Brexit and SMEs: a further perspective through structural transition and operational environments

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As negotiations rumble on around the terms and conditions of the UK leaving the EU, one interesting development has occurred in relation to understanding the implications on UK businesses. Previous debates around the economic impact of Brexit have focused on macro-economic modelling and input-output data, presenting aggregate pictures of the overall effect. More recently, with some further clarity on what leaving is going to look like, there has been increased interest in considering how these agreements affect the operational environment within which firms function. Impacts on big business are still order of the day, driven by headlines of job departures, such as HSBC and Panasonic, or risks, such as JLR or Airbus. Pressure has however increased on politicians to provide some meaningful guidance on what the new environment might mean for Small and Medium-sized Enterprises (SMEs).

The importance of SMEs to the national economy cannot be underestimated. In both stock and employment terms, SMEs make notable contributions. Of greater significance is their principal role in the renewal process[1], leading economies through structural transition with a flexibility and responsiveness big businesses and governments cannot achieve[2]. This response does not happen either uniformly or in isolation. As resource-limited entities, SMEs depend on collaborative or collective relationships often underpinned by agglomeration systems or public goods[3]. The operational environment for an SME is therefore critical. Similarly critical is the industry of the firm, representing a micro-climate of sorts where development and dependencies can be quite distinctive from an aggregated picture of business performance and practice[4].

Focusing on operational environment and what Brexit may mean is difficult without concrete details. We can however consider this in the context of a set of consistencies offered by membership of the EU. These can be defined through the four principal freedoms of movement of goods, services, capital and people alongside the regulatory centralisation of the EU. This offers us a framework of five consistencies of the internal market.

Within most analyses of the potential impacts of Brexit, adjustment to these consistencies is not considered to offer many positive outcomes at least in the short term. Such outcomes are however not the focus of this discussion. Instead, we want to discuss what are the critical components of these consistencies for SMEs and what this means for the SME operational environment, and thus for SMEs to grow. Such an approach offers an alternative perspective to thinking about how individual firms might plan a response to the challenges of Brexit.

Focusing on these five defined consistencies, their relevance to performance of the SME sector can vary quite considerably. In this piece we focus on variation between the aggregate SME sector and that of the emerging Green sector as indicative of a nascent industry with expansion potential in a rapidly restructuring global economy. In the absence of clear answers on what the world post-Brexit would look like, instead we focus on analysis exploring the progress and key components contributing to success during the post-2008 financial crash period.

In the aggregate SME sector, three key components are critical to the development process. The first of these is focused on people and skills, improvements in the strategic management capabilities and insight of SMEs[5] complemented by the availability of high-quality skills through a migrant labour force[6]. Second is the availability of finance, the limitation in financial products representing an ongoing barrier to innovation and productivity-based improvements within SMEs[7]. Finally, there is the regulatory environment, where a mix of stimuli used by the state to support SME performance[8] run alongside embedded supra-national agreements on quality and protection[9]. For each of these components, the effects of Brexit on availability of labour, expansion of investment products, and extent and consistency of regulation has potential to be significant.

In comparison, specific focus on the Green sector shows some divergence from these key components. Within this sector the principal weight is placed on the role of regulatory influence as essentially a 'market-maker' for green industries. Compliance broadly across industry in the shape of environmental requirements (waste and carbon reduction measures) has led to the development of innovative products and services to accommodate or absorb such demands[10]. Limitations faced by Government through EU competition regulations has seen the evolution of 'nudge' mechanisms, punitive or incentivised through tax- or grant-based interventions.

This comparison raises a few interesting discussion points. First of these is the role of regulation in supporting and shaping business. Limited issues identified around capital and skills, or even goods and service exchange, within the Green sector may be indicative of its patronised position through central Government, EU, and international (COP21 Paris treaty) commitments. Productivity and investment issues may become more prescient in an environment where state-based sponsorship is reduced or even removed. This may seem a far-fetched statement, but the current US position on environmental policies and treaties illustrate how close national policy can be to a hostile shift.

Second, related to this is how regulation is shaped to support firm and sector development. The form of support used post-2008 for the SME sector in the UK was principally stimuli focused on encouraging SMEs to more proactively focus on growth. This included extolling the virtues of entrepreneurship and introducing a mix of grant- and skills-based packages to support the development of capabilities within the SME itself[11]. By comparison, Green sector support has used aforementioned 'market-making' regulatory forms to stimulate demand for the greening of products, processes and SME activities. The specific development pathways and management demands of the Green sector are generally considered homogenously addressed through standardised SME development support packages; accommodating management needs in social or environmental enterprises with a triple bottom line (profit-planet-people[12]) is ignored.

Finally, worth noting is the impact of restructuring tendencies beyond the defined five consistencies of the internal market. Development of both the SME sector broadly and the Green sector specifically have been shaped by changing social values. In particular, social demand has seen entrepreneurship more broadly adopted as a career choice by many younger groups, with implications for the forms of management within SMEs and types of support required from both state and financial markets. Entrepreneurship however manifests in quite different ways; one distinctive manifestation is the environmental entrepreneur, balancing business aspirations with a commitment to strict green credentials. Such credentials are being slowly adopted by a growing group of consumers, mixing increased awareness of environmental matters with options of personalisation offered by new technologies.

This comparison between the general SME sector and the Green sector more specifically illustrate some variation between underwriting factors in the development process. Context here is of course integral; at the individual SME level, these components may vary distinctly from the aggregate picture. Behind this discussion is however one important point of contention. Any form of planning is fundamentally dependent on using the past as a benchmark, be it macro-economic projections or operational environment assessment. Such presumptions may be wholly misguided. One of the key components not discussed here is access to markets for exchange of goods or services. In the event of a so-called 'hard' Brexit, the operational environment of the past 25 years, of consistency of open trade with the EU and through this with other countries and blocs, may change radically and abruptly. As such, there may be little in modern history to act as a guide here.

End Notes

[1] Kuratko and Hodgetts, 1995; Bravo-Biosca, 2010

[2] Solomon, 1986

[3] Neffke et al, 2017; Capello, 1999; Hawawini et al, 2002

[4] Barney, 1991; Wernerfelt, 1984; Gilman *et al*, 2015

[5] Economist Intelligence Unit, 2013

[6] LSE Growth Commission, 2017

[7] Goldman Sachs, 2015

[8] Roper & Hart, 2013

[9] LSE Growth Commission, 2017

[10] Perino & Requate, 2012; Yu *et al*, 2017

[11] Roper & Hart, 2013

[12] Gillis & James, 2015