Zoltan J. Acs, Bo Carlsson and Charlie Karlsson (eds.): Entrepreneurship, Small & Medium-Sized Enterprises and the Macroeconomy

1999, Cambridge: Cambridge University Press. 405 pages.

Martin A. Carree
Faculty of Economics, Erasmus University Rotterdam and Maastricht University, The Netherlands

Entrepreneurship and small business have received strong public policy and academic interest in the last 15 years. It has been claimed that small firms are the source of considerable innovative activity, generating many new jobs and playing an important role in industrial evolution. This has obvious consequences at the macroeconomic level. Countries that encourage entrepreneurship and free entry should benefit from this vital contribution of the small sector to the long-term health of the economy. However, integration of research on small and medium-sized enterprises (SMEs) and the macroeconomy has been scarce. The volume *Entrepreneurship, Small & Medium-Sized Enterprises and the Macroeconomy* seeks to contribute to our understanding of the connection between changes that occur at the microlevel and macroeconomic performance. The selections in the volume are edited versions of papers presented at the conference of the same title held at Jönköping University in June 1996. The chapters in the book are arranged in four parts. Part I deals with the general subject of entrepreneurship and its role in industry dynamics and in the macroeconomy, Part II covers issues of financing entrepreneurship and SMEs, Part III deals with job creation and destruction and Part IV focuses on innovation, productivity and economic growth.

In their introductory chapter, the editors present some historical background and empirical evidence on the role of small firms in Western countries. Furthermore, they pay considerable attention to the implications for public policy of the conclusions provided by the contributors to the book. The editors focus on the dynamic behaviour of new and growing SMEs to explain the impressive performance of the US economy in the 1990s compared to a rather lackluster performance in both Europe and Japan. They stress the role of the entrepreneur — 'the *persona causa* of economic development' — as the instrument causing the US economy to restructure away from an industrial to an information economy. Two categories of public-policy issues are discussed. The first relates to the importance of 'creative destruction'. The advice is not to retard the process of change and displacement but to facilitate it, particularly by encouraging entrepreneurship and free entry and by tolerating failure. The second relates to the financing of SMEs. The main conclusion from the chapters in Part II is that a very important reason for lack of access to external finance for SMEs is that they have inadequate managerial competence and other forms of human capital. The main challenge for public policy, therefore, is to encourage a rise in the level of competence in small firms.

Part I starts with a chapter by Mark Casson, who proposes a synthetic model of the firm centred on the entrepreneur as the founder and prime mover within it. Casson defines the firm as a specialist decision-making unit. It is chosen as an institutional framework by people who want to exploit their comparative advantage in collecting and processing information. His analysis identifies the employment relation in firms as a natural consequence of a division of labour in information processing. The synthetic theory suggests some important determinants of the growth of new firms. The success of small firms is explained in terms of the inability of large ones to adjust their organizational structures to a change in the market environment. In this context, Casson suggests that the growth of small firms in the 1970s and 1980s is strongly related to the development of new products for niche markets which required flexible forms of organization.

David Audretsch presents an evolutionary theory to explain the persistence of the skew size distribution of firms in Chapter 3. The large majority of firms in industries are small, even if there are considerable scale economies. Audretsch describes this as being the result of a continuous process of new suboptimal-size firms entering the market and becoming engaged in a selection process whereby the successful firms grow and ultimately approach or attain optimal size. This may be a better explanation for the persistence of an asymmetric distribution of firm-size in many industries, instead of taking it to be the consequence of the permanence of small and suboptimal enterprises. Economic agents, confronted with differences in beliefs about the expected values of new ideas, may choose to appropriate the value of their knowledge by departing from an incumbent firm and launching a new one. Audretsch claims that such differences are not constant across industries but depend more upon the knowledge conditions inherent in the underlying technological regime. This is argued to be an important reason for start-up activity to differ across industries. The importance of the evolutionary processes at the industry level is reflected in the fact that government policies of the 1990s shifted away from constraining to enabling.

Paul Reynolds asks the important question in Chapter 4 of whether creative destruction is really important in explaining economic growth. In terms of US labour market areas, he finds empirical evidence that creative destruction appears to have a strong association, but not a causal relationship, with economic growth. In short, he claims that without creative destruction, there can be no growth, but that creative destruction does not seem to cause growth. The analysis fails to make clear what features of the creative destruction processes might be central to enhancing economic growth. In the next chapter, Pontus Braunerhjelm and Bo Carlsson investigate the link between industry structure, entrepreneurship and macroeconomic performance, by concentrating on Ohio and Sweden. These two economic regions have a similar industrial structure and history, and have faced similar restructuring challenges in recent years. In terms of the growth of gross domestic product, the regions have performed considerably worse than the United States or OECD over the 1975–1994 period. Braunerhjelm and Carlsson claim that much of the lack of entrepreneurship found in Ohio and Sweden depends upon history. The industries which led the regions to a leading position in industrial development may now be retarding the transition to a more modern structure. The authors are quick, though, to indicate that their conclusions may be too rash and pessimistic, as there are signs of new firms entering the clusters leading to industrial renewal in Ohio and Sweden.

Part II of the book starts with a chapter by Robert Cressey on small business failure. He finds that human capital is a key determinant of the failure rate of UK start-ups and that financial capital does not play an important role. Cressey uses a panel data set of about 2,000 start-ups commencing in business after 1988, and tracked them on a quarterly basis thereafter. He employs a duration analysis to find that businesses run by proprietors with low human capital die relatively early and that borrowing constraints are absent. Gavin Reid finds the related result in Chapter 7 that financial structure is not a major determinant of performance in the earliest phase of the life cycle of micro-firms. His empirical results are based upon data from direct interviews with 150 entrepreneurs in Scotland. The firms in the sample were very young (on average less than two years old) and very small (on average three full-time employees). Out of the sample of 150 firms, 28 ceased trading. This small sample size does not prevent Reid from using a probit analysis with a very large set of exogenous variables. The results show that non-financial rather than financial factors such as advertising and business planning are important in explaining business survival.

Paul Gompers provides an interesting contribution, in the next chapter, on the role of venture capital as a source of financing for promising young firms. Although, yearly, only 1,000 to 2,000 of the nearly one million US start-up firms receive venture capital, those are primarily high-growth, high-potential companies with the opportunity of becoming dominant players in their industries. US venture capitalists are active investors who not only monitor the progress of firms, but also help in hiring managerial talent and sit on boards of directors. Gompers discusses three control mechanisms used by venture capitalists to cope with the asymmetric information associated with start-ups. These are the use of convertible securities, syndication of investment and the staging of capital infusions. In the periodical re-evaluation of the firm, staged capital infusions are a potent control mechanism for reducing potential losses from bad decisions. By working in syndicates, venture capital firms can diversify. This is vital for high risk projects and those requiring a 'second opinion'. Gompers pays special attention to the instrument of convertible debt and claims that it is a competitive, incentive-compatible financing instrument for venture capitalists.

Part III of the book begins with Chapter 9 by John Haltiwanger. By using the variables 'employer size' and 'age class', he explores the cyclical dynamics of job creation and destruction. Using data from the US manufacturing sector for the 1972–1988 period, he finds that the cyclical volatility of job destruction is much greater than that of job creation. This asymmetric pattern is caused entirely by the mature plants (10 years or older) in his sample. Small and young plants are found to exhibit much higher average rates of job creation and destruction than larger and more mature plants. However, employer age is more important than employer size for understanding the cyclical dynamics of job creation and destruction. A similar study, although for a much shorter time period, is performed for Sweden in Chapter 10 by Per Davidsson, Leif Lindmark and Christer Olofsson. They study the job gains and losses for small and medium-sized establishments and large ones for the years 1989 to 1994. During that period, Sweden went through a serious economic crisis. The results show that SMEs have seemed to lag in the downturn and to have led the upswing. SMEs were heavily overrepresented as gross and net job creators during the recession period. It was primarily the development among the many very small, single-site firms that made the SME sector come out as relatively better as job creators in Sweden than large firms. The importance of their results may be limited, though, due to the small size of the sample (only six observations).

The next chapter, by Luuk Klomp and Roy Thurik, attempts to shed light on the question of whether the well-documented patterns of job creation and destruction in the manufacturing sector also hold for the under-researched service industries. They use data for the Dutch retail trade and hospitality industries for the four-year period, 1985–1988. They find that gross job reallocation rates are the highest for the smallest, youngest firms, as is found for manufacturing industries in other studies. However, the authors do not encounter job-creation prowess of small firms in the retail and hospitality sectors, but they do find some job creation prowess among young firms. A possible explanation is that many firms remain small in those industries, because of the limited importance of scale economies.

The final part of the book, Part IV, only has two chapters. Chapter 12, by Andy Cosh, Alan Hughes and Eric Wood, describes the extent and nature of innovative activity amongst SMEs in the United Kingdom in the 1990s. The survey data show that the introduction of innovations increases steadily with increasing firm size and that firms with less than five employees are rarely innovative. They find that larger firms with overseas competitors, and a recent history of innovation, are the ones most likely to innovate in the next period. Furthermore, process innovation is a good survival strategy, although this is not the case for product innovation. Although small firms are less innovative, the sheer number of them makes them an important 'seed-bed' for technological change and industry evolution. Finally, in the last chapter, Zoltan Acs, Randall Morck and Bernard Yeung study the question of whether productivity growth is related to the distribution of market share in an industry. They use US cross-sectional, industry-level data for the year 1991 to investigate this. They find that industries in which larger firms have a greater market share have greater productivity growth, and that total factor productivity growth also increases with the growth in larger firms' market share. The results appear to go against the ideas which lie behind the book and this may be a reason for the authors to advocate caution in interpreting the results. Another reason is that data of only one year are used. It takes some time for the contribution of radical innovations by truly small firms to manifest itself and influence productivity. Carree and Thurik (1998, 1999) present evidence confirming the role of smallness in promoting economic growth for a European data set of manufacturing industries.

My opinion on the book is a simple: it is an important book for any researcher in the field of entrepreneurship and small business. It contains some very interesting contributions, which may interest a larger public, including macroeconomists and policy makers. The editors appear to have taken great care to maintain a good level of quality in each of the chapters. The book also raises some new questions on the role of entrepreneurship and small firms in modern economies, partly because some of the contributors to the book get results which are not simple to interpret. These new questions may encourage new research initiatives to explain the consequences of entrepreneurship and smallness.

References

Carree, M.A., and A.R. Thurik
1998 'Small firms and economic growth in Europe'. *Atlantic Economic Journal* 26: 137–146.

Carree, M.A., and R. Thurik
1999 'Industrial structure and economic growth' in *Innovation, industry evolution and employment*. D.B. Audretsch and R. Thurik (eds.). Cambridge: Cambridge University Press.

Bennett Harrison and Marcus Weiss: Workforce Development Networks. Community-based Organizations and Regional Alliances

1998, London, Thousand Oaks, New Delhi: Sage. 188 pages.

John Lawrenson
Leicester Business School, De Montfort University, Leicester, UK

Michael Muller
Department of Organization and Learning, University of Innsbruck, Austria

This book explores how community-based organizations help minorities and low-skilled employees in the United States to develop their skills and to find permanent employment. After the introductory chapter, the scene is set with a summary of labour-market changes in North America. This overview gives a good summary of trends such as declining real earnings, growing job insecurity and increasing income differentials that are described in more detail elsewhere. The following two chapters then explain why workforce development is crucial. Although there are numerous examples of large private companies that have made major commitments to firm-based training, overall, US firms systematically under-invest in human resource activity. Thus, there is a need for community development organizations to step in. However, in order to be successful, collective institutions do not only need to provide the actual training, but a constellation of activities for recruiting and training networks of a region's employers. Hence elements have to be packaged into a 'system' that compels groups to network with one another and with mainstream institutions such as city government and community colleges.

The core of the book is based on ten case studies of community-based orga-

Copyright © 2003 EBSCO Publishing