

Research Paper No. 104

EXECUTIVE SUMMARY

July 2023

(full paper link: <http://enterpriseresearch.ac.uk/publications/erc-research-papers/>)

Mapping Schumpeterian Outcomes in the UK Small Business Population over Time – The Effect of Social and Environmental Orientation on Innovation, Exporting & Growth

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The Enterprise Research Centre is an independent research centre which focusses on SME growth and productivity. ERC is a partnership between Warwick Business School, Aston Business School, Queen's University School of Management, Leeds University Business School and University College Cork. The Centre is funded by the Economic and Social Research Council (ESRC); Department for Business and Trade (DBT); Innovate UK, the British Business Bank and the Intellectual Property Office. The support of the funders is acknowledged. The views expressed in this report are those of the authors and do not necessarily represent those of the funders.



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Small businesses are the backbone of the UK economy and can improve it through business activities which we term Schumpeterian, namely innovation, exporting, and job creation (employment growth). A growing number of small businesses are socially orientated, that is placing high importance on the attainment of strategic social goals such as improving economic and social inclusion, communities, or tackling issues of health and aging. In the UK, around 30% of businesses are socially orientated (Social Enterprise Market Trends, 2017). These businesses are key to developing an economy which is simultaneously competitive and inclusive by addressing ambitious social objectives. In this research, we examine the Schumpeterian characteristics of UK small businesses and how these change over time, as well as how they are impacted by location (relative deprivation) and by the COVID-19 pandemic, considering their social and commercial orientation. Understanding their Schumpeterian outcomes across time can offer insights on how to navigate future crises.

This report analyses data from the Longitudinal Small Business Survey (LSBS), waves 2017, 2019, and 2021 to develop policy-relevant robust evidence about the economic behaviour of UK small firms 2017-2021. The LSBS is a unique large-scale data set, as it includes relevant information about business' social and financial goals, i.e., their social and commercial orientations.

This project address three main research priorities: (I) to understand how UK small business social and commercial orientation relates to Schumpeterian outcomes of innovation, exporting, and growth over time; as well as (II) to examine how geographical disparities (relative deprivation) and (III) the COVID-19 pandemic impact the relationship between business' social and commercial orientation and their Schumpeterian outcomes.

Sections 1 and 2 introduce key elements and structure of the report, as well as outlining the background to the research. Section 3 presents a detailed discussion of the sample and subsamples used, the variable definitions, methods applied, as well as a preliminary descriptive analysis. Section 4 provides the central results of the econometric analysis and highlights the importance of social goals for key Schumpeterian outcomes. The section discusses results for innovation, radical innovation, exporting, and employment growth. Each of these outcomes is considered across time; in terms of regional disparities; and with respect to the impact of the COVID pandemic. The Appendix documents further analyses and robustness check.

The analysis leads to the following insights:

Schumpeterian outcomes

Innovation

- The likelihood that a UK small business will innovate has decreased from 48% in 2017 to 35% in 2021. Radical innovation, a subset of innovation where businesses introduce products or services or processes that are new to the market rather than only new to the firm, has also decreased across years from 15% in 2017 to 11% in 2021%. These trends are probably due to this period being characterised by exogenous economic shocks and economic slowdown in the UK.
- The strength of both social and financial goals have significant positive effects on innovation, which persist across time. The effect of social goals on innovation increases across time. Additionally, there is a goal alignment effect, whereby jointly high levels of social and financial goals are beneficial for innovation. Thus, we find synergies between social and commercial orientation resulting in greater innovation.
- Socially orientated small businesses are not more likely to introduce radical innovation. Socially oriented businesses are often located in deprived areas and appear to grapple with resource constraints, which may hamper radical innovation as a more resource-intensive form of innovation. We need greater understanding of when socially orientated businesses undertake radical innovation to further introduce an innovation policy mix to support them.
- Location in terms of relative deprivation does not impact (moderate) the effect of business' social and commercial orientation on innovation, but regional disparities matter for radical innovation. For small businesses located in the 10% most deprived areas, low financial goals support radical innovation.
- Results for the overall effect of the COVID pandemic show that businesses that report negative impacts of COVID have an increased likelihood of innovation. Thus, the impact of COVID on innovation was positive, spurring innovation, likely out of necessity to adapt to the economic challenges related to the COVID pandemic. Put differently, the COVID pandemic appears to act as a challenge stressor, where small businesses innovate to survive, as opposed to innovating to achieve their goals.
- The positive relationship of social and financial goals with innovation is undermined by the impact of the COVID pandemic. The positive effect of social and financial goals on innovation only exists for businesses not affected by COVID. For businesses negatively affected by COVID, social and financial goals no longer have any significant effect on those business's likelihood of innovation.
- For radical innovation, COVID masked the positive effects of social goals on radical innovation. We see an increased likelihood of radical innovation for socially orientated businesses not affected by COVID, but a decrease in the likelihood of radical innovation for businesses negatively impacted by COVID. In sum, the impact of COVID is to reduce the likelihood of radical innovation for firms which otherwise might have undertaken it.

Exporting

- The likelihood that a small firm export has been relatively more stable across years but also shows a slight downward trend to 23% in 2021 vs. 25% in 2017 and 2019.
- The social orientation of UK small businesses is associated with a lower likelihood of exporting over time, while business' commercial orientation (their prioritization of financial goals) increases the likelihood of exporting over time. There is a goal misalignment effect between social and financial goals in relation to the likelihood of exporting, whereby jointly high levels of social and financial goals are detrimental to exporting, i.e., the likelihood of exporting is highest for businesses with strong financial but low social goals.
- In terms of the impact of relative deprivation, we do not find evidence that small businesses located in deprived areas have either a higher or lower likelihood of exporting. There is also no significant interaction effect of the index of multiple deprivation, i.e., businesses located in the 10% most deprived area, with social and financial goals on exporting.
- COVID reduced the likelihood of exporting for socially orientated businesses. The negative relationship between social goals and the likelihood of exporting is more pronounced for UK small businesses that were negatively impacted by COVID. Conversely, for businesses that report not to have been negatively affected by COVID, social goals appear to benefit exporting. Thus, the shock of the COVID pandemic seems to have affected mostly businesses that were less likely to export and masks a positive relationship of social goals with exporting.
- These results suggest scope for export support policies specifically targeted at socially orientated businesses, as opposed to introducing one-size-fits-all interventions. Socially orientated businesses tend to focus on the local level; thus, they may require different support to incentivise exporting.

Employment growth

- In terms of employment growth, 2017 – 2021 has been a period of relative stagnation or even decline across UK small businesses. On average, UK small businesses grew by less than 1%. External socio-economic shocks such as Brexit and the COVID pandemic may have posed greater barriers to grow business.
- Socially orientated businesses shrank less but also grew more slowly than commercially orientated businesses over 2017 – 2021 time period.
- The low variation in employment growth meant it was not statistically feasible to test for moderation effects of relative deprivation and the COVID pandemic on small businesses in relation to employment growth.

Further findings on Regional Disparities and COVID Impacts

- We find that more socially orientated businesses are located in the 10% most deprived areas. 14% of businesses with high social goals are located in the 10% most deprived areas compared to 6% for businesses with both high financial and social goals. This finding is in line with previous research on social enterprises being more prevalent in deprived areas.
- We found that 62% of small businesses perceived COVID to be a major obstacle to the success of their business and a greater percentage of socially orientated UK small businesses perceive that COVID had a negative impact on their business.
- This report provides information relevant for government agencies, academic institutions, small business owners, and key stakeholders in the third sector, on the innovation, exporting, and growth behaviour across time of the UK's small business population. The report offers new insights on how the social orientation of UK small businesses – often in synergy with their commercial orientation – can support innovation. For radical innovation and exporting, the positive effects of social orientations on facilitating these Schumpeterian outcomes seems to have been masked by the shock of COVID. The analysis provides insight and a basis for discussion towards policy dedicated to support Schumpeterian outcomes in a way that may help to mitigate the UK's social and economic disparities.