

Published in:

Productivity and the pandemic challenges and insights from Covid-19
[ISBN: 9781800374591] / edited by Philip McCann and Tim Vorley
(Edward Elgar, 2021).

Chapter 4.**Implications and impacts of the crisis on micro businesses and their future resilience**

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Introduction

Small businesses are widely regarded as an important aspect of the productivity puzzle in the UK, representing over 98 per cent of the business base. At the start of 2019 SMEs under 250 employees accounted for 61 per cent of total employment and 52 per cent of turnover in the private sector, with micro businesses and sole traders employing under 10 accounting for 33 per cent and 22 per cent respectively. The concept of this long tail of less productive businesses is one that has come to capture the imagination of researchers and policymakers alike. Current analysis of the productivity puzzle suggests that this tail is considerably longer in the UK when compared to elsewhere. The long tail of companies was described by Haldane (2017) as those firms with low and slow productivity growth which are unable to keep up, much less catch up with frontier companies. However, the composition of the long tail is contested. As these numbers imply, it is true that small businesses are inevitably less efficient than their larger counterparts which benefit from scale and specialisation. However, the highly heterogenous base of small unproductive firms is not responsible for all of the UK's productivity issues.

Many of the smallest businesses have borne the brunt of the immediate economic shock resulting from the Covid-19 global health crisis. However, this diversity of small businesses means that while some have experienced very dramatic reductions in turnover and needed to make temporary or possibly permanent adjustments to employment, others have found themselves presented with new opportunities with potential for productivity enhancement. Furthermore, supporting sole traders and micro businesses is not straightforward – a fact borne out in small business policy over the past three decades. The first section of this chapter begins by reflecting on the nature of sole traders and micro businesses, before the second section reviews emerging evidence and insights as to the impact of the Covid-19 crisis on micro businesses. A third section discusses the immediate responses and experiences of these businesses. A fourth section discusses the wider economic outlook and the prospects for recovery in a post-Covid world where productive sole traders and micro businesses continue to be important to the economy.

The micro business landscape in the UK

The academic literature on SMEs is fragmented (Wright et al., 2015), with even less known about micro businesses as a significant subset of SMEs with fewer than 10 employees. Unincorporated businesses and especially sole traders tend not to be included in official

collections of business data. In these businesses the owner-manager is often responsible for both managing and running the business, with the business survival and success often contingent upon them (Lean, 1998; Beaver and Prince, 2004). In responding to observations that there is very little research on micro businesses generally (Kelliher and Reinl, 2009), and on the drivers and barriers to micro business growth in particular (Perren, 1999), Gherhes et al. (2016) consider the specific factors that enable and constrain growth in micro businesses in their systematic review and identify a series of growth constraints. Importantly, many small firms do not think in terms of productivity, but instead tend to focus on survival, revenue growth and profitability, and while policymakers strive to maximise output per hour, this is often not the priority for small businesses. Moreover, only a minority of UK micro businesses self-report recent innovation activity, and productivity-enhancing innovation in the few tends to be motivated by a desire to win export markets (Henley and Song, 2020). Therefore, as Beaver and Prince (2004, p. 35) highlight, '[t]he small firm is not a large one in miniature', meaning that small business growth is also 'a very different affair'. Indeed, a particular characteristic of micro businesses is their owner-manager centric nature (Gherhes et al., 2016). As Kelliher and Reinl (2009, p. 523) note, 'the smaller the firm, the more power resides at the centre'. This has important implications not just for micro business growth but also for their productivity.

Kelliher and Reinl (2009) summarise some of the particular growth constraints facing micro businesses, emphasising an owner-centred culture, more limited ability to shape their external environment, and over-sensitivity to market changes. In their systematic review, Gherhes et al (2016) further unpack micro business growth challenges and focus on four dimensions, namely business capabilities, owner-manager characteristics, owner-manager growth ambition and the business environment. The owner-manager centric nature of micro businesses means that business growth is determined by their effort and ambition, as well as business acumen. In particular, business skills and capabilities associated with marketing, HR, finance and business planning were regarded as important in stimulating growth (Barbero et al., 2011; Richbell et al., 2006). Further to these growth challenges, owner-managers are often only motivated to strive for growth to a desired income after which non-economic objectives detract from growth ambitions.

By extension, the challenges resonate with the productivity challenge in many micro businesses. Indeed, despite the extensive and wide-ranging media coverage of the productivity puzzle in the UK, many owner-managers do not recognise the productivity challenge in the context of their own businesses. While there is a variety of explanations as to poor productivity that characterises the long tail, two of note are: (1) a lack of capital investment and technology adoption, which although relevant to all firms is particularly acute in small firms – as both an efficiency driver and enabler of wider digital transformation (Díaz-Chao et al., 2015); and, (2) the perennial question of leadership and management in small firms. While cautious of adopting the management practices hypothesis of Bloom and Van Reenen (2007), owner-manager centric businesses can lack wider management skills and leadership attributes necessary to improve performance and productivity – a challenge not unrelated to the retention of un(der)productive workers.

With regard to the latter, given that owner-managers are primarily responsible for all decision roles and for planning and implementing the business strategy (McCormick and Fernhaber, 2018), there is a pressure on them to be experts in all aspects of management (Kelliher and Henderson, 2006). However, not only is this a challenge in itself, but a lack of capability and capacity within the firm compound the challenge even where there is ambition and willingness

to grow. Moreover, not only are micro businesses more conservative by nature, but they also do not engage in managerial activities in the same way and to the same extent as their larger counterparts. For example, activities that are uncommon in micro businesses include formal business planning and formal strategic planning (Kelliher and Reinl, 2009; Brooks et al., 2018), with these being more informal and rather ad hoc where they occur. Information gathering activity also tends to be informal rather than derived from formal R&D activity (Henley and Song, 2020), while strategy and planning tend to focus on the short-term, with managerial decision-making often centred on survival and operational necessity rather than growth (Beaver and Prince, 2004). Importantly, the development of managerial skills and expertise can support the transition from day-to-day operations to actually managing the business (LeBrasseur et al., 2003), which would enable micro business owner-managers to focus on issues such as productivity.

For many micro businesses these challenges have been compounded over the past decade as firms have taken on more workers, or increased hours to meet demand, as opposed to investing in productivity-enhancing measures and technologies. The productivity challenge in micro businesses is therefore multidimensional, where enhancing productivity represents a choice to implement and adopt good practice across the business. The adoption of technology and implementation of management practices are generally inversely related to firm size, but to be effective in micro businesses this requires the engagement of owner-managers. Without their engagement the productivity performance of micro businesses will not improve.

In the current climate, as has been the case since the financial crisis, interest rates have been low. Indeed, it has been suggested that since 2008 low interest rates have increased the survival of more (unproductive) firms than may otherwise have been expected to be the case (Haldane, 2017). The presence of these so-called ‘zombie’ companies can have the impact of crowding out in terms of the wider economy, reducing the level of investment in more productive firms. With low interest rates, and now extended government support measures prolonging the existence of these firms, there is a danger that resources are being diverted from firms that have the potential to both grow and become more productive.

The impact of Covid-19 on micro businesses

At the time of writing, evidence is only just emerging of the business impacts of the Covid-19 health crisis. However, it is emerging at a pace and scale not previously seen in the context of small business research. In this section we attempt to make sense of what we currently know, and place this alongside further reflections on what is not known and what might be yet to happen.

The immediate economic impact of the crisis arose as a result of the population ‘lock-down’ in the UK in late March 2020. As a result, many micro businesses, for example in food, drink accommodation and non-essential retailing sectors were obliged by emergency regulations to close. A sudden increase in the rate of company dissolutions was apparent from company registration data, with the largest absolute impact in London, but high rates of dissolution proportionate to the size of business population in the English Midlands and in Wales (Prashar et al, 2020). Younger businesses appear to have been most likely to close as the pandemic’s economic impact hit. Others had little alternative but to scale back activity and furlough staff because customers were prevented from accessing their business premises. The scale of this impact on turnover and on employment has emerged from a number of official and independent business surveys. We highlight some of the findings here.

Collaborative survey research between the Centre for Regional Economic and Enterprise Development at the University of Sheffield and Small Business Britain is ongoing to survey and interview micro businesses in the UK. This work has focused on both the impact and implications of the crisis and sought to explore the impact on micro businesses. Between mid-March 2020 and late May 2020 three survey waves were conducted, each with 1200+ responses as well as over 50 interviews with micro business owner-managers. The first research ‘snapshot’ in late March 2020 illustrates the devastating impact arising from an immediate and rapid loss of income and a severe reduction in employee numbers, especially where the business did not qualify for the UK government Coronavirus Job Retention (furlough) scheme. For example, around 72 per cent of those surveyed anticipated a reduction in turnover of more than 50 per cent, with 21 per cent expecting a more than 20 per cent turnover reduction and 5 per cent anticipating a reduction of more than 5 per cent.

Official data from the ONS Business Impact of Covid-19 Survey (conducted fortnightly from early April 2020) reveals that a month into lockdown, of those SMEs still trading, only 34 per cent had seen turnover increase or unaffected, and that 27 per cent had experienced a turnover reduction of over 50 per cent. (Unfortunately, ONS do not provide a breakdown for micro business). Seventy-eight per cent of the SMEs still trading had made use of the furlough scheme, and rather smaller proportions had taken advantage of other support schemes such as the business rates payment holiday, or one of various emergency business finance schemes. Therefore, while many SMEs had experienced unprecedented impacts on turnover, many used government support to try and avoid permanent staff layoffs. The ONS survey also reveals that 11 per cent of SMEs had been able to increase employee working hours and that 5 per cent had recruited additional staff.

Sole trader and self-employed business owners form a significant component of the UK micro business population. They were recognised early into the crisis as a potentially highly vulnerable group, and as a result the UK government introduced a Self-Employment Income Support Scheme providing cash support of 80 per cent of the previous financial year’s monthly profits up to a ceiling of £2500 for those whose main activity had been self-employment for at least six months. Early forecasts suggested that a large fraction of sole traders was at risk of total business loss, particularly because of their over-representation in sectors most impacted by the lockdown (Henley and Reuschke, 2020). Survey work by the London School of Economics reveals that almost half of the self-employed surveyed experienced a drop in weekly hours of work to below 10, compared to the previous year, and a more than doubling in the proportion of the self-employed earning below £1000 per month to over 60 per cent in April 2020 (Blundell and Machin, 2020). The impact was hardest, unsurprisingly, amongst those unable to work from home, although ability to work from home was no guarantee against loss of consumer demand. Perhaps unsurprisingly, those with business activity which appears to be resilient to the crisis tend to be older, high earning professionals.

Further information on the experience of self-employed business owners can be gleaned from ‘flash’ surveys conducted by the UK household longitudinal survey ‘Understanding Society’, using their well-established panel of 30,000 households. The April 2020 wave, conducted at the height of the pandemic, provides responses from a sample of approximately 1350 self-employed. Our analysis of these data reveals that 10 per cent of those self-employed at the beginning of the year had ceased self-employment by April and provides confirmation of earlier anticipated impacts on the micro business sector. Of those remaining in self-employment, 35 per cent experienced a drop in earnings of 50 per cent or more, and 48 per

cent in total experienced some drop in earnings. Younger, female and non-graduate self-employed were more likely to experience big falls in earnings. Two-thirds of the self-employed also experienced a fall in hours of work, with the majority citing the impact of lockdown regulations and loss of demand as explanations. For a minority, the need to self-isolate, perhaps as a result of personal or other household health concerns, was also a significant explanation for reduced working. However, the picture is not uniformly bad – 32 per cent of those still self-employed in April 2020 were reporting a rise in earnings of over 50 per cent. Overall this represents a huge diversity of experience amongst the micro businesses represented in this sample, and it seems likely that while around two-thirds of businesses here become immediately less productive, productivity-enhancing opportunities became available to a minority.

Immediate responses to the crisis

This heterogeneity of experience, alongside evidence of early business dissolution, points to the possibility that the crisis might have resulted in some ‘shake-out’ of businesses in the ‘long tail’ of the less productive. However, the Covid-19 supply shock is usual in its impact because restriction of supply has effectively been mandated by government emergency restrictions. So, the impact has been highly sector specific, focused on non-essential face-to-face services, such as in retailing, hotels and restaurants, and tourism and leisure, or in non-critical workplaces where social distancing or homeworking were impossible to implement. Therefore, the impact inevitably has a spatial dimension, reflecting regional and local differences in industrial and occupational structure. For example, the owner-manager of a micro business operating in a peripheral area that had to close temporarily explained: ‘We are a holiday destination ... [so] we haven’t really got a choice ... Because of the nature of where we live ... there’s very little other work because we’re in a rural area.’ Typically, micro and small businesses do not engage in extensive contingency planning. The Small Business Britain survey revealed that 93 per cent of small businesses surveyed were not holding business continuity insurance to mitigate losses. As one of the owner-managers interviewed highlighted: ‘We were prepared for certain disruptions, but nothing of this kind.’ Furthermore, younger and less well capitalised businesses, who are more at risk, are not necessarily the less productive. Larger and more resilient businesses may have been able to take advantage of restrictions on movement and small business closures to consolidate local market power.

As a consequence, the immediate response to the crisis has been reactive in nature, with most micro businesses taking advantage of government emergency schemes (furloughing, business rates relief, VAT payment deferral) where eligible and putting in place survival strategies, such as requesting loan or rent holidays from banks and landlords, renegotiating overdraft limits, requesting emergency funding, and drastically reducing overheads. In essence, the operations of most micro businesses have shrunken substantially due to a significant decrease in demand as a result of social distancing measures, the nature of the business relying on face-to-face interaction with clients, an inability to provide the product/service due to social distancing measures, or a combination thereof.

Survey evidence shows a range of mitigating strategies to address staffing issues. These include unpaid leave (29 per cent of respondents), reduced hours for staff (28 per cent of respondents), moving more of their business online (25 per cent of respondents), and working from home (22 per cent of respondents). Other contingency plans mentioned include moving staff to zero-hour contracts. All of these have potential implications for staff wellbeing, motivation and performance, with both short- and medium-term implications for labour productivity. Other

mitigating strategies tend to focus on the management of cash flow and working capital – taking payments only in advance, cancelling future stock delivery, introducing flexible payment plans, returning to a previous job, and, in the extreme, for example in the tourism sector, closing the business temporarily in order to relaunch in a year's time.

The interviews provided further, more in-depth insights into the immediate impact of Covid-19 and the response and adaptation strategies of micro business owner-managers. Importantly, only a very small number of those interviewed identified opportunities for growth and digitalised their business models to tap into the online marketplace. The great majority either closed their business temporarily, suspended operations and planned to endure the crisis with government support, or developed some form of minor adaptation through digitalisation, such as developing a digital product to generate new, albeit far from sufficient, revenue streams – or a combination thereof. The ability of micro business owner-managers to respond and adapt to the crisis was contingent, at least in part, on the nature of their business, specifically on the extent to which their operations depended on face-to-face interaction with clients. Where the nature of the business allowed, the owner-manager either shifted operations online entirely or developed new products/services to replace lost revenue or to develop new revenue streams. For example, one of the micro businesses previously reliant on face-to-face lessons and events developed online sessions to assist with cash flow during the crisis: 'We're not able to replace the festivals but we're looking at mostly replacing some of our [face-to-face] sessions.' Others resorted to e-commerce to continue to sell their stock. For example, the owner-manager of a microbrewery explained: 'We've set up an e-commerce shop within a couple of days, and we've started selling directly to customers ... and we are bringing a little bit of cash in.'

Importantly, the majority of the micro business owner-managers interviewed expect to continue to operate online, at least in part, after the crisis is subdued. As one of them explained: 'Originally, we thought it would be short-term, but because we're attracting customers who are outside of our reach, we figured that we might try and continue it.' Circumstances have in effect accelerated new-to-business processes and organizational innovation activity, with an expectation that that innovation will have a permanent impact on business models.

Perhaps the greatest challenge facing micro businesses is the uncertainty regarding the effectiveness and implementation date of government measures on the one hand and the end of the crisis and ability to return to 'normal' on the other hand. Reflecting the frustration of the majority of those interviewed, one owner-manager stated: 'You can't plan for anything and that's the stress from a business point of view ... You can't even plan what you're going to do next, because everything's just up in the air.' Not only are there questions with regard to the appropriateness of government measures for micro businesses, as many do not qualify for any of these, but the ability of government to support businesses throughout a crisis with no end in sight raises additional fears of insolvency and bankruptcy. Many of those interviewed criticised the support gaps in the case of the self-employed, explaining that 'a lot of directors of limited companies are sort of bawling their eyes out at the moment because they don't pay themselves through PAYE', while others emphasised the lack of support for start-ups, with one stating: 'People who are just starting up aren't entitled to any government help under the self-employed scheme, because they're not showing a profit yet or because they've not been operating for very long.' Critically, the longer the crisis persists, because lockdown and social distancing regulations are slow to gain traction over the spread of coronavirus, then the less likely that emergency measures to aid cash flow and transfer staff costs to government will succeed in ensuring business survival.

Importantly, and perhaps encouragingly, some of those surveyed and interviewed emphasised the importance of developing business and managerial skills during the pandemic to enable them to better plan and respond to the ongoing crisis. As such, the respondents mentioned the need for support with regard to financial planning (50 per cent of respondents), business resilience (41 per cent of respondents), marketing and sales (33 per cent of respondents), strategic planning (29 per cent of respondents), digital skills (18 per cent of respondents), HR (9 per cent of respondents), and supply chain management (5 per cent of respondents).

The wider implications of the pandemic and the prospects for recovery

The economic consequences of the Covid-19 crisis have presented micro businesses in particular with serious difficulties. These have compounded already existing business growth and productivity challenges, to the extent that for many micro businesses the priority has understandably been on their immediate survival. Since the advent of the crisis, and throughout the subsequent lockdown, many owner-managers have been grappling with the viability of remaining operational or developing plans to suspend operations to beyond lockdown. So cashflow, access to finance and access to funding to support staff retention have been immediate priorities. As the health crisis subsides in the UK, social distancing measures will continue to constrain the level of activity in workplaces and retailing space. As well as continued loan and grant support, attempts to improve supplier payment terms are important.

Each of the specific dimensions of micro business growth drivers described earlier remain salient. First, on business capabilities, capacity for innovation remains critical for supporting productivity. The ‘digital dividend’ has allowed some micro businesses to adopt digital tools and technologies that have mitigated or maintained productivity levels. Impacts are likely to be strongest in knowledge-based sectors. Business model redesign and innovation is revealing a high level of experimentation, but there is an as yet unanswered question about the sustainability of this activity over the medium term some of this activity might be. An important aspect of organizational design to emerge is in the use of homeworking and the effectiveness of videoconferencing. Greater flexibility on this in the future has the potential to impact positively on workforce wellbeing and effectiveness as well as providing benefits in terms of reduced lost output from business travel and commuter congestion. But not all sectors are able to reap these benefits.

Second, the skills and resilience of micro business owner-managers are likely to play a role in the future recovery of productivity. The adoption of specific management practices, such as the articulation of clear and realistic business plans and performance indicators, will be important characteristics. However, for micro businesses, where organizational structures and processes tend to be highly informal, psychological resilience and soft people management skills are also likely to be important. Past research has highlighted the importance of business networking (Pittaway et al., 2004), an activity now well-supported by online social media systems. Business networking to support the transmission of tacit knowledge will be of high importance during recovery from the crisis. Many micro business owners are serial entrepreneurs. Business failure creates victims, but the building of resilience in the face of failure can be supported through appropriate insolvency practices and policies.

Third, micro business growth ambitions will need to be supported through the continuation of the accommodating business finance environment which policy intervention was able to create in the early weeks of the crisis. A continuation of existing small business growth support

programmes, such as those funded in the past by European Regional Development Funds and more recently through various UK government funded programmes including for example ‘Be The Business’, need to be maintained and extended. In the context of challenging trading conditions during the phase of recovery from the lockdown-induced recession, as well as (at the time of writing) uncertainty surrounding the UK’s post-Brexit trade regime, interventions to raise the level of support for micro businesses to win export business will be important. A desire to win exports can stimulate innovation and lead to productivity growth in micro businesses (Henley and Song, 2020). Growth ambitions will also be enhanced if appropriate skills can be recruited. Micro businesses typically have very limited capacity for workforce training and development. Public investment in reskilling is important in itself to avoid the scarring effects of unemployment. It will also provide particular benefits for micro businesses, and support addressing many of the issues identified above.

Finally, prospects for a return to productivity growth will depend heavily on the domestic business environment. Recent commentary has highlighted the fragility of supply chains, highlighted, for example, in the need at the height of the Covid-19 infection crisis to switch to domestic sourcing of medical equipment and supplies. Discussion has also centred on the possibility that automation (robotics, 3-D printing) may allow reshoring of supply chains and a reverse globalisation effect (Seric and Winkler, 2020). Post-Brexit trade uncertainty may also have a role to play here. Such reconfiguration of supply chains present risks as well as growth-enhancing opportunities for micro businesses. Bodies such as the Federation of Small Businesses also point to the importance of local public sector procurement spend, as well as other local strategies such as high street redesign. However, at the risk of labouring the point, they will need support of various kinds to better position themselves to take advantage of these potential opportunities. The macroeconomic environment itself will be important. At present it is unclear whether the economic recovery will be rapid (V-shaped), as predicted by some forecasters, or may take time (‘swoosh’-shaped). The level of fiscal and monetary policy accommodation which will be possible, and its impact on consumer confidence, will be of considerable significance to the micro business sector.

Conclusion: small businesses in a post-covid world

The Covid-19 pandemic has forced businesses to rightly focus on their survival, but the productivity question continues to loom large in the background. The fact that the productivity of many small and micro businesses has been hit during the pandemic is now of secondary importance compared to what happens next as part of the recovery. Given the poor productivity performance of many smaller firms in the UK before the crisis, the challenge is to ensure that this poor performance does not become further engrained and undermine future competitiveness.

The reality is that it is unlikely that the pandemic will have resulted in a significant shake-out of the ‘long-tail’ of less productive firms. This is in part due to measures introduced by the government to mitigate the impact of Covid-19 on the UK economy, an inadvertent consequence that is likely to see growing numbers of dormant if not ‘zombie’ firms that will survive beyond the crisis. The resilience of less productive, if not unproductive firms will therefore continue to undermine the productivity statistics, as they have no reason or need to adapt or grow. Future measures and support from government now needs to ensure that the growth and productivity of small and micro firms is prioritised if they are to serve as engines of the economic recovery.

In many respects, the challenge remains the same. The issues underlying the challenge have not gone away, and the answer remains to be found in fostering a productive culture of entrepreneurship that drives the growth and competitiveness of small firms. The ‘silver lining’ of the pandemic, if there is one, has been the way in which many firms have embraced digital technology and new ways of working that could serve as the foundations for further transformation. In the introduction of government-backed programmes that promote the adoption of digital technologies, the pursuit of innovation and the creation of new business models are an essential first step in unlocking the productivity puzzle.

So regardless as to whether the term ‘productivity’ remains in favour or not among subsequent governments in a post-Covid world, the underlying premise of the productivity outcomes which are associated with striving for greater business dynamism remain more important than ever.

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