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SMEs under uncertainty: What evidence tells us about policy shocks and firm performance

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Uncertainty is a central and unavoidable element in economics, business, and management. It shapes decision-making, strategy, and organisational behaviour, influencing everything from investment to policy response. While large firms may delay or hedge against risk, SMEs often make irreversible decisions under incomplete information. Investment, hiring, pricing, and innovation strategies may be postponed, redirected, or abandoned. Despite this acute exposure, most empirical studies focus on large firms or treat uncertainty as a homogeneous, external shock. The experiences and adaptive responses of SMEs remain underexplored.

This review asks: What do we know about how policy uncertainty affects organisational decision-making and performance? How do firms, particularly SMEs, interpret and respond to different types of uncertainty? Under what conditions does uncertainty constrain growth or trigger strategic adaptation? We address these questions by mapping the conceptual, theoretical, and empirical landscape of research on policy uncertainty.

Context

Uncertainty is not only a challenge but also a defining feature of today's economic and business environments. For SMEs, its scale, complexity, and persistence have intensified. Fiscal reversals, shifting regulatory regimes, geopolitical fragmentation, and technological disruption have created a policy environment where unpredictability is structural rather than episodic.

Policy uncertainty is now understood as a multidimensional and multi-level phenomenon, encompassing macroeconomic instability and regulatory, institutional, and geopolitical disruptions. Three dimensions are particularly relevant:

1. **Regime volatility** refers to shifts in political leadership, strategic priorities, or legal frameworks that reshape the policy landscape. Brexit exemplifies this, introducing prolonged uncertainty around regulation, market access, and trade. More recently, short-term economic, fiscal and industrial policies, exacerbated by leadership turnover and policy reversals such as the 2022 mini-budget, have further destabilised the investment environment, especially in sectors reliant on long-term policy consistency.
2. **Instrumental ambiguity** arises from unpredictability in policy implementation, enforcement, or duration. UK SMEs have faced persistent uncertainty, from shifting guidance on post-Brexit customs to delays in finalising the domestic subsidy control regime, and inconsistencies in planning and energy schemes. This ambiguity erodes trust in policy durability, making strategic planning harder, particularly for SMEs that lack the capacity to hedge or absorb regulatory risk.
3. **Geopolitical overlay** adds further unpredictability through the externalisation of strategic tensions. The UK's alignment with US-led initiatives in technology, security, and investment control—seen in the National Security, Investment Act or the recent US reciprocal tariffs—has introduced added uncertainty for internationally engaged firms. Emerging controls on critical inputs, export restrictions, and shifting trade alliances reflect a fragmented global order where external shocks increasingly shape domestic business risk.

These dimensions of uncertainty interact in ways that are hard to model or mitigate using traditional risk frameworks. Their cumulative impact is particularly acute for SMEs, which often lack foresight, flexibility, and institutional access, leaving them more exposed to disruptive shifts.

This structural shift aligns with developments in three theoretical traditions. Real options theory (ROT) explains deferral of irreversible investments under uncertainty, especially in capital-intensive or high sunk-cost contexts, as seen with trade policy uncertainty (Handley & Limão, 2015). Institutional theory emphasises institutional quality and predictability in shaping firm behaviour. Firms in robust institutional environments (Tarkom & Ujah, 2023) may adapt more effectively than those in weaker settings. Finally, the resource-based view (RBV) highlights firm heterogeneity and dynamic capabilities, such as absorptive capacity and strategic flexibility, as critical to uncertainty response, particularly for agile SMEs.

Complementing these is the call by Van Assche & De Marchi (2024) for clearer definitions and interdisciplinary approaches to address complex, multi-level uncertainties in international business. This is especially pertinent for SMEs, which lack the buffers and policy influence of larger firms, leaving them more exposed to policy volatility.

Overview of Evidence

Measurement approaches

The empirical literature offers a wide array of approaches to measuring policy uncertainty, falling broadly into three categories. Each method has distinct advantages and limitations, particularly in terms of capturing the experiences of SMEs and distinguishing between domestic and international policy exposure:

Conceptual and econometric models

Macroeconomic models remain foundational. These include fiscal uncertainty indices derived from New Keynesian models (Fernandez-Villaverde et al., 2015), volatility in public spending or tax shocks (Fatás & Mihov, 2013), and GARCH-M models (Grier & Perry, 2000). In the UK, Smietanka, Bloom & Mizen (2018) use firm survey data to estimate how perceived uncertainty affects investment, showing Brexit-related policy debates significantly depressed investment in both SMEs and large firms. While these models quantify structural uncertainty, they often lack behavioural nuance and rely on strong assumptions.

Text-based and news-based indices

Textual methods dominate macro-level analysis. The Economic Policy Uncertainty (EPU) Index (Baker, Bloom & Davis, 2016) captures keyword frequencies in national newspapers relating to fiscal, tax, and regulatory uncertainty. Extensions include indices for monetary policy (Husted et al., 2020), trade policy (Caldara et al., 2020), and machine learning-enhanced indices that expand dictionaries and reduce human bias (Chung et al., 2022). These indices are widely used, but they reflect media coverage rather than firms' perceptions, may suffer editorial bias, and often lack granularity at the regional or sector level.

Sector- and firm-specific measures

To address such gaps, newer studies develop more granular measures. These include sector-level tariff-based TPU (Handley & Limão, 2015), event-based indicators tracking major policy regime shifts, and firm-level measures using earnings calls or managerial surveys (Hassan et al., 2020; Benguria et al., 2022). In the UK, survey data from the Bank of England and ONS (e.g. Decision Maker Panel) shed light on how firms, including SMEs, perceive regulatory and fiscal uncertainty. Bloom et al. (2019) use such data to track Brexit-induced investment and employment responses, offering rare firm-level detail.

Industry-led surveys are also useful. In the US, the NFIB Small Business Uncertainty Index is widely cited as a small business sentiment proxy. In the UK, the CBI's Industrial Trends Survey and its SME supplement capture expectations and uncertainty in manufacturing. The Survey of Business Uncertainty (SBU), developed by the Federal Reserve Bank of Atlanta, provides high-frequency panel data on expectations and has been applied to empirical studies like Altig et al. (2022).

No single measurement method is sufficient. Combining macro indicators with sectoral and firm-level measures, particularly real-time surveys and textual analysis, offers a more holistic picture. For SMEs, future work should prioritise scalable approaches that monitor their distinct exposure to both domestic and global uncertainty.

Impacts on performance

Policy uncertainty influences multiple organisational outcomes, including financial management, innovation, employment, and internationalisation. This section synthesises key findings across five domains:

Financial Performance

Uncertainty affects firm value, liquidity, and capital structure. Firms typically adopt precautionary strategies – holding more cash and reducing debt (Duong et al., 2020). In the UK, Brexit-related uncertainty reduced valuations and increased reliance on internal

finance (Bloom et al., 2019). Tobin's Q, a common valuation proxy, often declines with elevated EPU (Bose et al., 2024). Liquidity stress is especially acute for SMEs, disrupting investment and limiting growth.

Trade and Supply Chains

TPU and geopolitical tensions influence sourcing, exports, and supply chain resilience. Firms often delay market entry when trade rules are uncertain (Handley & Limão, 2015). Brexit and the US–China trade war increased volatility, particularly for smaller exporters reliant on a narrow set of partners (Benguria et al., 2022). Post-Brexit, UK SMEs increasingly turned to local suppliers or relocated supply chains (Du et al., 2025).

Innovation

The effect of uncertainty on innovation is non-linear. While moderate uncertainty may prompt adaptive innovation (Liang et al., 2024), sustained ambiguity suppresses R&D, particularly in sustainability (Kyaw, 2022). Firms with strong operational or marketing capabilities may convert uncertainty into learning. However, SMEs with weaker absorptive capacity often scale back innovation during prolonged uncertainty unless supported.

Employment and Labour Markets

Uncertainty often leads to hiring freezes, wage delays, or shorter hours. Brexit-related uncertainty reduced employment in exposed sectors (Bloom et al., 2019). Globally, trade-related shocks have driven job cuts and reallocation (Pierce & Schott, 2016). SMEs tend to respond more immediately, delaying recruitment, relying on temporary contracts, or freezing hiring, preserving flexibility but undermining job quality.

Investment

Investment is consistently suppressed by uncertainty. Many studies link high EPU with lower capital spending, especially when investments are irreversible or public-sector dependent (Gulen & Ion, 2016; Baker et al., 2016). Public firms appear more sensitive than private ones (Dreyer & Schulz, 2023).

Yet responses vary. Hoang et al. (2023) find that some Japanese start-ups, especially with venture capital backing, maintain or increase investment under uncertainty, suggesting age, funding, and orientation matter.

TPU has similar effects. High TPU deters export-related investment due to sunk costs and risk (Handley & Limão, 2015). In contrast, credible trade deals stimulate entry and investment (Caldara et al., 2020). Trade uncertainty reduces capital stock and R&D (Benguria et al., 2022).

Other uncertainties show comparable patterns. Political risk, based on earnings call data, reduces investment and hiring (Hassan et al., 2020). MPU is similarly associated with lower investment (Husted et al., 2020).

Overall, policy uncertainty, whether economic, political, or trade-related, dampens investment. But impacts vary by firm characteristics, sector, and uncertainty type.

Strategic decision-making

Beyond investment, policy uncertainty shapes a broader set of strategic choices affecting firms' growth and positioning. High uncertainty, particularly of a regime or instrumental nature, deters firms from committing to path-dependent initiatives. Decisions to enter new markets, pursue acquisitions, or restructure operations are often delayed, scaled back, or abandoned when policy direction is unclear (Nguyen & Phan, 2017). For SMEs, with tighter constraints and lower risk tolerance, this effect is especially pronounced.

In response, firms often recalibrate strategies to maintain flexibility and safeguard reputation. One notable shift is the increased use of corporate social responsibility (CSR) and ESG initiatives—not always as innovation-led commitments, but as precautionary measures to manage stakeholder expectations and enhance resilience (Rjiba, Jahmane & Abid, 2020). Such shifts suggest that uncertainty not only constrains investment but also reorients strategy towards signalling, legitimacy, and optionality.

Resource allocation and capability development

Uncertainty also influences how firms allocate resources and build capabilities, especially in innovation, sustainability, and stakeholder engagement. Regulatory ambiguity or shifting priorities often lead firms to favour short-term compliance and cost containment over long-term capability building. For instance, Teeter & Sandberg (2017) show that uncertainty around Australia's carbon pricing prompted firms to prioritise immediate cost control rather than investing in green innovation.

Firms frequently channel resources into ESG and CSR activities—not always from proactive sustainability goals, but to manage reputational or regulatory risk. Studies (e.g. Rjiba et al., 2020; Peng, Colak & Shen, 2023) show that CSR intensity increases during periods of elevated uncertainty, functioning as a form of reputational insurance.

This risk-management role of ESG is reinforced by evidence linking ESG engagement to greater resilience. Ahsan & Qureshi (2021) find ESG activity can buffer the negative effects of EPU on performance, while Azimli & Cek (2024) report similar findings for firm valuation. Collectively, this literature shows that uncertainty affects not just the scale of investment, but also its orientation—encouraging strategies that favour legitimacy, adaptability, and stakeholder alignment on growth or innovation.

Overall, uncertainty shapes the timing, structure, and direction of firm decision-making. Its effects depend not only on the type of uncertainty, but also on firm characteristics, sectoral exposure, and institutional context.

Contextual moderators and heterogeneity

The effects of policy uncertainty are highly context dependent. Rather than producing uniform outcomes, uncertainty interacts with institutional, cultural, organisational, and temporal factors. This heterogeneity is especially salient for SMEs, whose responses are shaped by structural constraints and situational exposure. This section synthesises key contextual dimensions moderating firms' responses:

Institutional environment

Institutional strength and coherence shape how firms experience and manage uncertainty. Firms in well-regulated, predictable environments adapt more effectively. Tarkom & Ujah (2023) show firms in high-quality institutional contexts are less disrupted by uncertainty shocks.

In the UK, institutional fragmentation—devolved governance, uneven local authority capacity, and regional policy disparities—amplifies uncertainty for firms outside major

urban centres. During Brexit and COVID-19, diverging responses across administrations and local bodies added complexity, particularly for regionally bounded SMEs.

Cultural and normative factors

Cultural orientations influence how managers perceive and respond to uncertainty. In high uncertainty-avoidance cultures, firms adopt more conservative strategies, prioritising liquidity and risk aversion (Ahsan et al., 2023). Norms around stakeholder responsibility also shape responses. Bose et al. (2024) find that stakeholder-oriented firms maintain ESG commitments even under policy ambiguity.

Cross-national evidence suggests UK SMEs may exhibit greater caution in investment and diversification than North American counterparts—reflecting a cultural preference for risk management over risk-taking.

Firm characteristics

Firm-specific traits—size, ownership, age, and sector—shape exposure and adaptability. Larger firms benefit from greater buffers and policy access. SMEs, with limited resources and shorter planning cycles, often face more acute constraints.

Younger, venture-backed firms tend to be more agile, adjusting strategies rapidly (Hoang et al., 2023). In contrast, older SMEs with legacy systems may struggle to pivot. Sectoral exposure also matters: regulated sectors like care, construction, or energy are more vulnerable to policy churn, while digital SMEs, though more agile, face uncertainty in areas like data governance and IP regulation.

Temporal dynamics and policy type

The timing and nature of uncertainty affect firm response. Short-term ambiguity may cause brief delays, while long-term structural changes—such as Brexit or shifts in industrial strategy—can alter business models and strategic direction.

Policy domain also shapes behavioural responses. Climate policy uncertainty has deterred sustainability investments in high-emitting sectors (Hoang, 2022), while trade policy uncertainty affects export planning and sourcing (Handley & Limão, 2015).

Importantly, the sequence and clarity of policy changes matter. Sudden or poorly communicated shifts create disruption, whereas gradual clarification allows firms to adapt incrementally.

Evidence gaps and future research directions

While the literature on policy uncertainty has grown in scope and sophistication, important conceptual and empirical gaps remain—especially regarding how SMEs perceive, experience, and respond to uncertainty. These gaps limit the design of tailored interventions and effective support mechanisms. Table 1 summarises the most salient areas for future research, identifying key gaps and the types of data or frameworks needed.

Table 1. Evidence gaps in the policy uncertainty–SME nexus and directions for future research

Gap	Description	Future research needs
1. Firm-level perceptions and behavioural mechanisms	Reliance on macro indicators (e.g., EPU index) neglects how uncertainty is subjectively perceived and acted upon at the firm level.	Survey-based or qualitative methods capture expectations, decision rationales, and coping strategies.
2. Sectoral and geographic granularity	Overemphasis on large, listed or export-intensive firms limits understanding of uncertainty in domestically oriented, locally regulated sectors.	Finer-grained empirical analysis of SMEs in non-export sectors, peripheral regions, and devolved contexts.
3. Dynamic and longitudinal responses	Most studies capture immediate effects but fail to trace how uncertainty responses evolve over time or influence long-run firm performance.	Longitudinal panel datasets linking uncertainty exposure to adaptation and performance trajectories.
4. Compound and interacting uncertainties	Fiscal, trade, climate, and regulatory uncertainties are often studied in isolation, whereas firms experience them simultaneously.	Integrated frameworks that model overlapping and compounding policy risks.
5. Role of communication and signalling	Few studies explore how the tone, clarity, and timing of policy announcements shape firm interpretation and behavioural adjustment.	Empirical and experimental studies of policy communication strategies and their reception by SMEs.
6. Subnational and small economy evidence	Much existing evidence is drawn from the US, EU, or China, with limited insights from smaller open economies or within-country heterogeneity.	Comparative studies focused on UK regions, devolved administrations, and less urbanised economies.

Closing these gaps will require mixed-methods approaches, new sources of firm-level and regional data, and greater integration between policy, behavioural, and international business research. In particular, future work should aim to trace firm responses across time, explore overlapping uncertainty domains, and evaluate the effectiveness of different communication strategies and policy instruments.

Implications for policy and support systems

The expanding literature on policy uncertainty offers several actionable lessons for policymakers seeking to enhance SME resilience and competitiveness.

First, not all uncertainty can—or should—be eliminated. However, avoidable uncertainty arising from abrupt policy changes, inconsistent messaging, or regulatory churn should

be minimised. Stabilising the policy environment is vital for SMEs that lack the resources to absorb shocks or reorient quickly.

Second, policy credibility and communication matter. Clear, timely, and consistent messaging shapes how firms interpret policy developments and reduce overreaction or paralysis. Fiscal announcements, industrial strategies, and regulatory roadmaps should be accompanied by transparent rationales and timelines to support business planning.

Third, support systems must reflect the uneven distribution of uncertainty. SMEs in procurement-dependent sectors, regulated industries, or trade-exposed markets face distinct challenges requiring tailored interventions. Local support structures need analytical capacity to assess sectoral and regional exposures, and the flexibility to adapt accordingly.

Fourth, public programmes should focus more on building internal adaptive capabilities. This includes training SMEs in risk management, scenario planning, and digital transformation. Resilience involves not only withstanding shocks but also maintaining direction amid volatility.

Fifth, uncertainty should be incorporated into policy design and evaluation. Growth, investment, or innovation programmes should account for how uncertainty affects firm behaviour—potentially altering outcomes or reinforcing disparities across firm types.

In an era of structural uncertainty—driven by climate risks, geopolitical fragmentation, and institutional instability—SME resilience will depend not only on internal capability but also on the coherence, transparency, and consistency of the policy environment in which they operate.

Conclusion

As policy environments become more fragmented, dynamic, and strategically contested, uncertainty has evolved from a cyclical anomaly into a structural feature of the economic landscape. For SMEs, organisations marked by agility but constrained in scale and capacity. This shift presents both heightened risks and opportunities for adaptation.

This review shows that uncertainty permeates all aspects of SME decision-making, from investment and employment to innovation and resource allocation. Its effects are heterogeneous, shaped by institutional context, cultural norms, firm capabilities, and the nature of the policy shock. Importantly, uncertainty not only delays or deters firm activity but also redirects strategy, towards optionality, signalling, and stakeholder alignment.

The evidence base, while expanding, remains incomplete. Most measures are macro-level or firm-generic, offering limited insight into how SMEs experience, interpret, and respond to policy volatility. More granular, longitudinal, and context-sensitive approaches are needed—spanning firm-level surveys, behavioural analysis, and comparative studies across institutional settings.

Future research and policy must move beyond aggregate treatments of uncertainty. Support systems should be responsive to the specific exposures of SMEs—by sector, region, and institutional setting. At the same time, building firms' interpretive, adaptive, and strategic capacities is critical—not only to their survival, but to the resilience and adaptability of the wider economy.

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