Management, strategy and policy in the UK small business sector: a critical review

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Keywords

Small enterprises, Entrepreneurialism, Competitive advantage, Managerialism, Strategic alignment, United Kingdom

Abstract

This paper first considers the role and characteristics of the small firm and its collective, the small business sector. A brief examination of the small firm discourse and research agenda is provided. The following section undertakes a critical examination of the small firm management context. A critical appraisal of the strategic management approach suggests that strategic activity in the small firm sector is much more informal, intuitive and invisible than has been previously suggested by design school advocates. The final part of the paper considers the role and development of policy and its effects on the survival, growth and performance of small firms.

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Introduction

The smaller firm and the recognition of its centrality as a necessary competitive instrument in the development of a modern, vibrant and progressive economy have undergone a remarkable renaissance in the last quarter century. Smaller firms are now the focus of political, business and management research and are popularly regarded as the preferred vehicle for the generation of the enterprise economy (Gavron *et al.*, 1998; Carr, 2000; Beaver and Carr, 2002) and integral to contemporary economic and social regeneration (Stanworth and Gray, 1991).

All of the principal political parties have recognised and embraced the potential of the smaller enterprise and its collective, the small business sector, as the creator of employment, the provider of innovation and as the vehicle for entrepreneurial aspiration. In fact, the encouragement and support of the small business sector can be classified as apolitical, as contemporary research evidence continues to confirm its continuing contribution to overall economic performance. Policy initiatives designed to counteract the effects of resource and positional disadvantage may vary and have attracted considerable criticism (Storey, 1994; Deakins, 1999) but the smaller enterprise and its role in the economy are regarded as essential by all.

It is easy to overstate the role of the small firm sector through exaggerated enthusiasm for its other political function, as the vehicle for change in both social and attitudinal engineering, confirming and legitimising the necessity of self-employment, new venture creation and entrepreneurship. However, the statistics of the revival of the sector are extraordinary. The number of small and medium-sized firms (SMEs) in the UK has increased by 50 per cent in the last 25 years and these are now responsible for more than half of all the jobs and contribute towards some 35 per cent of gross domestic product (GDP). The smaller enterprise has also been the vehicle for one of the most sustained and energetic research programmes by academics, financiers, industry watchers and policy makers, reflecting the increased interest and recognition of its economic contribution (Stanworth and Curran,

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1986; Stanworth and Gray, 1991; Storey, 1994; Gray, 1998; Curran, 1999). Like any area of academic enquiry, the small firm is distinctive in the nature and kinds of research problems that it presents. However, until comparatively recently, much of the research output has been of mixed and indifferent quality, due principally to the failure to recognise and accommodate the special problems in researching small business issues and contexts (Curran *et al.*, 1986; Thomas, 1998). The small firm is not a large one in miniature and the management theories and enterprise research that have been developed and applied to the corporate sector are difficult to replicate in the small business context. New models and approaches are necessary to cater for the peculiarities and distinctive conditions facing the small firm and the entrepreneurs that manage them.

Another factor, and one that has posed serious problems for researchers, is that there have been considerable difficulties in estimating the number of small firms in the UK. The problem is further compounded by the issue of just what constitutes a small business? Definitions from the *Bolton Report* of 1971 are regarded by many to be of dubious value to a sector that has changed in complexion, composition, contribution and structure over 32 years (Storey, 1994; Gray, 1998). The issue of small business definition and classification remains a complex one that requires mature and sensitive adjustment (together with the use of innate business common sense) to dictate suitable criteria that are helpful in a given sector or operating context (Curran *et al.*, 1986; Beaver, 2002). Many commentators and academics have gone to considerable trouble to emphasise that small firms are not simply scaled-down versions of large ones. They invariably have special characteristics that differentiate them from their larger counterparts and render the business development management process a very different affair. It must be emphasised that small firms are not a homogeneous entity and that to think otherwise is dangerous and naïve. By their very nature, small firms are different and have special characteristics, operating contexts, objectives and qualities. It makes any attempt to generalise about some three million firms in the UK a difficult affair (Department of Trade and Industry, 1999).

Management and the small firm

Business ownership is one of the factors at the very heart of what characterises and differentiates a small business and is probably the key feature of difference (apart from size) between small and large firms and their management (Stanworth and Curran, 1973; Curran *et al.*, 1986; Stanworth and Gray, 1991; Storey, 1994). The ownership of large organisations is usually distanced from its management and control, which are not evident in the majority of small enterprises. The issues and complexities that result from ownership and control in the small firm have been the subject of substantial research over the last 30 years. The major differences have been noted by, among others, Stanworth and Curran (1973), Leppard and McDonald (1987) and Stanworth and Gray (1991) as relating to business objectives, management style and marketing and operational practices. It is now widely accepted that the particular characteristics of small firms require a different appreciation of management understanding and that the methods and techniques in the corporate sector are not applicable, valid or relevant (Carson and Cromie, 1990; Storey, 1994; Jennings and Beaver, 1997; Beaver and Jennings, 2000).

A model of small business management is shown in Figure 1.

Management in small firms cannot be separated from the motivations and actions of the key actors. They are the essential component in understanding the fashioning of the relationships between ownership and decision making, managerial styles, organisational structures and cultures, and patterns of business development. The role and nature of ownership, the pattern of business management that emerges from it and its connection with enterprise success and failure are now a common theme in small enterprise research activity (Goss, 1991; Goffee and Scase, 1995; Cosh and Hughes, 1998; Beaver and Jennings, 2000). Understanding the management practices of small firms therefore

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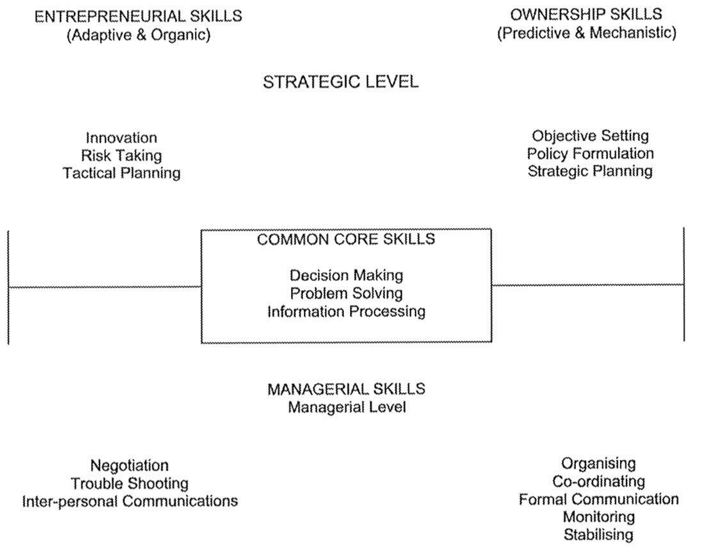
Figure 1 The small firm management process



Source: Beaver and Jennings (1995)

requires an appreciation of the psychology of ownership and the perceptions that owner-managers and entrepreneurs have of themselves and their operating context. Contemporary research findings have shed much new light on an area that has been characterised by stereotypical interpretation and anecdotal evidence (Curran and Stanworth, 1979, 1981; Curran, 1991; Curran and Blackburn, 1994).

The characterisation of the owner/entrepreneur offered in the *Bolton Report* (1971) was unidimensional.

Despite the substantial research that was undertaken, the Committee's researchers appeared to have taken the key actors fairly uncritically and at their own estimation. The evidence from the report suggests that the small firm owner-entrepreneur regarded himself as disadvantaged by politicians, large companies, banks and local authorities and misunderstood by the public at large. The demands of the business required a total commitment of time and energy, with the rewards barely adequate. Trade unions were also perceived as a threat, despite the fact that their workers really wanted nothing to do with them, as relations with management were constructive and amicable. The picture of the owner-manager/entrepreneur post-Bolton is more comprehensive and carrying substantially more conviction. Bolton (1971, pp. 22-5) had noted that such individuals were not randomly drawn from the population, and that many of them had an indifferent education. The more general conclusion, derived from the studies of the backgrounds of entrepreneurs, is that they tend to be people who consider themselves misplaced by the conventional role-allocation processes of their society. Starting and running a small firm were perceived as an alternative form of both expression and achievement in contemporary society, where success and independence could be fashioned on terms suitable to the key actor. The following quotation taken from the largest US survey on entrepreneurship supports this point particularly well:

> Entrepreneurs are men who have failed in the traditional and highly structured roles available to them in society. In this, as we have seen, entrepreneurs are not unique. What is unique about them is that they have found an outlet for their creativity by making out of an undifferentiated mass of circumstance a creation uniquely their own: a business firm (Collins *et al.*, 1964).

The point to note here, that is frequently absent in accounts about small firm management, is the need to appreciate the special social character of the key players and their reasons for embracing the entrepreneurial role. Understanding this facilitates an understanding of attitudes towards growth (or lack of it) later in the life of the firm. Curran and Stanworth (1981) have developed this theme further and proposed a convincing explanation of "social marginality" as a major determinant in small business formation and management (Curran *et al.*, 1986). Understanding small firm management processes also needs to recognise a consistent research finding that has been found time and again. Few owner-managers and entrepreneurs make financial gain their primary goal (Boswell, 1973; Stanworth and Curran, 1973; Bannock, 1981; Storey, 1982, 1994; Deakins, 1999; Thomas, 1998; Beaver, 2002). The consensus of these studies places autonomy and independence as the principal motivation for business management, with the enterprise as the major arena for their expression. The great resilience of the small firm sector against formidable economic and political pressures underpins strong motivations of autonomy and the value that is placed on it, in the psychological composition of the key players (Kets de Vries, 1977; Goldthorpe *et al.*, 1980; Storey, 1994).

These dominant and consistent psychological characteristics of the main actors in small firms have been repeatedly reported as manifesting themselves in a distinct managerial style (Stanworth and Gray, 1991; Storey, 1994; Carter and Jones-Evans, 2000). Much of the available literature reveals that this managerial style is autocratic, egocentric, impulsive and often unpredictable. Strategy and planning are limited to the short term and relations with employees are highly particularistic, involving personal and sometimes highly idiosyncratic relationships (Scase and Goffee, 1980, 1982; Gray, 1998; O'Gorman, 2000; Marlowe, 2000). Caution must be exercised here, as there is a need to avoid over-generalisation.

There are a range of entrepreneurial and owner-manager identities that result in different management styles and priorities. Such identities will be conditioned by the type of economic activity, the operating environment, interpretations of success criteria, the period of establishment of the firm and whether the key players are first generation or those that have inherited ownership.

What much of the small firm literature cited above confirms is the central contrast between the informal, particularistic management style of the small firm and the more formal, bureaucratic administration of many large enterprises. For many small firms, management decisions are made in the context of survival and operational necessity, rather than growth and business development. Theories of small firm growth, notably the stage-models advocated by Greiner (1972); Churchill and Lewis (1983); Scott and Bruce (1987) have all been criticised to a greater or lesser extent for their inability to cater for the reality of small firm growth, as shown by research evidence (Storey, 1994; Gray, 1998; Freel, 1999). The inadequacies of such approaches, based on positivist underpinning, often fail to explain the complex internal processes and the unpredictable nature of the small enterprise environment.

Stanworth and Curran (1986) propose an alternative social action perspective of the small firm that focuses on understanding the social logic of the enterprise. They argue that the key to understanding the management profile and capability of the firm lies in the meanings attached to participation in the firm by the actors involved:

> The small firm in this view is an ongoing social entity constructed out of the meanings and actions of those who participate in the firm, or who are "outsiders" in relation to the firm as a social grouping but nevertheless interact with the participants (Curran *et al.*, 1986).

Large firms may well be the consequence of the growth of small firms but, as discussed above, management principles developed for application in corporate contexts are unlikely to be useful in the smaller enterprise. The scarcity of resources and the expectations and capabilities of the key players necessitate a different approach to management understanding. The nature of the management function may well be driven by the necessity for the key actors to acquire generalist skills and embrace a change in attitudes towards delegation and succession (Goss, 1991; Smallbone *et al.* 1992; Atkins and Lowe, 1994). These are issues that are developed in the following section on Strategy.

Strategy and the small firm

The development of business strategy has its origins in the techniques and concepts of business policy and strategic planning. The associated literature is generally prescriptive in nature, suggesting that strategy is developed in a rational, two-dimensional process of formulation (deciding what to do) and implementation (taking the required action). The production of a formal statement of business objectives, such as plans and mission statements, is normally regarded as an essential feature of strategic planning (Campbell and Yeung, 1991; Hannon and Atherton, 1998; Hussey, 1998). This can then be used to construct detailed sets of functional objectives to embrace all aspects of the firm and its operations (Bowman and Asch, 1989). Much of the emphasis underpinning many of the

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initiatives of the business support infrastructure shows that the business plan is popularly regarded and promoted as the preferred management instrument, enabling small firms to fashion their success.

However, it is contended here that the notion of strategic awareness as a specific capability and planning as an embedded process is much more critical than the written business plan for shaping the competitive posture of many small enterprises (Richardson, 1991, 1995; Joyce *et al.*, 1996; Banfield *et al.*, 1996; Hannon and Atherton, 1998; Georgellis *et al.*, 2000; Beaver and Ross, 2000). Indeed, the growth and ultimate success of the small firm are likely to be constrained by the strategic awareness capability of the principal small firm actors. A major concept underpinning much of the literature is the rational actions and choices of managers based on logical analysis and stakeholder management. That managers (and owners/entrepreneurs) do not behave in such a prescriptive fashion has been noted by a number of writers and researchers (Cyert and March, 1963; Williamson, 1964). This has generated a body of literature that has catalogued observed behaviour rather than what it is thought should happen. In reality formulation and implementation are intertwined as complex interactive processes in which management values, politics and organisational cultures determine or constrain strategy decisions (Mintzberg *et al.*, 1995; Franklin, 2002; Connor, 2002).

What is clear is that there is a large and growing body of literature on business strategy, very little of which relates to the small firm (Wheelen and Hunger, 1999; O'Gorman, 2000). Despite the debates about the value of strategic planning and the tensions between the theories and actual practice in firms large and small, there is a consensus that:

> All organisations make strategic decisions and have done so since the dawn of history ... strategic decisions can be taken carefully or negligently, deliberately, haphazardly or systematically (Argenti, 1974).

In a discussion about strategic planning and the small firm, Hall (1995) states that strategy is about the major moves made by a firm in the attainment of its objectives, or the pattern or plan that integrates the organization's major goals, policies and action sequences into a cohesive whole (Quinn, 1980). Both Hall (1995) and Quinn (1980) note that a formal planning process would include a variety of information-gathering and action-based activities, which, citing Hall (1995), typically might include:

- the setting of corporate objectives and targets;
- forecasting performance in key areas, comparing predictions with targets;
- assess strengths and weaknesses;
- generate alternative strategies;
- decide on the appropriate strategy;
- evaluate the chosen strategy;
- develop action and business plans;
- monitor progress.

Typically, analysis of the small firm and the assessment of its strategic posture have involved utilising frameworks and concepts such as the above, while recognising the limitations of such frameworks in the small business context. In particular, many contributions have adopted the design school approach to strategy – the classical, rational model of planning that has been a dominant strand in the general strategy literature. Such an approach is exemplified by Porter (1985) and much of the discussion of small firm strategy is based on Porter's (1985) approach. In this framework, competitive advantage is hypothesised to derive from product-market positions based on either cost leadership or product differentiation. A central theme in Porter's (1985) theory is that, if firms are to enjoy success and longevity, a clear and definitive strategy based on cost leadership, differentiation or focus should be adopted, and they should not succumb to combining a hybrid mixture that renders them "stuck in the middle".

There is common agreement throughout much of the literature that has adopted the generic strategy approach, that small firms should concentrate on developing market niches, as this is better suited to exploiting the expertise of the entrepreneur and caters for the positional and resource constraints present in many enterprises (Wheelen and Hunger, 1999). However, some commentators have noted that the advocacy of such strategies has become conventional wisdom based more on anecdotal

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evidence than on grounded research (Anderson and Atkins, 2001). However, broad cost leadership approaches may well cause difficulties for many small firms, as they are unlikely to raise the finance required to invest in cost-reducing technology, and attain the economies of both scope and scale that are needed to sustain such market positions. Similar resource constraints may undermine the choice of broad differentiation strategies.

Focus or niche strategies are considered to be more applicable and realistic for small firms with their inherent resource disadvantage, and conform with the objectives of many owner-managers that are driven more by survival and independence than by growth and by business development (Scase and Goffee, 1987; Grieve-Smith and Fleck, 1987; Storey, 1994; Burns and Dewhurst, 1996). Furthermore, small firms may well attain competitive advantage by deliberately selecting specific market segments that are ignored or dismissed by large firms (Shepherd and Shanley, 1998; Beaver and Prince, 2002).

The flexibility afforded by the absence of a formal organisational structure and the ability to respond quickly to customer demands and market conditions as a consequence of entrepreneurial management have been noted by a number of writers (Gibb and Scott, 1985; Kirby, 1990; Carson *et al.*, 1995; Hannon and Atherton, 1998). This relative advantage also reflects the disadvantage that is often present in large firms due to their inherent structural complexity and bureaucracy that may limit their ability to act quickly. The arguments in favour of focus strategies tend to concentrate on focused differentiation, noting that this approach allows the small firm to exploit its specialised knowledge of a particular product or service, type of customer or market arena. This is a consistent finding throughout the literature and has been endorsed by a number of empirical studies such as Reid *et al.* (1993) and the 3i European Enterprise Centre (1994). Many successful small firms have made a deliberate choice to exploit a particular market segment where they can either specialise in quality improvements not offered by large firms, or attain a cost advantage by offering a particular expertise or specialised knowledge.

Much of the discussion in the literature regarding the strategic activities surrounding small firms and their effect on performance and longevity explicitly or implicitly uses Porter's work (1985) on generic strategies as its theoretical underpinning. Such approaches have been the subject of considerable criticism and have been summarily dismissed by many writers as either overly simplistic or inapplicable in many of the operating contexts that favour small firms. Other criticisms reflect differences of opinion amongst alternative schools of thought. One such approach is the view that strategy is an emergent process that develops on a piecemeal basis without the precise knowledge of outcomes or objectives. Mintzberg *et al.* (1995) distinguish between "intended strategy", which is fashioned by an organisational leadership, and "realised strategy", which is the actions actually taken by the firm. The importance of incrementalism and management learning has been emphasised in many studies (Davig and Brown, 1992; Boussouara and Deakins, 1999; Rae and Carswell, 2001). Resource-based approaches contend that attempts at strategic analysis should focus on the key resources available to the firm in its attempts to fashion competitive advantage (Kay, 1993; Connor, 2002; Klein, 2002).

There is considerable merit in many of the criticisms directed at Porter's (1985) generic strategies and their applicability and relevance, and it is surely the case that a variety of different approaches should be adopted to analyse the small firm context. Many small firms will need to consider the impact of the strategies adopted by competitors and will not be able to determine their strategy in isolation from the strategies being undertaken by larger firms in the market. Therefore not only is it of crucial importance to examine the strategies of small firms and their larger counterparts together when they co-exist in the same market context, but it may also be necessary where no direct competition currently exists due to the threat of new entry.

Strategic management, as an emerging and increasingly sophisticated body of theory, tools and techniques, is still more applicable and more closely associated with the corporate sector, due principally to the design school

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approach in analysing, prescribing and legitimising strategic actions. A critical appraisal of this approach suggests that strategic activity in the small firm sector is much more informal, intuitive and invisible than has been previously suggested by design school advocates. It is contended here that the strategy process is emergent and instinctive rather than fixed and regulated. This approach recognises that management decisions are often based on information that is imprecise and subject to fluctuation. This is not to suggest incompetence, but to acknowledge the volatile and short-term nature of contemporary market conditions. Hence, a strategic approach that is emergent is both more appropriate and efficient for the majority of small enterprises to deploy when integrating their business activities with the competitive environment. It could also be argued that a relatively simple framework is appropriate, as small narrowly focused firms typically face relatively simple strategic choices. A case can be made that complex and detailed strategies are a distraction for all but the largest companies, as only these concerns can use such strategies to sustain the competitive advantage that makes an investment in such planning worthwhile.

Strategic planning and enterprise success and performance

Typically, the construction of a business plan is regarded by some as evidence that the firm is engaged in strategic activity. This is not a tenable assumption, as many small firms are required to produce such instruments in response to stakeholder pressures (e.g. bankers and grant agencies) and often have subsequent minimal regard for them as management instruments that guide decision making (Richardson and Jennings, 1988; Richardson, 1995; Hussey, 1998). Furthermore, there is a notable tendency in some of the research undertaken to adequately clarify the distinction between the process of anticipating the future through the strategic assessment of market intelligence and subsequent managerial action, and outputs in the form of business plans.

There is little doubt as to the equivocality of much of the literature on this subject. Schwenk and Schrader (1993) in a meta-analysis of research evidence suggested that on balance planning was positively linked to growth, but that there is little causality between strategy and business performance. This has been endorsed by other studies, notably, Camillus (1975); Grinyer and Norburn (1975); Schrader *et al.* (1989). However, there are many studies that have identified a consistently positive relationship between strategy and planning, growth and performance, including Robinson and Pearce (1984); Ackelsberg and Arlow (1985); Bamberger (1986); Baker *et al.* (1993); Joyce *et al.* (1996); Beaver and Ross (2000). In considering the above evidence, it is first necessary to mention that there are very real problems with the measurement and assessment of performance and its various interpretations and perceptions in the small firm sector (Scase and Goffee, 1987; Jennings and Beaver, 1997; Gray, 1998). By its very nature, the small business community is characterised by its heterogeneity and this includes reference to the diverse range of ambitions and motives in business formation and management in many different sectors. Perhaps the best and most accurate way to judge performance is to ask the key actors whether the particular goals of the enterprise have been achieved.

In attempting to seek clear indications of the financial effectiveness of business planning, the evidence, which emerges, is mixed. Bracker *et al.* (1988), commenting on the use of planning in small, mature-firm contexts, found a clear correlation in the use of planning and enhanced business performance. Bryers (1991) examined much of the published work and concluded that earlier applications of business planning had been successful and resulted in superior performance but found that later results from research studies were more mixed. Argenti (1990) and Hussey (1998) both state that they do not know whether the process impacts directly on corporate performance but agree on its ability to improve the quality and nature of decision making.

Aram and Cowan (1990), commenting from the position of planning consultants to small firms, express confidence in the ability of the business planning to improve organisational effectiveness and performance – provided that

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the planning process is undertaken effectively, formally and professionally. They add that for the majority of small business owner-managers strategic planning is an atypical activity and therefore professional assistance should be sought. Further, Storey (1994) in his considerations about the growth of small firms makes the following comment:

> Formal planning procedures and their monitoring appear to be more characteristic of larger businesses. It may also be the case that faster-growing firms are more likely to be devising and implementing formal planning procedures. The evidence is less clear whether this is a factor which encourages growth and performance, or whether it is merely associated with a movement towards greater size and diversity (Storey, 1994, p. 148).

These comments suggest that the existing research has failed to provide conclusive evidence of a direct relationship between small business strategy and growth. However, is this really so surprising? It is noteworthy that many of the commentators and researchers distinguish between financial performance as one potential benefit and improved decision-making capabilities and managerial confidence as others. Those who seek a definitive answer to the question of a contributory relationship between strategy and performance suffer from the inability to establish what level of performance would have been achieved if strategic actions had not been undertaken. Further, strategic planning may well be a proxy for a number of organisational activities and characteristics, such as management competence and involvement, style of leadership and employee participation. The issues are complex, as the organisational activities suggested here are very difficult to measure and document accurately.

Strategy is not a process with a clear definition and list of activities – it can and does mean different things to different actors. In some cases, business owners and managers may not recognise that they are engaging in strategic process, simply because it is not formalised. However, throughout much of the literature, and especially that designed principally for "practitioner" consumption, the terms "strategy", "strategic planning", "business planning" and "strategic management" are frequently packaged and used as though they were interchangeable, identical concepts and activities. Quite clearly they are not (Mintzberg *et al.*, 1995), and many writers have taken strong, often entrenched intellectual positions about the notion and meaning of these terms. In the research undertaken by Beaver and Ross (2000) this surfaced as a major issue because, simply put, the majority of small business actors that participated in the study had neither the time nor the inclination to play these "language games" (Franklin, 1998; Beaver, 2000). Strategy and planning were for the most part seen as identical and equivalent activities, with only a marginal distinction being made between the nature of business-wide decisions and operational activities.

Successful small firms appear to regard planning as an aid to innovation in business processes (Georgellis *et al.*, 2000) and to surface the use of new technology and training to raise their performance and productivity. The act of planning often instils the confidence to invest long-term and to embrace new techniques and ideas, which retain and enhance market share. Further, the act of planning provides a framework for the assessment of overall performance, noting that assessment invariably triggers the will to improve.

Policy and small firms

Rationale

Most governments, irrespective of their political complexion and global position, endorse the need for a small business policy. For many Western economies, small business policy has indeed come of age (Curran, 1999; Johnson *et al.*, 2000). In the UK, it is now such an established feature of the political landscape that during the 1997 and 2001 General Elections all the main political parties were at pains to demonstrate their enthusiasm for supporting small business and enterprise development. Barbara Roche, the then Shadow Minister for Small Business in 1997, stated that:

> Labour is dedicated to providing the right conditions in government for small firms to grow and thrive . . . we want strong small businesses because they are crucial to this country's success (Labour Party, 1997, p. 4).

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The rhetoric surrounding the "enterprise culture" (Carr, 2000; Scase, 2000; Beaver and Carr, 2002) and the espoused positive attributes of small firms, such as employment creation and innovation, have resulted in a great variety and number of initiatives, delivered by a plethora of agencies and introduced to the small firm community. This concern to promote the development of small firms is not new nor unique to the UK. What some commentators have described as "a steady stream of measures" during the 1970s became a torrent during the 1980s (Stanworth and Gray, 1991). The rationale for state intervention is not an issue that is widely discussed by the small firm policy or research community; indeed it appears to be taken as given that measures to support the small firm sector are justified primarily on the grounds of economic, social and employment-related contribution.

However, despite the increasing maturity of government policy towards small firms, there is still no White Paper, or indeed any other published statement, specifying and justifying policy aims and objectives. This has meant that measures have been frequently been developed, rejected, modified and sometimes reintroduced on a piecemeal basis (Storey, 1994; Thomas, 1998). This has led to Curran (1999) reporting that aspects of policy have become:

> An excess of loosely connected and apparently uncoordinated initiatives shooting off in all directions, generating noise and interest but not commensurate light (Curran, 1999).

In the absence of a formal, published statement about policy objectives, it is necessary to make inferences about the aims, emphasis, direction and coherence of small business policy from government and other statements. The conventional economic justification for state involvement is defended on the grounds of market failure, i.e. where the free market mechanism fails to provide an efficient allocation of resources within society. Given that small firms (with some exceptions) are private sector organisations aiming, for the most part, to generate profits for the owners of the business, then any intervention needs to be justified in terms of the wider stream of benefits that accrue to society. However, despite the apparent surface validity of intervention for reasons of market failure, this finds little support with some commentators, for, as Storey (1982) notes:

> Those favouring a market approach to economic problems argue that, subject to certain qualifications, the free market would provide an optimum number of new firms. New firms would be created in industries where there is an opportunity for profit and firms will disappear from industries where demand for the final product has declined. Government intervention is only legitimate where the social and private costs and benefits of new firm formation diverge, or where it is believed that the existing income distribution significantly reduces the extent to which willingness to pay reflects an individual or group's demand for a good or service ... It is not immediately clear to what extent subsidising the formation of new firms (and thus increasing, *ceteris paribus*, the existing stock of small firms) can be justified on any of these bases (Storey, 1982).

Storey (1994) also states that, with a few notable exceptions such as the Loan Guarantee Scheme or technology policies, very little justification has been provided by the UK government, in terms of market failure, for these policies and, with some exceptions, that continues to be the case today.

Notwithstanding the significance of the above, a number of types of market failure have been identified that are used to justify supporting small firms, such as the dilution of monopoly power and as an agent of competition policy, the presence of imperfect information, positional and resource disadvantage (including financial provision) and the presence of externalities (Johnson, 1990; Beaver, 1991; Stanworth and Gray, 1991; Curran, 1999). It is appropriate then to examine the case for state intervention in the small business sector and the arguments that have been advanced in supporting small firms. Probably the most frequently heard but the least sophisticated is that small firms are a major source of employment creation (Storey, 1982, 1992, 1994). This is examined in the following section.

Social and employment-related policies: small firms as employment generators

This is a major issue and has been the subject of much political rhetoric and rigorous examination throughout the last 20 years or so.

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The relationship of employment generation and the small business sector is at best a controversial one where the evidence is conflicting. The debate probably started in earnest as a consequence of pioneering studies in the USA, notably Birch (1979), that showed that some 66 per cent of all new jobs were created by firms employing fewer than 20 people and that 80 per cent of net new jobs were created by firms employing fewer than 100 people. In the UK, Fothergill and Gudgin (1979) and subsequently Gallagher and Doyle (1985) and Doyle and Gallagher (1987), applying similar techniques to data covering the period 1971-1981, concluded that 36 per cent of new private sector jobs were created by firms employing fewer than 20 people and 52 per cent by those employing fewer than 100. Reduced figures for the UK are to be expected because small firms account for a reduced proportion of employment. There are also significant differences in the economic complexion of the UK that can be expected to result in a different outcome. However, the results of some of these studies have been challenged, notably the work of Birch (1979), by Armington and Odle (1982), who question the use and interpretation of the data used. Both the methodology and the evidence for the findings by Birch (1979) have been vigorously challenged and the results have certainly not been replicated in the UK or elsewhere.

One of the most vociferous and consistent critics of the job-generating capacity of the small firm sector is Storey (1982, 1991, 1992, 1994) (also Storey *et al.*, 1987), who contends that policies advanced to encourage new firm formation are nothing more than a lottery. The problem for policy makers is that at start-up it is extremely difficult to distinguish between those firms that will succeed, in the sense of creating sufficient numbers of jobs, compared with those that fail. Furthermore, the high mortality rate of new firms is endemic and central to the small firm sector. An important and consistent research finding from Storey's work is that employment growth in small firms is heavily concentrated among the few, with some 4 per cent of the firms that start in business over the course of the next decade providing some 50 per cent of net new jobs. This has been endorsed by other studies including Gallagher and Miller (1991); Smallbone *et al.* (1992); Atkinson and Meager (1992).

In short, the evidence from these studies classifies the small firm population into three categories: first, short-life firms that are unlikely to trade for more than three years; second, firms that are likely to survive for a considerable period, but which are unlikely to create significant numbers of jobs; third, a tiny proportion of small firms (4 per cent), that are disproportionately important for employment generation and to the economy. Storey (1992) and his colleagues are strong advocates for a policy emphasis that should abandon support for new firm formation and instead reallocate resources towards encouraging the growth of this small proportion of existing firms in the sector, essentially a "picking winners" approach (Beaver and Jennings, 1995).

It is also the case that the magnitude of job creation in the small business sector is frequently exaggerated, often for political purposes. Furthermore, some of the more reputable research studies merely provide an accounting description of the sizes of firms that change employment. They fail to provide an economic cause of such changes. An obvious, contemporary example relates to the outsourcing of activities previously undertaken by large firms as part of their operational activities, in order to improve efficiency and reduce costs. From the perspective of employment accounting, what is recorded is that the large firm has shed jobs and that new (small) business formation has increased. Researchers continue to have problems in getting policy-makers to listen and to pay attention to their findings, some of which directly contradict the anecdotal and instinctive measures of support and assistance currently on offer. Politicians still seem unwilling to produce rationally based policies to facilitate the small firm in making its maximum contribution to the UK economy.

Although the evidence from Storey and other studies is compelling, it does not go unchallenged, with forceful, articulate and passionate arguments advanced from the start-up support lobby (Gavron *et al.*, 1998) and from recent statements from government spokesmen:

> For too long, small businesses have been regarded as the Cinderellas of the business world, yet they are some of the most enterprising and ambitious

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firms. They are the Vodafones and the *Prêt-à-Mangers* of the future and this government is determined to ensure small businesses have a voice at the heart of government, together with the local support and services they need to grow and develop. The Small Business Service will achieve this" (Stephen Byers, the then Department of Trade and Industry Secretary, speaking at the launch of the public consultation stage of the small business service in April 2000).

However, this is not to say that small firms do not create employment opportunities and have been instrumental in doing so in certain industries and sectors. There is a belief that small firms tend to be more labour-intensive and therefore more likely to create jobs, while larger organisations are more likely to utilise innovation and new technologies to achieve efficiencies and economies of scale, thus shedding labour. There is certainly substantial evidence to show that many large enterprises have "exported jobs" by relocating all or part of their manufacturing process to whatever part of the world offers the most favourable (and cost-effective) factors of production.

The quality, longevity, substance, remuneration and conditions attached to the jobs created by small firms are also somewhat controversial and comparisons with their large enterprise equivalents are often made (Marlowe and Patton, 1993; Marlowe, 2000). However, the current preoccupation with employment flexibility and deregulation make such comparisons hard both to analyse and to substantiate. Furthermore, the definition of what constitutes a full-time job and the statistical methods used to measure it render the examination of small business employment creation highly problematical. Questions of employment generation and the role of small firms have more to do with issues of competitive advantage, resource provision, ownership and management dynamics than measures of size *per se*. However, this is not to ignore the very real problems of both "dead-weight" and "displacement" in employment-centred small firm policies (Smallbone *et al.*, 1992; Storey, 1994). Indeed, the work by Gray (1990) and Gray and Stanworth (1989) together with that of the National Audit Office (1988) and Corry (1987) all suggest that employment creation takes place in relatively few of the Enterprise Allowance Scheme-assisted firms.

Macroeconomic policies

Before any attempt at critiquing the construction, delivery and effectiveness of other approaches to small business policy can be made, it is important to establish the areas of consensus. First, given their role in the economy, there can be no justification for ignoring the interests of small firms in the composition of legislation. Second, there can also be little justification for the legislature being unaware of the impact of legislation on smaller enterprises, particularly where that impact could be reduced or eliminated by more proficient drafting or by minor changes. Third, it is far from satisfactory that the volume of legislation relevant to the operation of a small firm is so extensive that in practice much of it is ignored by the small firm actors.

It was partly a consequence of the need for improvements in the deregulation and administrative simplification towards small firm policies, together with the need for consistency in the promotion and delivery of policy initiatives, that led to the establishment of the Small Business Service, in April 2000. It has been charged with the mandate to improve the delivery, quality and co-ordination of small business interests, assistance, training and support. It is no surprise that the government reviewed and re-organised its support and service provision, as the previous business support infrastructure attracted substantial criticism in its dealings with the perceived as opposed to the real needs of the small business sector. Furthermore, aspects of quality, consistency, professionalism and organisation have all received less than favourable acclaim. Whatever the long-term outcome and success of the Small Business Service and its impact on small business support, it is clear that, given the multiple and often conflicting objectives pursued by government, it is unlikely to cater for all the needs, wants and deficiencies of the small firm sector.

Nowhere has such criticism been more acute in small business policy than in the measures and activities that have been advanced to promote business development and growth. Indeed, given the statements by Hewitt (2000) to make the UK the world-class location for enterprise, it is hard to know with any certainty

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exactly what will be the policy instruments used in this attainment beyond that of obvious macro-economic measures. It is hard not to agree with Storey's (1994) conclusions from his authoritative work that government, in its dealings with small firms, needs to do less and better rather than more and worse. The clear message from the small firm community that comes across from so much of the research evidence is the creation of a suitable macroeconomic framework within which enterprise can prosper.

This has been endorsed by other writers and published reports (Bannock and Peacock, 1989; Aston Business School, 1991; Richardson, 1993; Deakins, 1999; Forum of Private Business, 1999) that confirm that small firms seek an environment in which there are low inflation, low interest rates, steady economic growth and a high level of aggregate demand. It is the ability of government to deliver these macroeconomic conditions which is the main influence on its judgement of competence by the small business sector. In practice, of course, every government would like to achieve these objectives, not only for small firms but also for all firms in the economy. Nevertheless, the macroeconomic framework appears to be the acid test by which small firms judge the economic effectiveness of government. Notwithstanding the above, substantial progress has been made since a small business policy was first accepted by the UK government as being a necessary item on its agenda. Indeed, the recognition that the sector is in some way disadvantaged and that its problems are different, special and need attention is now accepted by most enlightened governments as a given. However, there remains a need for government to promote greater clarity and continuity in articulating policy towards small firms, and especially to differentiate between small firms that have the ambition to grow and embrace innovation and risk-taking strategic management practice and those that do not.

Conclusion

To conclude, it is difficult not to agree with the concluding remarks from the research from Georgellis *et al.* (2000), who note that one of the most important implications for policy, management and strategy (from their findings) is the criticality of the entrepreneurial culture of the small business sector of the UK and the need to encourage the ambition for growth and its associated tolerance of calculated risk taking. Their work does not refute the consistent finding showing that many small business owners are interested in independence rather than wealth creation, but argues that, if there are to be innovative policies for small firms with the goal of generating a more prosperous economy with enhanced employment opportunities, then public intervention must favour the encouragement of entrepreneurial motives. Governments cannot make small firms innovate and embrace new management structures and business models. Small firms and the entrepreneurs that drive them must want to do this for themselves, to pursue growth and development and exploit new market opportunities in a strategic framework. However, government can do more to create the right economic, fiscal and regulatory framework within which innovation and entrepreneurship can flourish. It can also help raise the awareness of the benefits of innovation, of adopting progressive strategic management practice and provide sufficient financial resources for efficient business support services.

Government and policy makers need to understand much better the motivations and requirements that shape and drive the modern, wealth-producing firm. In short, government and the business support infrastructure that it has created must also be innovative, imaginative and progressive. This can only be achieved by a radical change in policy, commitment and approach that embraces all aspects of the support network and promotes the innovative enterprise to the position and significance that it rightly deserves and requires.

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