ROUTLEDGE REVIVALS

Small Firms and Economic Development in Developed and Transition Economies: A Reader

Edited by **David A. Kirby and Anna Watson**

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Foreword

Since the late 1980s considerable attention has been paid to the development of new small firms and the creation of enterprise cultures. With the collapse of communism and the opening up of the economies of Central and Eastern Europe, small and medium sized enterprises have been seen as the vehicle for economic and social development in these countries and many of the lessons learned in Western Europe have been transferred through national and European aid programmes and other initiatives. In 'Small Firms and Economic Development in Developed and Transition Economies', Kirby and Watson present a series of 11 essays by leading academic scholars from throughout Europe to provide a timely review of the achievements to date and the challenges facing those responsible for driving the economies of a free-market Europe. Not only do the individual essays give detailed insights into the issues facing the developed and transition economies, and the approaches being taken to promote economic development through small and medium sized enterprises, but there is a coherence to the Reader that so frequently is lacking from such works. In part, this is provided by the editorial team who have skilfully sequenced the essays and provided the synthesising commentary and observation very necessary in this sort of work. Overall, therefore, the work makes a very valuable contribution to the body of understanding on the role of small and medium sized enterprises in economic development in general and the developed and transition economies of Europe in particular. Clearly, it is not without its limitations, as essay collections of this type so frequently are, but the publishers and the two editors are to be commended, in particular, for taking the initiative and producing a statement that is timely, relevant and, importantly, readable.

Professor Tom Cannon
London

Acknowledgements

This Reader is based on a selection of papers presented at the XIIIth annual Research into Entrepreneurship workshop, which was held in London in November, 1999. The editors would like to thank all those who participated in the conference and helped contribute to its success. In particular, they would like to thank the organising committee and EIASM for their support, especially Graziella Michelante and Katrin Stichtenoth. Finally they would like to thank the authors for allowing their work to be published in this collection, and, importantly, for following instructions! Their compliance eased the editorial task considerably.

Not all of the papers presented at the workshop are reproduced here. Others were published in a special edition of Small Business Economics. The editors would like to acknowledge those delegates whose papers appeared in the workshop proceedings but in neither of the two edited works. Their forbearance and understanding is greatly appreciated.

Chapter 1

Introduction

David A. Kirby and Anna Watson

Introduction

Over the past decade, there has been considerable academic debate over the contribution of small firms to job generation. Birch's seminal research (1979) suggested that in the United States (US) between 1969 and 1976 something like half of the gross job gains were created by new ventures and, of these, half were produced by independent entrepreneurs. While these rates of job creation may be somewhat over-optimistic, Storey (1994) has concluded that small firms do create jobs at a faster rate than large firms and that they are more consistent, since they are less influenced by changes in the macro economy. Indeed, in the United Kingdom (UK) between 1995 and 1999, new businesses created 2.3 million jobs and the vast majority (85%) were provided by micro, small or medium sized enterprises.

The contribution of SMEs to the economy is not just one of job creation, however. According to research undertaken in the 1980s and 1990s by such bodies as the US Department of Commerce and the National Science Foundation, US small entrepreneurial firms were responsible for half of the country's innovations post World War II and 95% of all radical innovation. In addition they were responsible for twice as many innovations per research and development (R & D) dollar spent than larger firms, and provided 24 times as many innovations per R & D dollar than megafirms with more than 10,000 employees. Despite this impressive contribution, it should be remembered that the vast majority of small firms are not innovative (Birch, 1979). Small firms in the 'sunrise' industries (high technology sectors including biotechnology, computer software and electronics industry), however, have been perceived as the source of innovation and economic growth and regeneration throughout the world (Berry, 1998 and Eisenhardt and Forbes, 1984). In order to flourish, though, such enterprises require, according to Galbraith (1984), a complex infrastructure that comprises universities, government research laboratories and mature firms. However, very few small businesses survive, and an even smaller proportion actually grow (Storey, 1994). Clearly, in order for their full potential to be realized in terms of job creation and economic growth, small businesses require support.

Given the importance of small and medium sized enterprises to economic prosperity and growth, it is of no surprise, perhaps, that since the collapse of the "Berlin Wall" on November 9th, 1990, and the opening up of the former socialist economies of Central and Eastern Europe, small businesses have been seen as the vehicle for economic and social development. As has been found in mature economies, however, small businesses require support if they are to survive and grow. In Western economies the need for support infrastructures has long been recognized by government and there is often a comprehensive and well-established system, offering a variety of 'hard' (tangible) and 'soft' (intangible) measures. Many of these have been transferred to the transition countries of Central and Eastern Europe through national and European aid programmes and initiatives.

Despite the well established support systems in Western economies, there is little consensus as to the impact of support measures, with Curran (2000), for example, finding little evidence of any significant impact on the performance of small businesses that have accepted support.

This Reader brings together some of the leading-edge research from across Europe in order to explore these key themes of SME employment generation, innovation and support needs. Chapters 2-6 provide insights from Western Europe, whilst the latter chapters examine some of the key challenges faced by SMEs in the transition economies of Central and Eastern Europe.

Employment Generation

As highlighted earlier, one of the key reasons governments across the globe are eager to encourage and support small businesses has been their perceived contribution to employment. However, the evidence suggests that it is only a small proportion of businesses that actually make any significant contribution in this respect. Indeed, Birch's (1979) study suggests that it was the 'gazelles' (new ventures that grow rapidly and are based on significant innovation) that produced 87% of the new jobs in the US between 1984 and 1987, despite only accounting for 5% of the new ventures.

The contribution of high growth firms to employment creation is thus explored in the first of the contributions to this Reader. In chapter 2, Davisson and Delmar investigate the role of high growth firms in the creation of new employment in Sweden during the 1987-1996 period. The data set used captures both enterprise and company group levels of analysis, enabling organic growth to be separated from growth from acquisitions, because, as is argued, growth through acquisition is unlikely to contribute to job creation.

The issue of employment generation is also explored in chapters 7-12, in the context of a number of different transitional economies, namely: Ukraine, Moldova, Belarus and the Russian Federation (Chapter 7); New Germany (8); Slovenia (9); Latvia (10), Romania (11) and Bulgaria (12).

The reader is directed to chapter 13 for a synthesis of the findings.

Innovation and Technology

As highlighted by North, et.al (chapter 3), innovation is key to competitiveness. As such, this is an area of interest to policy makers at both a regional and a national level, though, as the authors observe, defining innovation in the context of SMEs is problematic. Given the traditional industrial base of the Lee Valley area of North London, they argue that it is appropriate to adopt a broad definition of innovation that includes 'new to firm'. Having adopted such a definition the authors explore innovation issues in the regional context and identify the support needs associated with the innovation process within SMEs, and the extent to which these are being addressed within the region. This theme of innovation is continued in chapter 4 where Chamanski and Waggo focus on new technology based firms (NTBFs) in Norway. Using a multidisciplinary approach, they develop an analytical framework to explore the organizational success of NTBFs.

The financial barriers to the success of innovative companies is the subject of chapter 5. In a study of the financial markets in Germany, Ruda considers the impact of the Neuer Markt in helping small companies overcome the capital constraints they face, while in chapter 6, Lam considers how innovative SMEs can be developed around research institutions or universities, using a theoretical framework based on Gidden's structuration theory.

Support for Entrepreneurship and Small and Medium Sized Enterprises

In the United Kingdom, as with other developed economies, there are comprehensive and well established systems in place to support SMEs. Whether these systems are effective and meet the needs of new ventures or small businesses is, however, a matter of debate. Indeed, it has been suggested (Bennett and McCoshan, 1993, p. 78) that there is a 'general pattern of fragmentation and overlaps which is confusing, complex and offers no assurance that quality networks can be supported', and that all too frequently 'too few small business appear willing to accept support' (Curran 2000, p. 45). Such arguments as to the relative effectiveness of the different measures, and the confusion of having so many different forms of support on offer, comes from a position of privilege compared to the situation in the newly democratized transition economies, where the support system is often rudimentary or non-existent (Mugler, 2000).

It is the transition economies that provide the background to the final chapters of this Reader. Chapters 7 to 12 each examine the experiences of different transition economies in their move towards economic liberalization and the strategies employed to assist entrepreneurs. In chapter 7, Smallbone and Welter take an institutional perspective on enterprise strategies in transition economies drawing on various projects in the Ukraine, Moldova, Belarus and the Russian Federation. Institutional theory is particularly relevant in this context given the inadequate and incompatible formal and informal institutions frequently found in these regions.

The impact of the wider environment on entrepreneurial behaviour is also explored by Pistrui, et.al in chapter 8. This chapter examines entrepreneurship in the New Germany, a unique context in which to explore whether and how entrepreneurs operating in economies facing very different challenges differ. The distinguishing characteristics and orientations of entrepreneurs in Eastern and Western Germany are compared across three dimensions, namely, individual characteristics, inter-social factors (family and personal alliance networks) and environmental perceptions.

In chapter 9, Glas and Drnovsek focus on the experiences of small businesses in Slovenia. As they observe, in Slovenia the importance of entrepreneurship for growth, job creation, innovation and prosperity has long been appreciated. As far back as the 1980s, measures were introduced to try to foster entrepreneurship. Against this background, this chapter analyzes trends in the number and nature of enterprises, along with the obstacles they face and the profile of Slovenian entrepreneurs.

Chapter 10 presents the findings of an investigation by Kuzmina into the peculiarities and trends of Latvian entrepreneurship during the transition period. A problem common to many studies of entrepreneurship in transition economies, and one faced by Kuzmina, is the scarcity of reliable statistics on SMEs. This problem is exacerbated by the number of different definitions of micro, small and medium enterprises that exists, not just between different countries, but within them, with different definitions used for tax and legal purposes, and those used by support agencies. It can only be presumed that, as enlargement of the European Union comes closer, a common (EU) definition will be used throughout both the Western and the transition economies.

The study by Catoiu and Veghes (chapter 11) of the present level of SME development in Romania provides a timely assessment of entrepreneurship after ten years of transition to a market economy. It highlights a number of factors that have contributed to the level of development of SMEs, and suggests potential solutions to be implemented in order to support the future development of this sector.

In the final contribution to this Reader, Mateev (chapter 12) provides an insight into the state of small business development in Bulgaria, a country with a relatively high proportion of newly established enterprises, compared with other transition economies. Barriers to development are identified, and recommendations made to help overcome them.

Conclusions

Over the past decade or more, small and medium enterprises have made an important contribution to economic development in the economies of both Western and Central and Eastern Europe. Particularly in the transition economies, where there was no indigenous enterprise culture throughout the whole of the communist era, the situation has not been easy. As the Reader will show, the SME sectors in these countries have been beset with numerous problems which, despite the transfer of "know-how" from the west, the support infrastructure has not always been able to overcome. Even so much has been achieved in only a relatively short period of time, though there can be little doubt that if a united Europe is to play a significant role in the global economy, much more will be expected of the SME sector in the first decade of the millennium. In a post-Fordist, post Communist era, large firms will continue to "downsize" and, with the continued break-up of mass-markets, SMEs will continue to play an important role. When this is coupled with the continued emergence of the new knowledge-based economy, even more will be expected of SMEs in both the transition and the developed economies of Europe, as elsewhere. Increasingly, they will be expected to contribute to the generation of wealth through the development of new knowledge-based innovations. How this can be achieved is a question that is exercising the minds of policy makers not just in Europe, but throughout the world. It is timely, therefore, that after a decade of "free-enterprise" in the transition economies of Central and Eastern Europe, and more than two decades of Enterprise development in the West, not only are the achievements of the small firm sector reviewed, but the future opportunities and prospects for SMEs are considered. It is this dual function that the Reader attempts to fulfil.

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Chapter 2

Hunting for New Employment: The Role of High Growth Firms

Per Davidsson and Frédéric Delmar

Introduction

A large number of studies from various countries have in recent decades arrived at the conclusion that small and medium sized firms (SMEs) are of large and/or growing importance for new job creation (see, e.g., Birch, 1979; Davidsson, Lindmark & Olofsson, 1994; 1996; Fumagalli & Mussati, 1993; Kirchhoff & Phillips, 1988; Picot & Dupuy, 1998; Spilling, 1995; Storey, 1994). Therefore, few would deny today the empirical truth of the notion that the majority of new jobs emerge in small firms. There are, however, opposing views as regards how small firms' job contributions are distributed across the population of business organizations. Studies from the US (Birch & Medoff, 1994; Birch, Haggerty & Parsons, 1995) and the UK (ref. in Storey, 1994) point at a few rapidly growing firms as accountable for almost the entire effect, whereas Swedish data rather suggest that small changes in a large number of units sum up to large effects on the population level (Davidsson, Lindmark & Olofsson, 1994, 1996).

The two hypotheses have implications for the fundamental reasons behind a country's structure of business organizations and its (in)ability to create new employment. Taking Sweden's high unemployment during the late 1990s as an example, one reason may be that too few new firms were started (Delmar & Davidsson, 1999). The limited in-flow of firms, rather than their subsequent development, would therefore be the cause for too few new jobs being created. Another possible reason would be a lack of growth firms in the Swedish economy. That is, a sufficient number of new firms are started but subsequently too few of them enter into an expansion phase. This line of reasoning matches well with the widespread belief in the Swedish 'hourglass', i.e., that the size structure of firms is heavily skewed towards the top and the bottom, with a relative lack of medium-sized firms (Meyersson, 1995; Henrekson & Johansson, 1997). The non-Swedish reader may note that this does not seem to be unique to Sweden. And indeed, some investigations claim that the Swedish firm size structure does not deviate markedly from the EU average (Nutek, 1994), and there are even signs that the 'hourglass' metaphor is only partly correct for Sweden (Henrekson & Johansson, 1999).

While there have been earlier attempts to investigate high-growth firms in Sweden (Blixt, 1997) there is no doubt that our knowledge about the existence and contribution of such firms is incomplete. It is also highly likely that Swedish results on this matter are indicative for several other EU countries. This leads to the first research question to be pursued in this study, namely:[1]

How much new employment do the most growing firms in the Swedish economy create?

The answer to this question is also the starting point for discussing whether or not there is a lack of high growth firms.

Usually, a question of the above type is investigated by studying the size development of enterprises (the legal unit) over time. As companies may change their legal form and structure such an analysis runs the risk of yielding biased results. This problem is all the more serious as high growth firms are probably more likely to undergo changes in their legal-structural make-up than are stable firms.

This problem has been handled in two ways. Firstly 'company code' has not been accepted as *the* criterion for following a unit over time. When a company changes ownership, industry (SIC code) or location it gets a new company code in Statistic Sweden's registers. In order to be able to follow surviving units through such changes, establishments' identity codes have been used instead, which are more stable, as the point of departure. If essentially the same group of establishments appear in the registers under different company codes in different years, they remain in the data set as the one and same surviving firm.

During the development history of a high growth firm it is likely that eventually it reaches a point where growth no longer occurs (only) within the original unit but (also) by adding new units (subsidiaries; a holding company). Thus, the enterprise becomes a company group, and if only the original company's size development is followed a large part of the company's (now: the company group) growth is missed in the analysis. An ideal study, then, would follow units first as individual enterprises and then, when applicable, as company groups. The data set used gives some, but not an entirely satisfactory opportunity to conduct such analyses. Therefore, an easier method is needed to check whether the choice of unit of analysis has a major impact on the results concerning high growth firms' employment contributions. This is achieved by conducting a separate analysis on the company group level. Hence, the second research question becomes:

How much new employment do the most growing company groups in the Swedish economy create?

Another distinction that is rarely made in this type of study is whether the studied growth is organic or achieved through acquisition activities. From an employment creation perspective this distinction is crucial, and the reason why it is so often overlooked is probably that data are so organized that they do not allow separate analysis of these two types of growth. The event that existing business activities

[1] We are grateful to the Swedish Council for Work Life Research (RALF) and Knut & Alice Wallenberg's Foundation, who funded this research.

and associated employment are moved from one organization to another may be associated with productivity and competition changes that are important for the progress of the economy. The growth of the acquiring company does not, however, represent new jobs. When a firm grows organically it is, arguably, more likely that the new employment represents a genuine addition to the economy.

Through the above-mentioned link to the establishment level the data set offers the unique possibility to distinguish between acquired and organic growth. This is because it is known for each year whether an establishment is (i) old to the economy and to the firm, (ii) old to the economy but new to the firm, or (iii) new to the economy and to the firm. The initial stock of jobs in units of type (ii) are regarded as growth-through-acquisition while all other size increases are regarded as organic growth. The third research question is thus:

How large a share of high growth firms' and high growth company groups' expansion is organic?

Apart from these three questions the analysis will also be broken down by different categories of firm. The fourth and final research question, then, becomes:

How are high growth firms and high growth company groups and their employment contributions distributed across industries, size classes and firm age groups?

The Data Set

The raw data were collected from Statistics Sweden. Working closely with their register experts,[2] data from three different registers were combined: the Central Firm and Establishment Register (Centrala Företags och Arbetsställeregistret [CFAR]), The Register of Company Groups (Koncernregistret), and the Register of Foreign-owned companies (Registret över utlandsägda företag). Ten annual versions of each register were combined in order to create a data set for the specific purpose of analyzing high growth firms. As mentioned above, separate firm and company group versions of the register were created. In the firm level analysis both independent and company-group affiliated companies are included. Each company in a company group is included as a separate case as long as it fulfills other criteria. In the company group level analysis the entire company groups are the cases, while independent companies without company group structure are excluded from the analysis.

The data include all commercially active enterprises or company groups within the non-government sector in Sweden as long as they had at least 20 employees in November, 1996.[3] There are 11,515 such enterprises (both independent and affiliated

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[2] In particular Peter Thorén at CFAR has made a major contribution to making possible the analyses presented in this paper.

[3] The answers to a research question are always in part contingent on the method choices the researcher makes. Even if it can be hoped that method differences do not lead to diametrically opposing conclusions it is therefore important to understand the assumptions and conditions that