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Successful rural SMEs – which catalysts work?

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Summary

This study is concerned with exploring the determinants of success in the context of rural locations. Generally, it is assumed that success can be measured in quantitative terms such as growth and profitability, while occasionally surrogate measures such as growth and employment are used (Storey, 1994). However, other research suggests that success may be measured in a much more personalised way by each stakeholder, which necessarily encompasses both quantitative and qualitative measures (Beaver & Jennings, 1995). Despite this plurality of methods, and despite different definitions, there are certain common characteristics, which influence the success potential of SMEs in a rural context. Whilst previous research has considered the subject of growth (of employment, market share, turnover) and profit as key determinants of success, this study will provide a richer and deeper understanding of what may characterise the term ‘success’ with respect to the English definition of rurality than is currently presented in the literature.

Hopefully through the developmental paper, other avenues in the interpretation and measures of success can be discussed/reviewed.

Current Discourse

Growth

The literature has somehow considered growth as the main measure of success (Dobb and Hamilton 2006, Wiklund et al. 2009, Leitch et al. 2010, McKelvie and Wiklund 2010, Hansen and Hamilton 2011, just to mention very recent papers on the topic). However, although surveys do document that in an overwhelming majority of cases growth is indeed an important aspiration of business owners (roughly two third of respondents), it could be argued that in general and in the context of rural areas in particular other objectives, such as independence, life style choice may equally be important giving some ground to the idea that survival (longevity) is important in itself (see in particular Dobb and Hamilton 2006, Wiklund et al. 2009, Leitch et al. 2010, McKelvie and Wiklund 2010, Hansen and Hamilton 2011).

SME growth is an important issue that needs to be examined in greater detail. Penrose (1959) discusses a number of vital issues within the examination of SME growth. She highlighted that a number of key traits such as the age and size of business can affect the overall success of an SME. Moreover she further posits that SME growth is dependent upon industry affiliation. Often growth is determined by a number of factors such as employee numbers, market share and turnover. Pasanen (2006) suggests a likely determinant of successful SME growth could be based upon the number of employees and establishments it has. For research into SMEs, employee numbers are limited or constrained to under 250.

Nonetheless while employee numbers can be a measure of growth, it is often viewed with less importance by business owners (Walker and Brown, 2004). Instead growth based upon turnover and increases in sales are the more likely focuses of current business. The drive towards profitability and expansion of market share is constantly

examined indicator of growth within the literature (Garengo et al., 2005; Roper, 1999; Kaplan and Norton, 1992).

Interestingly, and echoing the vital issues for growth highlighted by Penrose's (1959), Pasanen's (2006) own findings suggest that the age dimension is related to SME growth. Smallbone et al. (1993) argues that age is not linked to high-growth although younger firms have a higher rate of growth in comparison to older and more established businesses.

While profits are often linked to size of a business and in turn growth, Walker and Brown (2004) find that it is highly difficult to determine the linked causality of the two. Indeed these differences are ever more evident when analysing small business growth in absolute or relative measures. Cooper et al. (1989) found that when measuring growth through a relative approach it is the younger businesses that return with higher levels of growth. Davidsson and Delmar (1997: p312) suggest that "growth defined by relative measures tend to favour smaller firms in comparison to a definition based on absolute growth". Examining growth as percentage change can often highlight more prolific growth in small firms. Growth examined through such relative measures has the potential to be skewed as, for example, small increases in employment numbers in small firms inevitably return a higher percentage of relative change. As such small firms having a 50% increase in percentage growth may only have recruited a handful of new staff. This compared to a large company, where a 50% increase may equate to a few dozen new recruitments.

Longevity/Survival

Small firms are historically (Ayyagari et al., 2011) important in the vital role they play with the economy and local community in terms of the creation of jobs and wealth. However, studies have shown (Lee et al., 2012) that they face an uphill struggle to survive and grow. Often, many small firms die during their first years of operation, or struggle to survive, with the only a small number of small firms that achieving large economic returns. Nonetheless the ability for small firms to embed themselves within their locality provides both an advantageous position by which to attain a competitive edge as well as catering to the needs of the community (Roberts et al., 2006). This embedding within the local community allows many small businesses to not only survive but excel.

The definition of success of an SME may depend on the time frame. Indeed SME performance can be viewed or measured as either a short or long-term phenomenon, where a high economic output for a financial year can be interpreted as success. Likewise, the existence of a firm in the long run, i.e. longevity, can equally equate to success through firm survival. As a matter of fact, it has been argued that the most important and most challenging business goal is long-term survival (Simon, 1996). Moreover, survival is, at least in the long term, a prerequisite for success in other terms, such as market share or profitability. To date, however, studies of firm longevity have focused on large companies. On the one hand, the probability of survival decreases over time, where on the other hand, the probability of survival of new firms is lower than that of older firms, which refers to their 'liability of newness' (Stinchcombe, 1965; Aldrich and Auster, 1986).

It is interesting to note a strong emphasis on survival especially when examined within the scope of small firms within previous discourse (Lu and Beamish, 2001; Sapienza et al., 2006; Stuart, 2000; Ruzzier et al., 2006). As highlighted in earlier chapters, numerous measures of performance exist and are commonly used without clear consensus on which approaches are most accurate (Dobbs and Hamilton, 2007;

Chaganti et al., 2002). Nonetheless within the area of small firms, survival seems to be a prominent issue (Taylor and Cosenza, 1997; O'Gorman, 2001; Barringer and Jones, 2004).

Determinants of Success

A number of authors have explored and identified differences and similarities between rural and urban firms (see Keeble *et al.*, 1992; Curran and Storey, 1993; Bennet *et al.*, 2001). Examinations of the performance of small firms in the United Kingdom during the 1980s revealed differences across regions (Hart and Gudgin, 1999). Studies which have considered urban and rural firms have dealt with features such as founders, start-up and growth, competition, employment and job creation, finance, labour skills, markets, customers, types of activities and support bodies. For example, Keeble *et al.* (1992) made the following points:

- rural business founders are much more likely to be in-migrants,
- there is a higher birth rate of firms in rural areas than in urban areas,
- rural firms occupy specific market niches which they have successfully exploited and this differs from urban firms,
- firms in accessible rural areas are significantly more likely to be exporting than firms in urban areas,
- firms in accessible rural locations are more innovative.

Although differences between urban and rural firms can be identified in the literature (see Mason, 1991; Lloyd and Mason, 1984), it has been argued that there are many more similarities between urban and rural firms, in terms of attributes and attitudes, than there are differences (Westhead, 1995). Others have remarked that many of the problems of operating a business are the same, irrespective of location, so the urban-rural dichotomy should not be drawn too sharply (Curran and Storey, 1993).

Methodology

Given the scope of the study and its examination of SMEs within a rural location it was decided that a quantitative methodological approach would be best suitable. Given the geographical locations as well as logistical difficulties in collecting data across the North West of England, utilising a quantitative approach would not only allow wider collection of data but would be able to examine the effect of certain issues on SMEs success. Moreover as the study looks at the success of firms over a period of time, cross-sectional examination through qualitative approaches would not be suffice.

The usage of both a structured questionnaire and financial data best fits the research strategy, philosophy and needs of the study. Indeed utilising a quantitative approach allows the study to ensure that all SMEs within a rural location have an equal opportunity of being sampled. Moreover the use of secondary financial data allows the study to track the success of firms over a period of time, thus substantiating the overall performance of an SME in a rural location, while still collecting rich and current data for analysis.

Thus, for the purposes of this study, a quantitative approach, through the use of a structured questionnaire alongside secondary financial data is utilised in the data collection process. On

balance, the assimilation of questionnaire data alongside financial performance provides the study with not only a rich dynamic of perceptual data from rural SMEs, but the ability to chart successes financially simultaneously enables valid and robust examination.

In order to ensure that the data collected was reflective of small and medium sized enterprises in a rural location a number of parameters were utilised in the selection of businesses for the purposes of this study. Utilising terminology by the European Commission (2005) companies that firms that fall under the definition of SMEs must contain:

1. < 250 employees
2. An annual turnover of < 50 million Euros or An annual balance sheet of < 43 million Euros

Utilising Bureau Van Dijk FAME database, SMEs were selected based upon the criteria above. In addition to this, selection of respondents was drawn from rural locations. The Bureau Van Dijk FAME database was used to identify potential businesses for research as it provided, as best as possible, accurate details of businesses officially registered in the UK. This ensured that an accurate sampling frame could be drawn in order to undertake probability sampling methods.

Moreover as the study reviews the longevity of SMEs and potentially how the length of a business can be related to success, the FAME database provides financial data for analysis over a period of time. Once again, as financial data on FAME is that which is reported officially, the data provides accurate and externally verified data for analysis.

Another key element in the selection of samples is in the definition of rurality. Based upon Defra's (2005) nomenclature of territorial units for statistics (NUTS) as well as its rural/urban local authority district classification, the overall population of SMEs in rural districts of the North West of England is identified for sampling.

It is hoped that the above methodology will be able to deliver viable outcomes to the research hypotheses detailed below.

Hypothesis	Rationale
<p>H1 – Rural SME success and survival is linked to the entrepreneur’s background and ability. (This hypothesis considers the age, education, level of ownership and previous experience of the entrepreneur.)</p>	<p>Storey (1994) and Gaskill et al. (1993) indicate the important role the entrepreneur plays in ensuring the firm’s success. This hypothesis seeks to review demographic information on the entrepreneur to identify if differences in background such as age, education and his/her level of ownership affects the success of SMEs in a rural location. Utilising data drawn from both secondary literary sources as well as statistical testing on questionnaire data, the study hopes to identify if the background of the entrepreneur can limit or be catalyst to business success.</p>
<p>H2 – Locality affects SME success in a rural location</p>	<p>The ability for an SME to work and engage with the local community is an important catalyst to success (Littunen, 2000; Reid, 1991). Lack of engagement with the community could lead to failure. The current body of literature suggests that engagement, selection of locality and ability for the business to adapt can promote or hinder SME success. For the purposes of this study, SMEs located in a rural location are examined to identify if specific issues related to locality are viewed as important and vital to the running of the business. This would shed valuable light into the rural location dimension.</p> <p>This hypothesis also considers the supply chains that exist in the operation of the business.</p>
<p>H3 – Longevity of an SME is an indicator of success</p>	<p>Dobbs and Hamilton (2007) among others highlight potentially (Lu and Beamish, 2001; Sapienza et al., 2006; Stuart, 2000; Ruzzier et al., 2006; Taylor and Cosenza, 1997; O’Gorman, 2001; Barringer and Jones, 2004) how longevity is an indicator of success, where a firm’s ability to survive can be viewed as successful and as such posit an interesting question in relation to rural SMEs. Examining SME success in terms of financial performance through the use of FAME data, the study seeks to examine if the longevity of a firm has a relationship to SME success.</p>
<p>H4 – Certain characteristics of SMEs in a rural location contribute to their success</p>	<p>A number of variables such as sphere and location of business, sources of business income and the number of employees are examined here to identify how these affect SMEs operating within a rural location. This hypothesis builds on additional issues highlighted in the literature (see Storey, 1994; Smallbone et al., 1992) and seeks to evaluate other variables that could be related to SME success.</p>

<p>H5 – Finances and financial planning are linked to SME success in a rural location</p>	<p>Utilising FAME as well as questionnaire data on financial performance and planning, this hypothesis seeks to test if these variables are linked to success. The hypothesis reviews the sources of finance as well as volume to examine if certain SMEs perform better as a product of financial stability or support. Moreover the hypothesis will examine what form of financial planning and management is applied at rural firms.</p>
<p>H6 – SME failure in a rural location can be linked to a number of factors</p>	<p>While it was vital that the study examined what leads to SME success, it was just as important to identify any potential elements that could contribute to SME failure. Previous discourse indicates a number of potential forces and issues that can affect SME survival (Gaskill et al., 1993; Carter and Van Auken, 2006; Beaver, 2003). Utilising questionnaire data, the study will be able to evaluate and potentially identify areas that need careful management in order to avoid failure.</p>

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