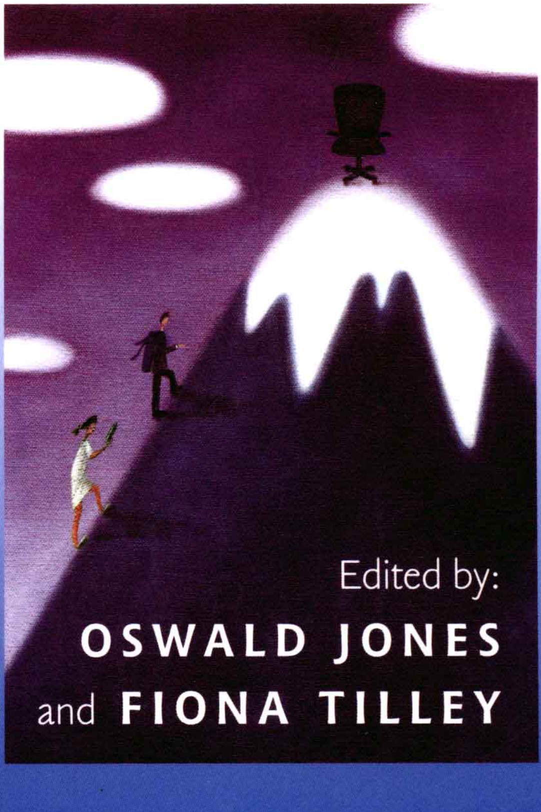
Competitive Advantage in SMEs

ORGANISING FOR INNOVATION AND CHANGE



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Library of Congress Cataloging-in-Publication Data

Competitive advantage in SMEs : organising for innovation and change / [edited by] Oswald Jones, Fiona Tilley.
p. cm.
Includes bibliographical references and index.
ISBN 0-470-84334-9 (pbk. : alk. paper)
1. Small business – Management. 2. Small business – Technological innovations. 3. Business planning. 4. Competition. I. Jones, Oswald. II. Tilley, Fiona.

HD62.7 .C653 2003
658.02′2 – dc21

2002191076

British Library Cataloguing in Publication Data

A catalogue record for this book is available from the British Library

ISBN 0-470-84334-9

Typeset in 10/12pt Palatino by Laserwords Private Limited, Chennai, India
Printed and bound in Great Britain by Antony Rowe Ltd, Chippenham, Wiltshire
This book is printed on acid-free paper responsibly manufactured from sustainable forestry in which at least two trees are planted for each one used for paper production.

COMPETITIVE ADVANTAGE IN SMEs

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David Taylor worked in the advertising industry before becoming a lecturer at MMUBS. His main teaching responsibilities include OB, HRM and entrepreneurship, and his current research interests focus on the role of personal networks in the learning and decision-making processes of owner-managers. David is also visiting lecturer at the University of Zagreb and Business College of Athens.

Dr Scott Taylor is a lecturer in Organisational Behaviour at Birmingham Business School, University of Birmingham. He researched HR issues in small firms for his doctoral thesis (undertaken at MMUBS) and is currently involved in research into the Investors in People initiative, corporate universities and workplace spirituality.

Dr Fiona Tilley recently joined the School of the Environment at Leeds University as a lecturer in Environment and Business. Prior to this, she spent two years as a senior lecturer at MMUBS and three years as a senior research associate at the University of Durham Business School. She has published on topics relating to small firms and sustainable business in a variety of journals.

Jane Tonge's background is in the public relations industry, where she worked in-house at an agency level and freelance, especially dealing with the B2B (business-to-business) sector. Jane is currently in the second year of her PhD, which is concerned with the development of agency–client relationships in the public relations industry, focusing on SMEs.

Liz Walley joined MMUBS ten years ago and currently teaches sustainable development and environmental management modules. Prior to MMU, her 15 years' work experience was in consultancy, banking and industry. Liz has published in the areas of environmental management and transition in Eastern Europe. Her current research focus is organisational 'greening'; specifically the roles of environmental champions and green entrepreneurs.

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PREFACE

As set out in Chapters 1 and 2, this book originated with our interest in the importance of encouraging small and medium-sized enterprises (SMEs) to adopt a more proactive stance towards improving competitive advantage. Interest was stimulated by a number of projects undertaken at MMUBS (Manchester Metropolitan University Business School) which have addressed this issue. Since 1998, the Business School has carried out three ESF (European Social Fund) projects concerned with improvements to supply chain skills within the SME sector (Homan *et al.*, 2000). The first project focused on mapping management skills and techniques as a basis for implementing management development within manufacturing-based SMEs. The second project concentrated on establishing future management development needs as perceived by SMEs themselves and by lead organisations in their supply chains. The research also included current and future skill needs of craft and technical workers. The main objective of the third project was to design an audit tool to assist companies in identifying staff skill development needs arising from fundamental changes taking place within supply chains. Project success has been aided by the participation of key collaborators, including the North-West Development Agency, which helped to identify the skills needs of SME suppliers. Significant private sector partners included the Forum of Private Business, Kelloggs, BNFL (formerly British Nuclear Fuels Ltd), BAE Systems, the chemical company, Ineos Chlor, and Cussons. Over 300 SMEs have participated in the research to date (see Chapter 12).

'Towards a Healthy High Street' was developed by the Department of Retailing and Marketing at MMUBS. Specifically aimed at independent retailers, the initiative builds on expertise established over the last decade. Independent retailing is an important factor in the vitality of local economies but is under threat from structural economic change, major multiple retailers and changing patterns of consumer expenditure. The first project, Retail Skills Forecasting, was part-financed by the European Social Fund (Objective 4) and focused on sectoral changes and their impact on the skill needs of owner/managers. 'Towards a Healthy High Street' Project I, supported by ESF Objective 4 funding, investigated the take-up of training and support systems designed to improve the sector's competitiveness. The initiative is now in its third stage and 'Towards a Healthy High Street II' (ESF Objective 3) has helped to develop a University Certificate in SME retailing as well as a nationwide mentoring programme for small retailers in light of recommendations made in previous projects. The programme's success can be attributed to the wide range of private and public sector partners involved (British Institute of Retailing, Association of Convenience Stores, Institute of Grocery Distribution, J. Sainsbury plc, B&Q, London Institute and Distributive Trade National Training Organisation and the Bakery National Training Organisation). Partnership ensures each project is relevant and has the 'voice' to influence policy and practice. The initiatives are helping to 'protect and encourage diversity within the sector' by looking at specific barriers to enterprise faced by small retailers including location, race, gender and age. Early in 2002, the partnership obtained substantial ESF EQUAL funding for a further project which will run for three and a half years.

MMUBS recently acquired ERDF (European Regional Development Fund) support for a project, which started in January 2002, designed to improve the competitiveness of SMEs in the north-west of England. This project builds on existing strengths in terms of understanding and interacting with SMEs. The overall project aim is to build better links between MMUBS and the small firm community by focusing on improvements to management practices related to innovation, enterprise, sustainability and performance management. Four experienced business analysts have been employed to engage directly with 300 SMEs and to help introduce new skills aimed at improving the competitiveness of individual firms, as well as impacting on the region as a whole. The project has also led to the creation of a Centre for Enterprise which will help the small business community make better use of resources within MMUBS by encouraging links, both formal and informal, with academic staff, postgraduate and undergraduate students.

Research over the last ten years indicates that entrepreneurs from socially deprived areas are excluded from access to support, advice and finance (Portes and Sensenbrenner, 1993; Greve, 1995; Fielden *et al.*, 2000). The New Entrepreneur Scholarship (NES) is a Treasury initiative that seeks to address this issue through the development of appropriate training materials. MMUBS was responsible for one of three nationwide NES pilots which helped entrepreneurs from socially deprived areas develop their business ideas. The DfEE (Department for Education and Employment) (now DfES) (Department for Education and Skills) together with the Prince's Trust and local enterprise agencies sponsored the scheme, which attracted fourteen participants from the Greater Manchester area. The programme, based on 'action learning' ran for six months, during which time the group met regularly to develop their ideas and also attended seminars given by successful role models from the region (Jones and Boles, 2002). The Learning and Skills Council (in partnership with the Association of Business Schools and the Federation of Enterprise Agencies) rolled out NES Nationwide in autumn 2001, and MMUBS was chosen as one of the institutions to participate in the expanded scheme. To date, three cohorts have attended NES programmes, and more than 100 entrepreneurs have been provided with direct support for their nascent businesses.

The Business School has also been involved in projects carried out within other faculties of Manchester Metropolitan University. For example, SMILE (Skills for Missing Industries, Leaders and Enterprises) was part of the ESF Adapt project undertaken by a multidisciplinary team led by the Centre for Employment Research, part of Manchester Institute for Telematics and Employment (MITER). The aim of SMILE was to identify and develop effective managerial strategies and new models for managerial learning, and highlight skill deficiencies within the sector. In doing so, the intention was to inform the strategies of relevant support agencies, training suppliers and SMEs themselves. The project's start pre-dated the launch of the North-West Development Agency's regional strategy document (Towards 2020) which stresses the importance of investment in businesses and ideas. SMILE's objectives are closely related to the NWDA's strategy as well as to the north-west's regional skills and e-learning strategies. SMILE was preceded by CLIME (Creative Leadership in Media Enterprises) which was an ESF Objective 4-funded project to support 'creative' SMEs operating in Greater Manchester.

Such practical engagement with the small firm community provides MMUBS staff with clear insight into problems associated with managing such firms. As discussed in Chapters 1 and 2, our aim has been to draw on this experience to help provide a better understanding of why competitive advantage is important to SMEs as well as improving understanding of mechanisms by which owner-managers can improve the performance of their firms. The principle on which contributors were asked to reflect was the extent to which 'large firm' concepts such as human resource management (HRM), strategic management and supply chain management are directly relevant to owner/managers trying to improve their firms' competitiveness; although, as pointed out by many experts, small firms are not simply 'little big firms' (Dandridge, 1979; Welsh and White, 1981) and therefore we do not suggest that such concepts can be applied indiscriminately.

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CONTENTS

Chapter 1

INTRODUCTION

Fiona Tilley and Jane Tonge

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)

Criterion	*Micro firm*	*Small firm*	*Medium firm*
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 Jennnings 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