Joining the Dots:

Building the Evidence Base for SME Growth Policy

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1. Introduction

An important strand of government policy, particularly as Small and Medium sized Enterprises (SMEs) seem adept at recovering from recession (Cowling et al., 2014), is that they have the potential to play a significant role in driving growth over the next few years. Maximising this potential requires effective evidence-based policy and the creation of a business environment which is growth enabling. Yet, despite considerable academic attention on small businesses and their contribution to the economy over the last 30 years (Gilbert et al., 2006; Shepherd and Wiklund, 2009), our understanding of the drivers of business growth remains partial. This is reflected in the fact that almost all empirical models of growth typically have low explanatory and predictive power, and debate continues about the most appropriate measures of growth (Westhead and Wright, 2011). Much remains unexplained, undermining our ability to assist companies in prioritising strategic and managerial development, introducing uncertainties into the design of effective policy support for growing firms and weakening management education.

Wright and Stigliani (2013), in a wide-ranging review article upon the entrepreneurial process and firm growth, argue that the research community needs to embrace more innovative research methodologies to address the vast array of questions that still remained and as a result the interventions of the public and private sector remain sub-optimum. While there are several gaps in our knowledge of SME growth, there is also a strong body of evidence that demonstrates the effectiveness of policy in supporting SME growth through innovation and exporting, finance and leadership and management development. However, hitherto we lack a comprehensive overview of this evidence base. This special issue seeks to address this concern by bringing together the evidence base in five key policy areas for the first time – job creation, diversity, entrepreneurial finance, innovation and exporting, diversity, and management and leadership skills. The invited contributions, which have undergone double blind developmental review, identify and outline where robust evidence does exist, where it is lacking and the implications for policy development and future research. Each article attempts to address three key questions:

- What do we know and therefore, in what areas of policy development can we make robust judgements about intervention and likely effectiveness?
- Where are there gaps in our knowledge and how do these limit our ability to make robust ex ante judgements about policy design and effectiveness?
- Where could future research be usefully concentrated to achieve maximum impact?

In this introductory article, we review the themes covered by the contributions to the special issue and identify a number of directions for future research and policy.

2. Growth and rebalancing

The article by Anyadike-Danes et al. (2014) brings together the existing evidence on job creation to inform the discussion of three key questions: What types of firms create the most jobs in the UK economy? What conclusions can be drawn from the evidence on types of firms and job creation? and "What are the choices for policy? The authors focus on different understandings and methods of deriving the contribution of different groups of firms to job growth. The review identifies three perspectives on the job creation process in the UK focusing on employer-only businesses: job creation and destruction metrics; contribution of HGFs to job creation and an analysis of the growth trajectory of cohorts of start-ups in terms of jobs.

The analysis suggests some striking stylised facts. First, the majority of jobs in the UK are created by small firms (i.e., less than 50 employees and including micro-enterprises). As a result, smaller firms have been increasing their share of total employment year on year; in 2010 their share of employment was triple that of 1998. Second, the profile of job creation and destruction is relatively stable over time - even the economic downturn after 2008 did not affect the overall scale of job creation and destruction taking place in the UK economy. Third, although definitional differences make a significant difference to apparent outcomes, high growth firms and larger non-high growth SMEs are most prolific in terms of job creation. Fourth, despite this evidence the 'brutal facts' of UK business demography mean that around 75 per cent of firms which start small stay small and over a decade, around 75-80 per cent of new firms will close.

Two of these stylised facts are worthy of particular emphasis in thinking about UK growth. First, the increase in the importance of small firms as a provider of jobs emphasises the importance of the SMEs in the future growth of the UK economy. Second, the stability of the profile of job creation and destruction through time emphasises the difficulty of developing policy initiatives which are powerful enough to enhance (or perhaps counter) the market processes which drive business demography. However, this is a council of realism not despair as internationally, differences in business demographics – including the role of high growth firms – are evident (Anyadike-Danes et al., 2014, this issue). Where market failures can be established, targeted policy initiatives may also have significant value. As Carter et al (2014, this issue) point out for example, ethnic minority owned businesses (EMBs) constitute around 8 per cent of the small firm population in general but this figure rises significantly in the main urban areas, notably London, Birmingham, Manchester and Leeds. In these areas, effective measures to support the growth of EMB businesses are likely to have a disproportionate impact on business demographics and growth outcomes.

The findings in this article identify an obvious tension in existing policy discussions between the focus on developing the growth potential of existing firms and the promotion of start-ups (particularly by certain under-represented groups e.g., young people). The evidence presented suggests that both start-ups and established businesses have rapid growth potential. The article suggests a greater need for understanding of the processes which drive growth in different types of firm in order to develop a robust set of policy interventions. One aspect where greater analysis is needed to inform policy concerns the pace of job creation at the firm-level. For example, we do not yet know whether there is any uniformity in the performance of the very small group of extraordinarily prolific job creators; nor the extent to which the composition of such a group is influenced by taking different time horizons and examining different modes of significant growth.

3. Innovation and exporting

Love and Roper review the evidence on the relationships between innovation, exporting and growth of SMEs. SMEs which have a track record of innovation are more likely to export, more likely to export successfully, and more likely to generate growth from exporting than non-innovating firms. Both internal and eco-system factors are important in shaping SME innovation and exporting. For SMEs specifically, however, the evidence base remains limited in some areas.

There is strong evidence for the importance of internal enablers in the form of skills, R&D, capital investment and liquidity in shaping SME innovation and exports. The evidence base is weaker - particularly for SMEs – in terms of the value of design, intellectual property management, people management, employee engagement, workforce diversity and other firm characteristics such as family ownership. External enablers – ‘openness’ - purposive links formed between SMEs and their partners – play a positive role in innovation and export growth, particularly in strong eco-systems. Targeted supply-side and demand-side policies have also proven effective in promoting SME innovation and exporting. Less is known about which eco-system characteristics are most important in influencing SME innovation and export success.

For firms of all sizes there is a strong positive association between innovation, exporting and productivity and/or growth. Innovation and exporting operate jointly to improve business performance. Evidence on the inter-relation between innovation and exporting in SMEs specifically, however, is limited.

Evidence on the internal drivers of innovation and exporting reinforces the importance of a number of key policy initiatives. In the UK, for example, measures such as the recently extended Employer Ownership Pilot, Innovation Vouchers, Smart Awards, Knowledge Transfer Partnerships, and the Design Leadership Programme are all likely to have significant performance benefits. Similarly, with respect to external drivers, many aspects of the UK business eco-system are also strong in respect of the Business Bank, to which we return below, and local initiatives. Moves towards more localised policy design and delivery have been emphasised by the recent City Deals and the Heseltine Review. Potential growth gains here are evident in a number of areas. The potential for local co-operation is, for example, illustrated in Lockett et al (2014, this issue) in the context of management skills and dynamic capabilities. Based on the importance of leadership skills and dynamic capabilities Lockett et al illustrate the potential for national measures such as the Growth Accelerator to be augmented by locally implemented programmes such as the Warwick Business Innovation and Growth Programme and Goldman Sachs 10,000 Small Businesses Programme. Such programmes – as well potentially as local innovation voucher type programmes – can help to create the inter-organizational knowledge sharing networks that serve as inputs into evolving dynamic capabilities. Evidence reviewed by Love and Roper also emphasises the contribution of local business eco-systems and partnering to both SME innovation and export performance. This creates the potential for localised policy initiatives which can help form or strengthen local partnerships to boost SME competitiveness. Such initiatives may also be important in helping to tailor support initiatives to the specific needs of local businesses, perhaps particularly those led by women or members of ethnic minorities. While we know that the evidence base on the need or justification for such specific interventions is often weak, there is some evidence to suggest that a range of support delivery, including that targeted at specific groups, can be highly beneficial both at the early start-up stages and also in linking specific business owning groups with public and private procurement opportunities.

Synergies between SME innovation and exporting suggest the value of co-ordination in providing timely and accessible support. However, Love and Roper point out that policy developments may be needed to enable such coordination, For example, in the UK responsibility for supporting exporting and innovation is, divided between UKTI and TSB.

4. Ethnic and gender diversity

The article by Carter et al reviews the evidence relating to growing ethnic minority-owned businesses (EMBs), a diverse and changing group that comprise long-established communities and new migrants from a wide range of countries, and women owned businesses. The challenges to growth in EMBs are complex, but relate mainly to: access to finance, their concentration in particular sectors and markets, and the limited attention to management skills.

First, with respect to access to finance the evidence base shows growing consensus on three key points: poor credit outcomes for particular ethnic groups, notably Black Africans and Bangladeshis; standard risk factors rather than direct discrimination explain variation between different ethnic minority groups; ethnicity remains an explanatory factor for discouragement, particularly for Black Caribbean firms.

Second, regarding access to markets it is evident that many EMBs owners are subject to structural disadvantage arising from the market sectors into which they are concentrated. This is a feature that applies to many ethnic minority groups, and is a pattern that is recurring amongst new migrant communities.

Third, concerning access to management, while ethnic minorities are increasingly well 'credentialised' and have a growing presence in non-traditional sectors such as IT, pharmacy and the media, the mismatch between qualifications and self-employment occupation persists. Further, EMBs face management challenges if they are to diversify into higher value-added sectors.

The evidence base reviewed by Carter et al. shows that the main challenges confronting growth in women owned businesses are similar to those faced by ethnic minority entrepreneurs, and relate to: access to finance, access to markets; and the effects of the initial resource constraints on business growth.

First, women-led businesses perceive higher barriers in accessing finance. They start with lower levels of overall capitalization, use lower ratios of debt finance, are much less likely to use private equity or venture capital, and are more likely to be discouraged borrowers. There is almost no evidence of supply-side discrimination, but substantial concerns that demand-side debt aversion is more pronounced among women. Second, women-led businesses are typically smaller and often located within services sectors, so access to markets may be more constrained than is observed among male-led enterprises. Third, studies demonstrate that, given the same starting resources, business performance by gender does not differ. However, women-owned enterprises typically start with lower levels of resources.

The authors conclude by identifying four tensions that characterise debates on policy and diverse SMEs. First, to what extent are the outcomes of diverse enterprises a product of discrimination or a reflection of complex social, economic and institutional factors? Second, successive governments have tried to boost self-employment among women and ethnic minority groups; but should greater emphasis be accorded to qualitative business development? Third, there is continuing debate on the desirability of mainstream approaches to business support versus more specialist interventions for diverse enterprises. Finally, the extent to which there is market failure in the support provided to diverse enterprises is still a matter of debate.

5. Entrepreneurial Finance

Discussion of funding gaps for growing businesses in the UK is longstanding, a discussion intensified during the financial crisis. The factors that affect funding gaps and the nature of the relationship between funding gaps and business growth involve complex and nuanced issues that are not completely understood. The article by Fraser et al. (2014) attempts to identify the gaps in the academic literature worldwide regarding supply and demand side influences on growth finance that should be addressed to better inform policy making. They observe that in recent years, loan rejection rates have increased sharply and discouragement has increased (see also Xiang et al., 2014). Early-stage venture capital funding also remains at a low level (Fraser et al., 2014, this issue).

The review of the literature on firm's financial decisions and their access to finance indicates that the underlying issues go well beyond traditional discussions of failures in entrepreneurial finance markets to include contingencies such as differences in: entrepreneur objectives, ownership types of firms, and firm life-cycle stages. For example, EMBs, while not facing direct discrimination, do experience worse credit outcomes due primarily to standard risk factors (e.g. age of business, financial track records) (Carter et al., 2014, this issue). Women owned businesses, are similarly more likely to be discouraged borrowers, and while there is no evidence of bank discrimination there is clear evidence of higher levels of debt-avoidance among women that constrains business growth. In this regard there are obvious training implications both for women entrepreneurs and for the institutions and agencies offering business support.

Alternative forms of financing such as crowd-funding may be useful but are used by few SMEs due to lack of: availability, awareness, financial expertise and confidence in being able to obtain these sources of funding. Yet, these forms of finance are growing rapidly, even if the impact is only beginning to be researched and their ability to help firms grow beyond start-up remains unclear. Trade credit also provides an important alternative form of funding and may also be helpful in playing a signalling role as firms using trade credit may gain greater access to bank credit.

Some of the bottlenecks to finance access can be addressed by supply side policies aimed at promoting the provision of credit and equity finance. Policy too can play a valuable role in stimulating a net increase in the availability of finance as indicated by recent analyses of the Small Firms Loan Guarantee (SFLG) and its successor the EFG (Fraser et al., 2014, this issue). Further, given evidence that funding gaps appear to be larger, and growth weaker, in the UK relative to other major economies and that there is also longstanding evidence that there is insufficient long term finance for UK SMEs, the establishment development of the UK Business Bank seems helpful. International experience provides some best practice in the design and delivery of such support from examples such as KfW in Germany, the Small Business Administration (SBA) in the US, and even fast growing emerging market counterparts such as the Small Industries Development Bank of India (SIDBI).

Some other bottlenecks may require different forms of intervention, such as access to information and advice about alternative sources of finance. Part of the role of the Business Bank is to align financial assistance and business advice along the lines of the 'one-stop shop approach' taken by both KfW and SBA. This may go some way to dealing with the awareness issues which seem to be a major constraint on existing policies (Fraser et al., 2014, this issue).

Yet, other bottlenecks are much more intractable. Ambiguous and less understood issues where there is a need for further research concern the relative impact of entrepreneurial cognition that affects demand for finance, different ownership and board configurations (for example, family owned firms, management buyouts), financing needs of firms at different stages in their life-cycle, supply side factors on access to finance and business growth, and the role of emerging forms of finance such as crowd-funding and accelerator programs.

There is scope for further research on how the growth/lifestyle objectives of businesses/entrepreneurs, and the importance of retaining control might affect decisions to look for VC or equity funding (and non-bank source of external funding, in general). Similarly, further research is needed on how the choice is made between alternative forms of non-bank finance, such as VCs, private equity, and business angels, and how these different forms of financing differently affect firm performance. Policy suggestions include the need for improved support to help businesses grow beyond the start-up phase.

6. Management and leadership

Lockett et al. (2014) argue that SME growth depends upon substantive growth capabilities, which are shaped by the upstream issues of leadership and capability development. There are four main vectors of growth supported by a large number of growth-oriented actions and processes. Management processes facilitating growth include those that support market penetration, innovation, new product development, new market development and internationalization. Growth is further supported by a foundation of solid general management processes without which, viable growth is less likely to occur. Management processes supporting alliances, joint ventures and M&A also serve to accelerate growth. The key resources supporting growth capabilities include financial and intellectual capital. Financial slack allows for greater exploration, risk taking and pursuit of uncertain outcomes. Intellectual capital (intellectual property, organizational, human and social capital) is important as the acquisition and exploitation of new knowledge lie at the heart of growth.

Leader's prior knowledge of the domain (i.e. industry) and prior entrepreneurial experience exert a strong positive influence on the number of market opportunities identified. The nature and diversity of knowledge among the entrepreneurial leadership team has a positive bearing on growth, both directly and indirectly via opportunity identification. Prior entrepreneurial experience allows entrepreneurs to develop broader and more complex mental models which allow them to "connect the dots" between seemingly disparate information. The nature and diversity of knowledge among the entrepreneurial leadership team also has a positive bearing on growth, both directly and indirectly via opportunity identification. Growth ambition may also lead SMEs to set specific, challenging goals. Evidence suggests that such goals result in higher performance than vague and / or easy goals (given adequate commitment, feedback and knowledge).

Entrepreneurial cognition, in the absence of motivation however, may result in knowledge not being put to the most productive use. The motivation to grow, reflected in the growth intentions of leaders and their goal setting, is an important determinant of growth. Fear of failure represents a potential barrier to growth.

Dynamic capabilities are central to the development of a sustainable growth path. Evidence suggests that dynamic capabilities have a positive effect on firm performance, both measured in terms of market and financial performance relative to firm's main competitors and industry averages. Qualitative evidence suggests that dynamic capabilities are positively linked to the substantive capability development, and that capability development is a mediator of the relationship between dynamic capabilities and firm performance.

Leaders need to be both willing and able to grow their firms. Therefore, policy should promote growth-oriented training programmes that develop entrepreneurial cognition and motivations, as well as knowledge and abilities. The programmes should disseminate best practice for opportunity identification, growth capabilities and goal setting. Leaders of SMEs, however, are often unable/unwilling to invest in growth. Therefore, additional support may be directed towards assisting SMEs in accumulating both the financial and intellectual capital required for growth. Also, since such investment is often motivated by key customers, policy should focus on supply chain development to indirectly promote capability building in SMEs.

Developing dynamic growth capabilities requires capable management. However, resource constraints mean that SMEs tend to invest less in management development than larger organizations. Further, SMEs may pay insufficient attention to developing boards of directors with the composition of skills to help the business grow. There is evidence that SMEs often lag behind best practice because owners and managers of SMEs are unable or unwilling to make the necessary investments of time or resources. Public intervention – such as the Growth Accelerator or Companies of Scale Scheme - may be justified to help SMEs overcome such resource constraints. Measures to support supply chain development may be important in indirectly promote capability building in SMEs (Lockett et al., 2014). Similarly – where market failure can be established – measures to support leadership development and 'breakout' in EMBs may also be a high priority in some areas (Carter et al., 2014).

7. Directions for future research and policy

Each of the articles in this special issue provides detailed agendas for future research and policy, so it is superfluous to repeat them in detail here. In summarising the contributions of the articles in the special issue, we have alluded to some linkages between the policy areas of job creation, diversity, entrepreneurial finance, innovation and exporting, diversity, and management and leadership skills. Further research and policy development needs to explore these interactions.

We hope that the special issue will be of benefit to both policy makers and researchers. Policy-makers will benefit from the summary of research evidence provided. Researchers will benefit from the literature overviews and the identification of gaps in the research evidence with policy relevance. As academia increasingly searches for opportunities to do 'impactful' research this type of opportunity will be particularly relevant.

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