



## Chapter 1



# INTRODUCTION

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Since the publication of the Bolton Report in 1971 the contribution of small and medium-sized enterprises (SMEs) to economic growth, job creation, innovation and promotion of enterprise has been widely recognised. While SMEs are important in terms of their overall share of GDP, it is also believed that many smaller firms lack both managerial and technical skills, which inhibits their effectiveness. Therefore, improving the competitive advantage of SMEs is important to individual firms and to the UK economy as a whole. In this chapter we present an overview of research on the growth of small firms, with a view to identifying factors which encourage success and act as barriers to growth. There is also an assessment of strengths and weaknesses related to government policy-making in this area. As discussed below, there has been a plethora of policies aimed at the small firm sector over the last thirty years. It is important to reflect on the extent to which policy initiatives have had a positive impact on the competitiveness of smaller firms.

Over the last thirty years there has been considerable discussion related to the appropriateness of categorising SMEs based on the number of employees (see Curran *et al.*, 1991). In 1996, the European Commission (EC) set out a definition of SMEs which was intended to be appropriate in all member countries (see Table 1.1). UK government agencies have since attempted to harmonise their approach to SMEs by adopting the European Commission's definition. While we acknowledge that using the number of employees as a measure of firm size may create a number of anomalies, we believe it is the most convenient and widely understood categorisation. Therefore, this is the approach which has been adopted throughout this book. This chapter begins with a discussion of those factors which encourage or discourage the growth of SMEs. We then briefly review the main policy initiatives in this area and end with a brief evaluation of SME-related policy-making.

TABLE 1.1 EC definition of SMEs (Source: DTI, 2001)

<i>Criterion</i>	<i>Micro firm</i>	<i>Small firm</i>	<i>Medium firm</i>
Maximum number of employees	9	49	249
Maximum annual turnover	–	7m euros	40m euros
Maximum annual balance sheet total	–	5m euros	27m euros
Maximum percentage owned by one, or jointly by several enterprise(s) not satisfying the same criteria	–	25%	25%

Note: To qualify as an SME, both the employee and the independence criteria must be satisfied, plus either the turnover or the balance sheet criteria.

## Understanding SME Growth

According to some experts, there is little justification for many of the government policy measures introduced to improve the competitiveness of SMEs. As Curran (1999, p. 42) points out, 'the alleged existence of shortages of start-up finance or the negative impact of employment legislation on small business expansion and job creation, have been overwhelmingly rejected by research'. Seeking to improve the competitiveness of SMEs is not only about understanding problems confronting businesses in this sector; it is also about a better understanding of how to overcome these barriers. Much research has focused on SME competitiveness and has sought to identify factors which make some SMEs successful, while others fail to grow or go out of business. While this research may contribute to our understanding of SME competitiveness, it also serves to demonstrate the complexity of this task (Storey, 1994; Watson *et al.*, 1998; Perren, 1999; Thompson and Gray, 1999). Although a multitude of factors are hypothesised to impact on business outcomes, there is no consistent pattern to the characteristics which contribute to business competitiveness, success and growth (Ray, 1993; Gibb, 1996). Fascination in the growth of small firms is based on the government's desire to promote opportunities for employment. From a public policy perspective, employment generation may be an appropriate growth criterion (Smallbone and Wyer, 2000). However, not all small firms are growth-oriented, and only a small proportion achieve significant levels of growth in employment. For the majority of owner-managers, day-to-day survival is more important than growth. As pointed out by David Storey (1994, p. 112) 'the numerically dominant group of small businesses are those which are small today and, even if they survive, are always likely to remain small-scale operations.'

Publication of the Bolton Report (1971) stimulated research into characteristics that distinguish owner-managers from other members of the economically active population (Watson *et al.*, 1998). One of the more significant contributions identified sixteen growth factors and four growth drivers including owner's motivation, expertise in growth management, resource access and demand (Perren, 1999). Attempts have also been made to identify the behaviours, skills and attributes normally associated with enterprising people (Storey, 1994). These include opportunity-seeking and persuasion (Gibb, 1996) and commitment of leaders to achieving growth (Smallbone *et al.*, 1995). There is evidence that rapidly growing firms are more likely to be founded by groups than individuals, and team

members will have higher levels of education and prior managerial experience (Storey, 1994). However, such findings have been contested by those who argue that there is no ideal type of personality nor set of entrepreneurial attributes that guarantee success for new ventures (Ray, 1993). As Ray goes on to argue, the probability of launching a successful business is not based on a fixed set of factors but on an infinite variety of combinations in which an individual's positive attributes might outweigh her negative attitudes. On the other hand, it is possible to reject the idea that success is equated with entrepreneurial competence and view businesses from an entirely different perspective. This involves a shift from a focus on the personality or characteristics of the business founder to the firm's underlying business concept and capacity to accumulate capital (Osborne, 1993).

In attempting to understand SME success, the characteristics of individual entrepreneurs, such as age, gender, work experience, educational qualifications and family background are frequently hypothesised to influence business performance. Yet, other than education, none of these factors appears to be consistently verified in major empirical studies (Storey, 1994). This suggests support for the Jovanovic (1982) notion that neither the individuals themselves nor other bodies have a clear understanding of whether particular individuals will succeed in business. In trying to identify the factors that help small business, it appears there is no simple pattern which maps growth or potential growth. Rather, the evidence points towards a complex set of interrelated factors that increase or decrease the probability that an individual will establish a successful and growing small business (Stanworth and Gray, 1991). Such complexity serves to illustrate the value of this book in contributing to a broader understanding of competitiveness in SMEs.

## Overcoming Barriers to SME Growth

A host of explanatory factors for the growth of SMEs has been advanced, and a number of authors have developed integrated models of the process. Seven sets of authors have made real attempts to conceptualise integrative models of firm growth rather than simply itemising factors or concentrating on one specific aspect of growth. These are:

- Durham University Business School's (DUBS) (Gibb and Scott, 1985)
- Keats and Bracker's (1988) theory of small firm performance
- Bygrave's (1989) entrepreneurial process model adapted from Moore (1986)
- Covin and Slevin's (1991) entrepreneurship model
- Davidsson's (1991) entrepreneurial growth model
- Naffziger *et al.*'s (1994) model of entrepreneurial motivation
- Jennings and Beaver's (1997) management perspective of performance

However, with the exception of Davidsson (1991), these authors do not conceptualise development of micro-businesses which are the typical 'entrepreneurial start-ups'. There is also a lack of empirical evidence and only Gibb and Scott (1985), Bygrave (1989) and Jennings and Beaver (1997) attempt to address the full range of factors influencing a firm's development. The remaining models, as pointed out by Perren (1999), concentrate on factors which influence the entrepreneurial process and behaviours. Authors also refrain from commenting on how the various

factors actually interact to influence development of the firm. Some element of causality is suggested but there is no real consideration of interactions between the various factors (Perren, 1999). These integrative models also tend to impose rather simplistic stages on the process of development. Kimberley and Miles Associates (1980) argue that there is no inevitable sequence of stages in organisational life. This point is also made by Perren (1999, p. 381), who suggests: 'Development is often much more a process of slow incremental iterative adaptation to emerging situations, than it is a sequence of radical clear steps or decision points.' Firms do not move through a series of stages in incremental fashion (Smallbone *et al.*, 1995); rather, as highlighted above, growth occurs as a result of a number of linked factors (Perren, 1999).

The success, and therefore competitiveness, of any business is dependent on a range of situational and contextual factors (Fielden *et al.*, 2000). Improving the competitiveness of SMEs also involves understanding the problems of such businesses and identifying potential solutions. New businesses encounter a number of barriers to success throughout the start-up period and during their first year of operation. These barriers can be both 'internal' to the firm such as lack of motivation and also 'external' including government controls and lack of skilled labour (Storey, 1994). Owner-managers often perceive barriers to growth as being external in origin. Issues related to 'money management' are regularly cited as the main difficulty for business start-ups (Bevan *et al.*, 1987; Fielden *et al.*, 2000). Problems include a poor understanding of tax, VAT, national insurance and book-keeping, as well as difficulties in obtaining capital and the absence of a guaranteed income. Owners of failed businesses often point to the shortage of working capital as the prime cause of business failure (Hall and Young, 1991; Hall, 1992). Lack of adequate start-up funds has a 'knock-on' effect restricting development and growth by reducing funds available for activities such as advertising, publicity and acquiring suitable premises (Fielden *et al.*, 2000).

Issues of finance are followed by concerns related to the level of demand for products and services as well as the nature of marketplace competition (CSBRC, 1992). Nascent entrepreneurs also express concern about difficulties in identifying and contacting potential customers (Fielden *et al.*, 2000). The strong desire of many small business owners to retain personal control and business independence has long been recognised as a key factor limiting the growth of many small enterprises (Gray, 1990). Hence, key constraints on growth are related to a combination of internal factors, an unwillingness to delegate or bring in external skills, and external factors including finance, employment and competition (Storey, 1994), poor products and inefficient marketing (Cromie, 1991; Smallbone, 1991; Hall, 1992; Watson *et al.*, 1998).

## **SMEs and Government Intervention**

SMEs, however defined, constitute the majority of all enterprises in most of the economies in the world (OECD, 1998). Such firms make significant contributions to private sector employment and output, which appears to be increasing over time (Storey, 1994). From 1980 to 2000, the number of businesses operating in the UK rose by 1.3 million to an estimated 3.7 million (DTI, 2001). SMEs, including sole traders, account for 99 per cent of all businesses, 55 per cent of non-governmental

employment and 51 per cent of turnover (SBS, 2001). In the UK, SMEs are now more important than larger companies in their contributions to business turnover and jobs (Curran, 1999). Statistical trends go some way to explaining why SMEs have gained attention from politicians, policy-makers and academics. However, between 1945 and the late 1960s there was little interest in small firms from either the government or academics. SMEs were regarded as being poorly managed, badly organised and reliant on outmoded technologies to produce inferior products and services (Mason and Harrison, 1990). During the corporatist era of the 1950s and 1960s, the state took a direct and active involvement in managing the economy. Cooperation between government, trade unions and employers' representatives (such as the Confederation of British Industry) was almost entirely concerned with large organisations (Crouch and Streeck, 1997) and there was no 'voice' for the small firm community. The common perception was that in industrialised nations SMEs were of little relevance to economic progress or competitiveness (Stanworth and Gray, 1991). Economic planning was based on the premise that 'big is beautiful'. Consequently, SMEs did not figure highly in government economic or industrial policies during this period.

In 1969, Labour Prime Minister Harold Wilson commissioned an inquiry into the state of the UK's small firms sector. The Bolton Report, published two years later, revealed that numbers of small firms were declining in the UK at a much faster rate than in other Western countries. The Commission also reported that small firms were constantly battling against unfair bureaucratic, financial and administrative burdens. With hindsight, the findings from the Bolton Report marked the beginnings of a resurgent interest in SMEs which eventually led to a 'sea change' in attitudes within society and particularly government circles. The 1970s were also notable for wider problems in the UK economy with the emergence of 'stagflation' (high inflation and high levels of unemployment) and trade union militancy, culminating in the 1979 'Winter of Discontent'. As a result of these difficulties, faith in the corporatist ideal began to recede and politicians associated with the New Right began to stress the importance of enterprise and entrepreneurship in stimulating economic growth (Hutton, 1995). At the same time, it was recognised that the economic success of Japan and West Germany was partly based on both countries having thriving small firms sectors (United Nations, 1993). The combination of these factors meant that, since the election of the first Thatcher government in 1979, small firms and enterprise have been important to the policies of both Labour and Conservative parties.

## **Government Policy and SME Growth**

In the first four years of the first Thatcher government, more than one hundred SME-related policies were introduced (Beesley and Wilson, 1984). More recently, the Competitiveness White Papers published during the 1990s acknowledged that small firms, particularly those that were growing rapidly, could make important contributions to competitiveness (Johnson *et al.*, 2000). To date, the rationale and objectives of policy measures have been multidimensional. As most SMEs are privately owned, intervention funded from the public purse needs to demonstrate benefits to wider society. Purists of economic liberalisation associated with the

New Right, under the leadership of Margaret Thatcher, argued that state intervention was only justified when markets fail to allocate resources, goods and services efficiently (Bennett, 1996; Bridge *et al.*, 1998, pp. 207–221). Others argue that government intervention can be justified on the grounds of equity with the removal of barriers that favour large firms in an attempt to provide a ‘level playing-field’ for SMEs (Johnson, 1990). Restrictions on the operation of free markets include barriers to trade arising from monopoly, imperfect information, problems associated with risk and uncertainty, and difficulties in obtaining finance. Government assistance for SMEs provides potential benefits in creating employment opportunities and establishing a seedbed of growing firms as well as improving innovation and competitiveness (Johnson *et al.*, 2000). The view that SMEs create new jobs is based, *inter alia*, on a study undertaken by Birch (1979) which concluded that small firms (those with fewer than 20 employees) in the USA generated 66 per cent of all new jobs between 1969 and 1976. Like many other claims made of SMEs, Birch’s findings have been contested (Storey and Johnson, 1987). Nevertheless, Johnson (1990) maintains that there is a substantial and theoretically defensible case for the inclusion of small firms in public policy interventions.

While there may not be a clear rationale for government policy related to SMEs, it is certainly possible to identify different phases of support since the publication of the Bolton Report (Curran, 1999). The 1970s represented an emergent phase and, from 1971 to 1974, eleven indirect policies were introduced. Among these were a series of deregulation measures aimed at reducing bureaucratic and administrative demands that were burdening owner-managers. The remainder of the decade witnessed further measures to reduce financial failures. In this phase, SMEs were perceived as a balance to set against the excessive bureaucracy and monopoly power of large businesses. The rationale for government intervention was described by the Department of Trade and Industry (DTI) in the following terms: ‘The small firms sector is recognised by government as having a vital part to play in the development of the economy. It accounts for a significant proportion of employment output, and it is a source of competition, innovation, diversity and employment’ (Frank *et al.*, 1984, p. 257).

In the early 1980s, there was a switch from supporting business start-ups as a way of reducing unemployment to policies aimed at improving competitiveness by growing existing SMEs. There was also a programme of deregulation designed to reduce bureaucratic red tape as a means of saving time and resources for SMEs. By the early 1990s, a further policy shift towards ‘software’ measures was evident. There was less emphasis on providing tangible financial support through the Enterprise Allowance Scheme and the Small Firms Loan Guarantee Scheme, and more concern with supporting SMEs with advice, consultancy, information and training (Stanworth and Gray, 1991). The proliferation of initiatives and constant changes of emphasis served to create the impression among owner-managers that accessing support was both complex and confusing. The government responded in 1992 by introducing a network of ‘one-stop shops’ called Business Links intended to provide SMEs with a single, local gateway to advice and assistance (Bennett *et al.*, 2001). The election of New Labour in 1997 appears not to have changed the UK’s commitment to SMEs and their contribution to an enterprise culture (Gavron *et al.*, 1998): ‘Entrepreneurship and innovation are central to the creative process in the economy and to promoting growth, increasing productivity and creating

jobs . . . The government's aim is to create a broadly-based entrepreneurial culture, in which more people of all ages and backgrounds start their own businesses' (DTI, 1998, pp. 14–15).

In their first term of office, the new government set out to build on the growth of SMEs by restructuring business support through the creation of eleven Regional Development Agencies (Shutt and Pellow, 1997). Further to this, the Small Business Service (SBS) was established in 2000 to provide a single governmental organisation dedicated to helping small firms and representing their needs within the government. The overall mission of the SBS is to build an enterprise society in which small firms can thrive and achieve their potential. The four areas of activity on which the SBS focuses are acting as a voice for small firms, providing a business service support network, mitigating regulation that unfairly burdens or hinders small firms, and championing entrepreneurship (Irwin, 2001). Other forms of small-firm support, such as the Small Firms Loan Guarantee Scheme, the High Technology Fund and the network of Business Links, are now the responsibility of the SBS. Looking ahead, Johnson *et al.* (2000, p. 52) maintain: '[I]t is reasonable to conclude that the role of the small business sector in promoting economic growth and competitiveness is at the forefront of current government thinking on small-business policy, and will continue to be so for the foreseeable future.'

It is acknowledged that SMEs make important contributions to the UK economy in terms of technological progress, increased competitiveness, the creation of new jobs and the economic revival of certain regions (Cabinet Office, 1996). However, the dynamism demonstrated by SMEs since the 1980s cannot be taken for granted. It is no longer certain that SMEs can continue to make significant contributions to economic growth in a global economy typified by accelerated technological change and ever-increasing market competitiveness (OECD, 1993). UK Government White Papers on Science, Engineering and Technology and on Competitiveness emphasise the significance of small firms as a catalyst for economic success through innovation and technology transfer (Cabinet Office, 1995, 1996). In the drive to sustain competitiveness among SMEs, there is growing interest within the government in fostering stronger links between the SME sector and Higher Education Institutions (HEIs) (Johnson and Tilley, 1999). It is believed that there are benefits to be gained by small firms from such interactions and partnerships, for example:

- Many small firms lack the time, resources, technology or expertise to research and develop new business ideas and innovations. HEIs can potentially provide access to expertise, technology and resources that could be of assistance to SMEs. Working in partnership with research departments can lead to new commercial developments that an SME may have been unable to achieve on its own. Student projects and placements, such as the Teaching Company Scheme, offer SMEs access to a wide range of knowledge, expertise and resources (Brereton, 1996; Jones and Craven, 2001). Furthermore, recruiting more graduates will result in a greater flow of talent, energy and innovation into the SME sector.
- SMEs may not always operate at the optimal technological level. A study undertaken by the Oxford Trust on technology transfer between SMEs in Oxfordshire and the local research base stated that: 'although technology

transfer is increasingly recognised as being of great importance, getting it to work in practice can be difficult' (Bell *et al.*, 1994, p. 5). The authors concluded that technology transfer was making an important contribution to local manufacturing and technology-based firms, but SMEs were still concerned with their own lack of know-how in accessing assistance from universities. Nevertheless, HEIs are repositories of specialist technology and expertise which can be of enormous benefit to SMEs willing to engage with academia.

- Owner-managers often possess the entrepreneurial drive but lack formal management training (Marshall *et al.*, 1995). This weakness can eventually become a critical factor limiting growth and expansion. Developing high-level workforce skills has been identified by Government White Papers as central to improving UK competitiveness. It can also be argued that SMEs would benefit from improvements in their commitment to management training.
- SMEs could make better use of skills available in the graduate labour market. Graduates are under-represented in the SME sector, but this is seen as the most likely growth area for future graduate employment (DfEE, 1996). Owner-managers are often wary of employing highly qualified staff because graduates are perceived as unlikely to remain committed over the longer term due to ambitious career plans.
- Traditionally, SMEs have struggled to obtain adequate and appropriate finance. However, links with HEIs present opportunities for owner-managers to increase their funding capabilities. Involvement in any SME–HEI initiatives, such as the Teaching Company Scheme (TCS), provides resources, labour and access to funding that would otherwise be unavailable to smaller firms.

## Evaluating SME Policy

SME policy has developed incrementally in the UK as the government responded to specific problems and difficulties as they arose (Green, 1992). Despite the growing importance of SMEs to the health and competitiveness of the economy, a constant complaint has been of the ad hoc and piecemeal approach taken to policy-making, resulting in a lack of coherence (Stanworth and Gray 1991; Storey, 1994). Over the years, government interventions have also been criticised for being regionally divisive. Indeed, during the 1980s, it was suggested that a 'north–south' divide was being perpetrated, with small firms located in the south being more likely to benefit from policy measures than similar firms located in the north (Whittington, 1984; Lloyd and Mason, 1984).

The present government remains steadfast in supporting SMEs to promote growth and competitiveness (Johnson *et al.*, 2000); although some critics remain unconvinced of this: 'It is difficult to say very much worthwhile about the impact of small business policy in the UK over the last 20 years' (Curran, 1999, p. 43). This claim is based, in part, on the premise that studies intended to evaluate small firms' policies suffer from inherent methodological problems. In particular, identifying and measuring additionality, the net positive outcomes (desired or otherwise) that can be reliably attributed to individual policy measures, is extremely contentious. A 'before and after' comparison would be an appropriate research design, but this approach is difficult to execute because small firms are extremely sensitive



to external influences. The obvious solution would be to use a matched control sample but, because of the sector's heterogeneity, this is not straightforward. With the added complexities of accurate sampling, response bias and self-selection it can be difficult, if not impossible, to assess additionality and, therefore, reach reliable conclusions when evaluating the effectiveness of small firms' policies (Curran, 1999).

The most damning assessment of government policy comes from SMEs themselves. Over the last 20 years, it is estimated that there have been approximately 200 initiatives to support the improved competitiveness of small firms, yet the take-up rate has been low. Even support programmes such as training and business health checks have rarely achieved more than a 10 per cent take-up, and often it is much less (Curran, 1999). Possible reasons for low take-up rates include:

1. Support providers do not understand the needs of owner-managers' businesses and therefore offer standardised support measures.
2. Owner-managers are sceptical of solutions based on large-firm practices which are delivered through top-down support programmes.
3. The largely standardised top-down support described in points 1 and 2 may be administratively convenient but fail to recognise the heterogeneity of small firms and the importance of locality.

The limitations of policy provision and delivery are not necessarily an indication of a lack of demand for assistance. The benefits of introducing policies which are directly relevant to the needs of the SME community are still a concern to all those interested in sustaining the competitive advantages of the UK economy.

## Conclusion

This brief introduction to small firms highlights a number of factors that can limit the competitiveness and growth of SMEs. The UK government recognises that the UK has some way to go in resolving these issues.

The lack of an enterprise culture is a particular handicap in the knowledge-driven economy. Attitudes in the UK to entrepreneurship are less favourable than in the U.S. and in some respects fall short of our European partners. Small firms can face difficulties in gaining access to finance, both at the start-up stage and in achieving sustained growth. Further work is needed to promote a culture of entrepreneurship, particularly among young people, and remove the barriers to the development of a dynamic small firms sector. (DTI, 1999, p. 57)

In part, some of the difficulties in understanding SME competitiveness described in this chapter are related to the sheer complexity of the small firm community. The heterogeneity of SMEs can create insurmountable problems to academics and policy-makers seeking universal explanations for SME growth, success and competitiveness. The first step may be to deepen our understanding of what sustains the competitive advantage of smaller businesses in a more individualistic manner.

The main body of the book consists of thirteen chapters divided into three sections. In the first section, there are four chapters dealing with what are described

as strategic issues related to SMEs (competitive advantage, strategic management, corporate governance and sustainability). The second section deals with topics categorised as 'people issues' (HRM, share ownership, creativity, innovation and networks). In the final section, four chapters described as 'functional' approaches to the management of SMEs are included (e-commerce, supply chain management, financial management, and marketing). In selecting these topics, the editors have built on the strengths of staff belonging to MMUBS as a result of their engagement with the small firm community. Some topics such as HRM, innovation, networking and strategy are regularly discussed in books related to the management of SMEs. Other topics, such as share-ownership (Pendleton), corporate governance (Warren), creativity (Banks *et al.*) and supply chain management (Macpherson and Wilson) are rarely examined in the context of SMEs. Therefore, it is suggested that this book will provide new insights into ways in which the owner-managers of SMEs can improve the competitive position of their firms.

Inevitably, in a book of this kind there are likely to be some omissions. At the same time, the editors believe that each of the chapters makes a positive contribution to a broader understanding of how competitiveness can be created and sustained in SMEs. As pointed out in Chapter 15, identifying and exploiting new opportunities demands that owner-managers (or the management team) are outward- rather than inward-looking. Long-term success for any SME means that there must be emphasis on the innovation of new products, services and processes. Owner-managers must strive to create a dynamic, entrepreneurial culture in which there is constant emphasis on the importance of regular access to new knowledge, resources and information. In this way, SMEs in all sectors can improve their prospects for longer-term survival, if not growth.

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