What really happens to SMEs in a global economic recession?
UK evidence on sales and job dynamics

Setting the Scene

The financial crisis, which began in September 2008, contributed to a fall of 6.4% in UK GDP in the subsequent six quarters that constituted the official recession. This represents the loss of three years of trend level economic growth for the UK economy. At a time when larger businesses shed vast numbers of employees, and general unemployment rose by 674,000, policy-makers increasingly looked to small and medium enterprises (SMEs) to provide new employment opportunities and help drag the economy out of recession (BIS, 2013). The implicit assumption being that (a) SMEs are more flexible and resilient (Smallbone, et al., 2012; Bednarzik, 2000; Binks and Jennings, 1986), and, (b) SMEs are more labour intensive (Cowling, 2003; Robbins, et al., 2000), and, (c) that periods of disequilibrium create new opportunities for entrepreneurs (Schumpeter, 1942; Parker, et al, 2012).

Our research contribution

It is the intention of this paper to use a unique longitudinal data set for the UK, which spans the period leading up to the financial crisis in September 2008 and all through the subsequent recession, to address 4 key questions;

- How many SMEs have still managed to grow in the current recession?
- Has the small business sector being able to maintain its employment levels during the current recession?
- What types of entrepreneurs and SMEs have shown the capability to grow and create jobs during the current recession (is there an entrepreneurial human capital (EHC) effect)?
- Can SMEs provide the future growth that will create new employment opportunities as the economy emerges from recession?

In doing so, we hope to add to our general understanding of what really happens to the SME sector during a severe economic downturn. This will enable us to speculate about the potential contribution of the small business sector to future economic growth. This is of great importance given the political onus placed on the small business sector to provide new jobs and economic prosperity in the future.

Our Research Findings

In terms of the question as to how many firms are still capable of achieving growth during the recession, we note that between 20 and 30% of firms grew their sales which is much less than the 50% that grew in more favourable economic conditions prior to the recession. Equally, between 15 and 20% of firms grew their employment during the recession, but again this is lower than in the pre-recession period when 30% grew their employment. This suggests that the recession had a very strong adverse effect, at least in the first six months, on the ability of firms to grow.

During the recession, it is the access to financial resources rather than the more subjective measures of human capital that are more important determinants of recessionary growth, especially regarding sales. This suggests that in more stable economic environments many more firms are able to take advantage of general growth in demand without having to compete vigorously with other firms and entrepreneurs. Nevertheless, during a recession when the whole small business sector is further constrained by limited resource, only the entrepreneurs that have access to essential financial resources can manage to achieve growth. Yet it is also the case that willingness to seek growth was found to be a positive attribute in more stable economic conditions, but this did not hold in a recessionary environment.

Further, we note that under any economic conditions there is a positive synergy between sales and employment growth. This positive relationship is only slightly diminished in terms of its effect size during recessions. What this does suggest is that any policy levers that stimulate either job growth or sales growth will be more likely to create a positive economic multiplier. In relation to our fourth, and final, question relating to future growth orientations, we have several important insights. Primarily, general growth orientations do decline during a recession, with 10% fewer firms reporting these intentions, but this depressing effect begins to recover within six months of the onset of the recession.

Conclusions and Implications

To summarise our overall findings, we are drawn to the conclusion that recessions do take their toll on the smaller business sector, but these effects appear relatively short lived in general, and affect specific types of small businesses and entrepreneurs more than others. But perhaps our most significant finding is that in a stable, and growing macroeconomic environment growth in more randomly spread across all types of firms and entrepreneurs. This is not true in periods of economic downturns when only the best entrepreneurs, in terms of larger size and better access to finance, are able to grow their businesses.

For policy-makers our results suggest that helping firms to access finance may create a positive growth multiplier, and many countries have adopted this policy position. But more importantly, any policy levers that stimulate jobs or general spending in the economy will help create a positive jobs-growth multiplier as they tend to operate in parallel in smaller firms. As to the general capability of the SME sector to grow and help drag depressed economies forward, our findings do offer some support for the contention that SMEs are more resilient and flexible to cope with the disequilibrium caused by economic recessions.

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