

Summary of “The Economics of Small Firms

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Abstract

Peter Johnson, Emeritus Professor of Business Economics in the Centre for Entrepreneurship at Durham University. He has published a wide range of studies on new and small firms.

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Introduction

The book is divided into ten chapters. Chapter 1 “Introduction” has been built on the backdrop of economic importance gained by small firms over the decade. The author presents interpretations for increased policy interest in the economic role played by small firms. The author derives the development of small firms from the collapse of communism in Eastern Europe vis-a-vis enlisting the benefits of SMEs in developing nations. The author also captures the shift of interest towards the growth of small firms in academic field. However, according to him economists have been the slowest in showing their interest in these firms. The reasons attributed for this are economic in nature namely small size of firms, economies of scale, competition and contribution of literature.

Chapter 2 “Why study small firms” brings out all possible explanations for growing policy interest in small firms. The author presents summary data on small firms in Europe across different countries. The author addresses some definitional issues of small firms referring to the report of the Bolton Committee (1971:para 1.4). Although to analyze the small firms, the study of complex family, social and personal relationships in which these firms operate is important however, the author restricts the scope of the book to legally independent firms.

Chapter 3 “The entrepreneurial function” examines the contributions of various economists who broadly classified entrepreneurial function under the heads of risk bearing, co-ordination and management, innovation and market alertness. Cantillon's and Frank Knight approach of risk bearing and uncertainty, JB Say support of entrepreneurial function as coordinator, Joseph Schumpeter identification of innovations as entrepreneurial function and Kirzner theory of entrepreneurial function as market alertness has been elaborated effectively. However, almost all the writers

have separated entrepreneurial function from that of a capitalist. “Schumpeter (1934:75), like many previous writers on the entrepreneur, made a clear conceptual distinction between the entrepreneurial and capitalist function....”. The author emphasizes on the function and not on individual entrepreneur which is a much broader context in nature. Later part of the chapter focuses on intensity and supply of entrepreneurship, which is not being viewed from a new, or small firms lens as the author believes that might limit the entrepreneurial activity.

Chapter 4 “Setting up in business” addresses the author's work done on setting up of businesses. The author explains the decision of setting up of a business by using a model based on present value of self-employment income and present value of paid employment income. The model brings out all the possibilities of favouring the setting up of business and various assumptions. Further, the author investigates the personal and other characteristics of self-employed and the related correlations “frequency of job change and experience of unemployment enhanced the livelihood of self employment....”

Chapter 5 “Variations in formation activity” investigates the variation in formation activity of small firms by analyzing individual and regional dataset on early state enterprise activity (ESEA) of 35 countries ranked by % of adult population engaged in enterprise activity available in GEM (2005). The analysis highlights the international differences in formation. However, as the data on OECD countries have been utilized, the author poses a question whether the findings of the analysis may alter if wider sample of countries are considered. Further, differences across regions and industries have been critically examined by taking UK as a special case and variations in birth rate across different regions and industrial sectors in 2004 have been represented in a table. Hotel & restaurant and real estate, renting and business sector are found to have highest birth rate in the

United Kingdom. Another finding was that a high positive correlation exists between birth and death rates for which the author has drawn arguments. The author has exhaustively studied the various factors which impact the formation activity using accounting and economic modeling approaches. In the last section of the chapter, empirical studies have been studied to analyze demand and supply side factors of formulation. However, these empirical studies have raised some questions for future research as differences in results across studies by different authors have been reflected.

Chapter 6 “Survival and Growth” examines the key issues of survival and growth of small firms. Empirical work done in this regard have been extensively referred and analysed. It was found that there exists positive relationship between size and survival. The author referred to the exhaustive work done by Audretsh to identify reasons and various conditions for the survival of small firms. In the later part of the chapter growth factors and stages of growth of small firms are studied at length. The author has tried to bring out the barriers to growth by interpreting survey response by over 8000 SMEs in United Kingdom in 2003.

Chapter 7 “The economic role of small firms” highlights the various economic contributions made by small firms with respect to employment, innovation, competition, economic growth. However, some of the issues on the contribution made by SMEs have been also discussed. The author has raised three key questions on the employment generation by SMEs and the same have been addressed in the chapter.

Chapter 8 “Finance” attempts to identify and interpret financing gaps for small firms based on United Kingdom experience. In the first section of chapter the author

compares some key financial ratios of manufacturing and non-manufacturing SMEs with respect to large firms for the period (1989-1990). The author tries to highlight differences in the structure of corporate financing for that period. It was found that SMEs are comparatively dependent on short term financing. The author presents his arguments for SMEs requiring more short-term finance. Second section investigates the historical data of small firms funding in United Kingdom. 'Macmillan gap' for long term finance for SMEs as identified by Macmillian Committee Report on Finance and Industry is a significant reference. Supply and demand analysis have been undertaken to interpret the various financial gaps of SMEs. However, “only some of which may be regarded as potentially giving rise to market failure”.

Chapter 9 “Issues in Policy” discusses the various policy measures taken by UK government to boost SMEs and the key arguments namely role model effect, infant firm arguments, informational problems, for market failure of policies have also been addressed. The author also discusses the policy delivery mechanisms and issues pertaining to evaluation of these policies have also been addressed. A case study in policy development in the northeastern region of England has been effective to address some of the policy related challenges.

Chapter 10 “Some implications for small business management” summarizes all the chapters and key issues with regards to every chapter have been highlighted. The author views that although the book may not be a ready manual for management of small business firms still it reads the reader with important aspects of small business firms.