

Policy Briefing

SME performance in core and peripheral UK regions: Exploring the role of innovation and firm networks during times of financial distress

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Small and medium-sized enterprises (SMEs) comprise 99.9% of the UK's business population and generate 61% of UK employment. It is therefore not surprising that a global negative shock on the scale of Covid-19 would exert a long-term impact on the entire economic machinery. SMEs were the hardest hit. Covid-19 exposed their unregulated financial frailties and utter unpreparedness to withstand negative shocks of such great magnitude. During stable times, well-relegated firms can appear to be masters of growth, and this is for a good reason. In uncertain times, however, and particularly when the uncertainty is persistent, weaker corporations are exposed and may be pushed out of the market unless kept afloat by government intervention. But government support for failing businesses imposes a costly burden on all, and it is a burden that, in the UK at least, seems to be growing bigger and heavier over the long-term. It is, for example, worth noting that the UK is currently experiencing high inflation, with consequent increases in the base interest rate. This paper contributes to the literature on pandemic-driven/financial crisis and the resilience of SMEs. Specifically, we empirically test the direct link between innovation, networking, financial obstacles, and several other variables, and SME performance, and examine the potential interaction effects of the key explanatory variables with a Covid-19 recession dummy.

Key empirical findings and highlights

The impact of Covid-19 was felt by both peripheral and core regions, although the effect was slightly higher in peripheral regions. Several peripheral regions underperformed against the core regions during the study period of 2015-2021. This perhaps hints at the core regions' stronger resource base and greater access to a breadth of scientific knowledge and information. Importantly, it also suggests the benefits of being geographically close to the policy-making units. There is, however, a silver lining. SMEs that focus on innovation and the endogenization of network externalities can better see off their competition by using these strategies as an engine to survive and grow during economic downturns. Innovation is an effective hedge for survival, growth, and leadership during uncertain times, and network capital can help SMEs mitigate their magnitude of risk. Our study elicits the role that innovation plays in the performance of SMEs. We find that innovation is an important strategy for achieving resilience and agility during uncertain times. It can help peripheral firms remain competitive and reduce excessive dependence on government support.

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The research also highlights the importance of firms' networks. Again, however, their effect is found to be stronger for core regions compared with that of the peripheral ones. This suggests that there is need to strengthen the networking and collaboration channels and practices of the peripheral regions. This might be done through knowledge creation, resource sharing, and information exchange. The results also reveal that financial obstacles can slow down SME performance, although government support helped organisations cope during the Covid-19 pandemic. Additionally, we find that other variables such as internationalisation strategies (proxied by exporting) can also boost SME performance.

Overall, we highlight from this study four key points for policy attention, which are outlined below:

- Encouragement of firm's innovation in peripheral regions can be an effective policy for withstanding external negative shocks and promoting regional growth.
- Enhancing firm's networks and collaborations between peripheral and core regions can be used as an engine of SME performance, economic equality, and prosperity.
- Although both innovation and firm's networks are important strategies for SME growth, in times of economic uncertainty, innovation becomes a more effective strategy for maintaining competitiveness.
- Government support can mitigate the negative effects that financial obstacles impose on firm performance during times of uncertainty and can thus help firms to remain in business.

Policy implications

The geographic differences in our results give a strong indication of the way in which strategic and thoughtful leadership at regional level could promote innovation as a preparer of the ground for withstanding future shocks. Finally, we recognise that irrespective of the era, financial constraints and uncertainty – of varied magnitudes – will be constant features of daily life. Embedding immersive network capital and innovative strategy into the growth plans of SMEs will help them navigate the complex waters of uncertainty. Here, the government should play an instrumental role as an instigator of the idea and a monitor of outcomes. This strategy is a win-win situation for all, and is globally welfare maximising. Acting now could enable the government to minimise the unexpected costs of supporting non-innovating SMEs during times of crisis, and the SMEs themselves would learn to adapt and become self-sustaining during periods of uncertainty.

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