focus on eliminating child labour

from football stitching work blinded us to the fact that more than half the workforce were females - who would not be allowed to work outside their homes, in the large stitching centres that were set up. An entirely laudable desire to create a more formal work relationship without child labour inadvertently marginalized female workers. The result was a severe decrease in the available labour force, and the loss of income for many families. Subsequently, the programme was changed to take account of that, but the deed had been done. The problem here was the lack of good research and the weakness of local institutions.

However, there has been a great result in India. There, the Government decided that of all the priorities in child labour, including tackling child prostitution and the number of child labourers rolling *bidis* (cigarettes) and producing fireworks etc, devoting resources to a small number of children performing relatively non-hazardous work in one of the richest regions of the country was just not on.

The answer was to mobilise the local civil society to garner the resources needed to raise awareness for children to be educated, to train teachers and to improve resources in schools. This takes a long time. However, in Jalandhar, this *has* happened and a wide number of organisations have collectively decided on goals to achieve 100 per cent primary school education within the next few years. And the added benefit is that this applies to all sectors in Jalandhar; both to those factories supplying the domestic market (where much of the problem was, and remains) and to those supplying the export market."

## GUEST VIEW



Stephen Rubin is chairman of the sporting goods company Pentland Group, and a member of the International Business Leaders Forum, and works with a number of organisations in the area of good corporate citizenship.

### Ethics conference

Stephen Rubin was a speaker at the CBR's Business Ethics conference in December. Under the theme "Understanding how issues in business ethics develop", delegates discussed issues ranging from child labour, and bribery in business, to the controversy over genetically modified foods.

The CBR's next Business Ethics Conference in September will take the debate on by asking how big companies should respond to ethical challenges when operating in countries abroad. The conference – on How Multinationals Build Social Capital - will debate how firms can and should co-operate with international development agencies and the national governments of the host countries they are working in, and how they can run projects to engage with local communities when working in countries with high levels of illiteracy, crime or AIDS. For further details, turn to the back page.

**A space will be open in every issue for a guest contributor to air their views. The editor welcomes submissions.**



## Speeding up the production line

It's a decade since the landmark study by Clark and Fujimoto of the Harvard Business School into the efficiency with which car makers around the world develop new vehicles. Their research showed that Japanese car makers were bringing new vehicles to market much more quickly, and with half the engineering hours, of their North American and European counterparts. This was allowing the Japanese to pursue a strategy of product proliferation and also to reduce product lifecycles, thereby delivering more frequent model changes.

But that was 1991, and since then a great deal has happened. Western car makers have been making strenuous efforts to catch up, while at the same time, the Japanese car industry has been suffering under the country's prolonged recession. Last year, two members of the

CBR undertook a study to see what the net effects have been.

Nick Oliver and David Primost conducted research into the product development performance of UK-based automotive manufacturers and that of their counterparts in Japan. Approximately 20 UK and 10 Japanese car and component makers took part in the research, which was commissioned by the DTI/SMMT (Society of Motor Manufacturers and Traders) Industry Forum. The mission of the Industry Forum is to improve the competitiveness of the UK's automotive industry.

The results revealed that there are still substantial differences between Japan and the UK (generally in favour of Japan), based on key measures such as development lead times, and the time taken for manufacturing performance to settle to normal levels following new product launch. However, there are also changes in UK car-makers' practice – particularly, for example, the fact that car makers are now asking suppliers to undertake

more of the development work on new models. Car makers' share of development effort has been reduced, while suppliers – who have long maintained that they can help make cars better and cheaper – are getting an increased share of the development work. This is particularly true of the major, or 'first tier', suppliers like Bosch, though there is also a slight increase in input from the second tier suppliers, who produce components such as pressings, plastic mouldings and the like.

The survey also shows that product development lead times – i.e. the length of time it takes to get a new car model from the drawing board onto the forecourt – have fallen significantly in the last few years in both the UK and Japan, suggesting that the number of manufacturing faults involved is also being reduced. First tier suppliers in the UK have reduced lead times since 1996 from 70.5 months to 40 months. Their counterparts in Japan have reduced lead times from 46 months to 26 months.

The survey also finds that:

- In the UK, the overwhelming majority of vehicle manufacturers and first tier suppliers are non-UK owned. Many engineering centres – especially for the major components suppliers – are therefore located outside the UK.
- Although there is a general trend of declining employment among component makers in both Japan and the UK, the number of people employed in research and development (R&D) is actually rising. This indicates the increasing importance of development activities as cars are

redesigned to make them cheaper to produce: cost reductions of 15-20 per cent are expected on new products.

- Relatively little basic R&D is occurring among the first and second tier suppliers in the UK. In Japan, this figure is also low in absolute terms, though double the level in the UK.
- It takes several weeks for production to settle to normal levels of volume and quality after a new product launch in UK first and second tier suppliers. This is very much longer than in Japan.
- The order-winning process in the UK is dominated by the

Request For Quotation (RFQ) system where car makers invite competitive bids from suppliers, and suppliers typically only have two to three weeks to respond. A considerable amount of effort goes into responding, particularly among second tier suppliers, and success rates are low at this level – less than 10 per cent of quotations result in an order.

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### London's Future



Senior Research Fellow Lilach Nachum's study of London's future as a global financial centre and the increasing foreign ownership of the City - featured in the last issue of TOP FLOOR - has received widespread coverage in the insurance press. (This research is part of a wider project on the competitiveness of the UK and its multinational companies, funded by the Economic and Social Research Council.) Both the London Market Newsletter and Insurance Day featured Dr Nachum's findings that London's position as one of the premier centres for financial services could not be taken for granted. The February issue of Reinsurance magazine used the research to lead off its own debate about the efficiency of, and the future for, the London insurance market.

### Demutualisation



CBR project researcher Dr Simon Learmount was the keynote speaker, alongside Sir Ronald Hampel, at the opening conference of the newly demutualised Tokyo Stock Exchange (TSE) last November. Its demutualisation has changed the TSE into a for-profits company with shareholders rather than a member-based society. The theme of the conference was UK Corporate Governance: the TSE has identified corporate governance as one of the most pressing issues it will have to address as a demutualised exchange, and the UK is widely acknowledged to have one of the best developed systems in the world. Dr Learmount, who is working on a CBR project on the evolution of corporate governance arrangements, and has published extensively in Japan on this subject, argued that the way in which the UK had managed corporate governance reform might be highly instructive for Japan.

### International Labour



Professor Simon Deakin delivered the International Labour Organisation's Social Policy Lectures at the Central European University in Budapest at the end of November. These lectures are an occasional series held to commemorate the award to the ILO of the Nobel Peace Prize in 1969. Professor Deakin runs the CBR's programme of research on corporate governance, contracts and incentives, and is also the Robert Monks Professor of Corporate Governance at the Judge Institute of Management. He lectured on the way in which long established institutional forms - like the employment relationship, the male breadwinner family and the industrial labour union - are now being challenged by the combined forces of globalisation, changes in family structures and different attitudes to the way we work. His lectures will be published shortly by the ILO.

## HOW DO MULTINATIONALS BUILD SOCIAL CAPITAL?

This is the title both of a new CBR Working Paper (WP220) and of the CBR's next Business Ethics Conference, which takes place at New Hall College, Cambridge, on September 26th 2002. The working paper, by Ian Jones, Chris Nyland and Michael Pollitt, tracks the activities of some of the multinationals working in South Africa (including Diageo, BOC and GlaxoSmithKline) and their engagement in projects to tackle crime, illiteracy and the problem of AIDS. It finds, among other things, that 'extractive' (i.e. mining and oil) and industrial firms - which have traditionally been criticised for their impact on communities - are engaged in practices conducive to the generation of social capital, along with medical sector firms.

For more information, or to book tickets, contact Mrs Sue Moore,  
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