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Regulation and Growth-Oriented Small Businesses in North-West England

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Research paper

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Abstract

Purpose

This paper examines the ways in which growth-oriented small and micro-businesses (SMBs) are affected by regulations. Case studies from North-West England are used to investigate the relationship between attitudes and responses to regulation and the characteristics of business growth.

Design/methodology/approach

This research examines the relationship between regulation and growth using eight case studies of SMBs. The selected cases are proactive in seeking new market opportunities and innovative in terms of product development or business process.

Findings

Case studies confirm that owner-managers of SMBs experience high levels of regulatory burden. However, some growth-oriented businesses also recognise the advantages in being proactive in seeking regulatory knowledge. These advantages were particularly prevalent in cases where growth is driven by product innovation in relatively new product-markets.

Research limitations/implications

The study is based on a limited number of case studies in one region of England. Even so, interviews facilitate probing to increase understanding of the underlying reasons for attitudes towards regulation. The cases demonstrate that even very small businesses can use regulatory knowledge as a basis for business growth.

Practical implications

The findings suggest that networking in order to engage with regulatory regimes can generate competitive advantages and open up new market opportunities for small businesses.

Originality/value

This research contributes towards the debate on the impact of regulations on the economy at the micro level and in so doing highlights important nuances in the relationship between business growth and the regulatory environment.

Introduction: Regulation and business growth

The relationship between regulation and economic growth has been the focus of considerable discussion in academia and policymaking over the past decades. These debates have taken place at a variety of spatial scales including international comparisons (Poel *et al*, 2014; Capelleras *et al*, 2008; Levie and Autio, 2011), as well as studies of different sectors within various national economies (see, for instance, Akinboade and Kinack, 2012 (Cameroon); Batsakis, 2014 (EU Member States); Gill and Biger, 2012 (Canada); Xheneti and Barlett, 2012 (Albania)). There has also been considerable discussion of this issue in the UK context (Chittenden and Ambler, 2015; Frontier Economics, 2012; Kitching *et al*, 2015). A prominent theme in these discussions has been the extent to which the regulatory environment affects business growth and innovation and, in particular, whether regulations place unnecessary burdens on businesses which impede growth plans particularly for smaller businesses that lack capacity to respond to administrative requirements.

The aim of this research is to examine the relationship between regulatory environment and business growth specifically *in the context of small and micro-businesses* (SMBs - businesses with less than 50 employees). Recent surveys of business tend to confirm the generalisation that businesses in this size category perceive greater burden from regulation (see for instance, UK National Audit Office survey findings reported in BIS (2015)) and that this implies that regulations have a generally negative impact on small business growth. Yet the research evidence provides at best only very partial support for this effect. International studies using correlation techniques have found associations between regulatory environment and economic performance, but it has proved to be difficult to infer impacts at the level of individual businesses (Achtenhagen *et al*, 2017; Branstetter *et al*, 2013). On the other hand, qualitative studies of business decision-making and competitiveness tend to illustrate highly varied experiences of regulatory impacts that have proven difficult to predict or explain in relation to key variables (Kitching *et al*, 2015).

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3 In the research reported in this article, we seek to contribute to this debate using a
4 small number of business case studies in the belief that this will provide a more
5 appropriate means to understand how business managers form their views on
6 regulation and business growth. The research focuses in particular on owner-
7 managers' views of regulation (opportunity or cost), their responses to them
8 (proactive or reactive) and how these responses might be influenced by the
9 characteristics of business growth. The research will then consider the implications
10 of the findings for policy and further research.
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16 **Regulation and growth at the International scale**

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19 The contention that regulation inhibits small business growth has been bolstered
20 over the past ten years or more by various studies that have identified statistical
21 associations between economic performance and regulatory environment using
22 cross country comparative data. A recent contribution to this debate is provided by
23 Poel *et al* (2014) who conclude from their study of administrative burden and
24 economic growth that reducing burdens on new firm start-ups can enhance growth
25 considerably. These findings reflect those of previous studies that make use of
26 similar data and techniques. An OECD study, for instance, examined how
27 institutional environments and regulation of product and labour markets can
28 influence growth (Nicoletti and Scarpetta, 2003). The research question focused
29 specifically on the extent to which market liberalisation is associated with productivity
30 growth. This hypothesis was based on the assumption that privatisation will alter
31 business behaviours, boost efficiency and stimulate innovation. The study noted
32 significant associations between liberalisation and productivity growth leading to the
33 conclusion that countries that are heavily regulated could derive sizeable benefits
34 from reform.
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46 Using similar data, Dawson (2006) noted that reductions in regulation need to be
47 steady and predictable for optimal effect on future economic growth. Using World
48 Bank data, Loayza *et al.* (2005) also showed that heavy regulation tends to be
49 associated with expansion of the informal sector, hence deregulation needs to be
50 accompanied by measures to strengthen governance and to streamline regulations
51 that are retained. Djankov *et al.* (2006) suggested that deregulation and reform of
52 regulation can improve growth prospects and these findings have been replicated by
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3 similar recent research (Griffiths *et al.*, 2009; Haider, 2012). Poel *et al.*, (2014) also
4 demonstrate how changes in the level of administrative burden are statistically
5 associated with changes in levels of economic growth. This particularly applies to the
6 time taken to pay tax and procedures for starting a business.
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10 These studies have, however, been subject to critique with regard to the quality of
11 data and the inferences that are made on the basis of broad patterns in macro-
12 economic indicators. Van Stel *et al.* (2007) are critical of using these very broad
13 findings to support policy interventions affecting individual business decisions and in
14 particular, the decision to form a new business. They argue that while there may be
15 statistical associations between different measures of growth and levels of regulation
16 at a global scale, it cannot be assumed from this evidence alone that reduced
17 regulation will affect individual business decisions and stimulate entrepreneurship.
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21 In seeking to address this question, these authors examine the relationship between
22 regulation and entrepreneurship across 39 countries. The findings show that while
23 some types of regulation do appear to affect levels of entrepreneurship (in particular,
24 minimum capital requirements and some labour market regulations) there is no
25 association between levels of business start-up and the administrative burdens
26 associated with starting a business (time, cost, complexity of procedures). They also
27 make the point that many “necessary entrepreneurs” in particular (those who enter
28 business primarily as a survival mechanism rather than to pursue a business idea for
29 profit) avoid regulation entirely by starting operations in the informal sector. (Xheneti
30 & Barlett, 2012 and Batsakis, 2014).
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41 In a more targeted study, Capelleras *et al.*, (2008) examine firm formation rates in
42 the UK and Spain, the former regarded as having “light regulation” in contrast to
43 Spain which is more heavily regulated. The results show that in the UK, new firms in
44 general appear to start smaller and grow faster. However, this difference disappears
45 when unregistered firms are included in the analysis, leading them to question
46 whether deregulation *per se* will stimulate higher levels of entrepreneurship. These
47 results also imply that heavy regulation can have unintended consequences by
48 shifting a higher proportion of new businesses into the informal sector. This
49 interpretation is certainly consistent with widespread evidence from both developed
50 and developing world contexts that regulation impacts disproportionately on smaller
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3 businesses (Akinboade and Kinfack, 2012; Loayza *et al.*, 2005; Wiederhold, 2011;
4 Wilson *et al.*, 2012; and Law *et al.*, 2014).
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7 Other studies suggest that while it may generally be the case that reduced regulation
8 removes barriers to entrepreneurship, this relationship may not be linear (Adomako
9 and Danso, 2014). In fact, in some cases regulations can be regarded as positive
10 contributors to firm performance (St-Jean *et al.*, 2010; Chittenden and Ambler 2015;
11 OECD, 2004 and Kitching *et al.*, 2008). This apparent contradiction over the effect of
12 regulations on SMEs may not only be due to variations in the type of regulation but
13 also because regulations have both direct and indirect impacts on small businesses
14 via customers, suppliers, competitors, regulatory authorities and infrastructure
15 providers (Gill and Biger 2012; Kitching *et al.*, 2008; Gray, 2008; Peck *et al.*, 2012;
16 Markantoni *et al.*, 2013; Vershina *et al.*, 2014 and Kitching *et al.*, 2015). These varied
17 impacts mean that SMEs can use regulations to their advantage (Douglas *et al.*,
18 2006). This extends into the realm of 'self-regulation' where markets and services
19 can be defined, nurtured and protected through voluntary codes that may even
20 extend beyond legal requirement (Anderson and Russell, 2011).
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30 **UK National context**

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33 The relationship between the regulatory environment and business performance in
34 the UK has been a significant source of debate both in academia and policy-making
35 since at least the 1980's. The impact of regulation on businesses continues to be a
36 focus of attention in the findings of recent business surveys. The most recent
37 Business Perception Survey published by the National Audit Office and the UK
38 Department for Business, Innovation and Skills (NAO/BIS, 2014) indicates that while
39 there has been continuous improvement in perceptions of regulatory burden, just
40 over half of all respondents (51%) still regard regulation as an obstacle to growth and
41 a significant proportion (43%) expect this burden to increase in the next 12 months.
42 This burden is particularly relevant to SMBs as the proportion of businesses that
43 regards regulation as an obstacle to success increases for those businesses with
44 less than 50 employees.
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53 Recent surveys tend to show that regulatory burden is greater for smaller businesses
54 (NAO/BIS, 2014 and BIS, 2015), confirming previous reviews of the effects of
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3 regulation on smaller businesses (Chittenden *et al.*, 2002, Crain and Crain, 2005).
4 These results also resonate with research findings across a range of sectors and
5 different aspects of regulation (Schmidt *et al.*, 2007; Wilson *et al.*, 2012). This
6 evidence suggests, at least in terms of perception, that small and micro-businesses
7 are disproportionately affected by regulatory costs and burden (Carter *et al.*, 2004).
8 Studies also show that small business owners tend to be reactive rather than
9 proactive in addressing regulation. In the context of health and safety, for instance,
10 Vickers *et al.*, (2005) report that in a survey conducted in 2001-2, small firms (under
11 50 workers) had lower awareness of legislation and while some businesses could be
12 classed as “proactive learners” with regard to regulation, most were described as
13 “minimalists”, “reactors” and a minority of “overt avoiders”.
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21 While the negative effects of regulation on small businesses is widely reported,
22 Kitching *et al.*, (2008) suggest that the relationship between regulation and business
23 performance is ambiguous. Their analysis indicates that owner-managers are much
24 more aware of negative aspects of regulation than regulation as an enabler of
25 change and growth. They argue that regulation does not have a pre-determined
26 impact on performance but much depends on the context and, critically, the
27 approach used by business owners in response to regulation. It is, they suggest,
28 simplistic to argue that regulation either impedes or enables growth. It can do either
29 (or indeed both) depending on certain situations. Regulations can create markets for
30 products and services and also release resources required for growth (capital, land,
31 premises, labour). Other regulations can motivate productive actions (innovation in
32 product development) as well as protect markets from rogue traders. Regulation, it is
33 concluded, generates multiple tendencies simultaneously that can be contradictory.
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43 Intuitively, one might anticipate that high growth firms are more likely to experience
44 difficulties with regulation due to the process of change involving entry into new
45 markets, development of new products, forms of diversification and the need to
46 recruit new staff possibly with new skills. There is limited evidence to support this
47 conclusion and mainly from firms that claimed to have been deterred from specific
48 actions rather than those that had actually adopted growth strategies (Gray, 2008).
49 By comparison, the weight of evidence appears to suggest that growth-oriented
50 small businesses are actually less encumbered by regulation than small firms in
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3 general. As Gray (2008, p7) observes, '*entrepreneurial firms are more forward and*
4 *outward looking and less likely to be held back by actual or possible problems*
5 *related to regulation compliance*'. Kitching *et al.*, (2008) also argue that high growth
6 firms are more likely to be proactive and seek opportunities associated with
7 knowledge of the regulatory environment. In a recent study of financial regulation,
8 Lee (2014) also notes that high growth small businesses may be less likely to view
9 regulation as a barrier to growth since the achievement of growth itself demonstrates
10 that owner-managers have '*succeeded in overcoming some regulatory difficulties or*
11 *have been lucky enough not to face them*' (Lee, 2014, p. 189).

18 **Regulation and competitive advantage**

20 This use of regulations to gain competitive advantage by some firms may explain
21 why regulation is seen as less of a burden to high growth firms than '*potentially high*
22 *growth*' firms (NESTA, 2011). This would then support the argument that the impact
23 of regulation depends on whether the SME CEO is '*regulation promotion focused*' or
24 '*regulation prevention focused*' causing the firms to use regulation as an enabler or a
25 disabler (Wallace *et al.*, 2010). Similarly, Levie and Autio (2011) argue that
26 regulations have different impacts on entrepreneurs. Their study identifies "strategic
27 entrepreneurs" who not only seek opportunity but also recognise and proactively
28 exploit sources of competitive advantage. These types of entrepreneurs, therefore,
29 are not only likely to incorporate regulatory costs into their business planning but
30 also recognise competitive advantages that can be derived from knowledge of
31 regulation. In contrast, '*non-strategic entrepreneurs*' are less proactive and more
32 likely to view regulation as a burden rather than a potential source of advantage.
33 These authors note that strategic entrepreneurs (as opposed to non-strategic
34 "necessity" or "forced" entrepreneurs) have a disproportionate effect on job growth,
35 but they are also '*a small percentage of a nation's nascent and new entrepreneurs*'
36 (Levie and Autio, 2011p. 1411).

48 The idea that businesses may be able to utilise regulatory knowledge and practices
49 to gain competitive advantage is, of course, not new (Maijor and van Witteloostuijn
50 1996, Taylor 2001). However, it is, perhaps, an overlooked business strategy in
51 practice, particularly when applied to smaller businesses (Rossi, 2010; Anderson
52 and Russell, 2011). On the one hand, business growth, particularly if it is based on

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3 diversification or entry into new markets, will almost certainly lead to additional cost
4 related to the process of learning and subsequent compliance with regulatory
5 requirements that are new to the firm (Kitching, 2006, Doern, 2009 and Kitching,
6 2015). However, growth firms are also more likely to be “strategic” in their approach
7 to regulation and to recognise the competitive advantages that can be derived from
8 knowledge of regulation. They are therefore more likely to be characterised as
9 “proactive learners” in their approach to regulation.
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14 **Regulatory environment and small business growth – analytical framework**

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17 Research reported above indicates that while broad associations can be observed
18 between aggregate measures of growth and levels of regulation, the relationship
19 between regulatory environment and growth of individual firms is much less clear.
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21 There is certainly sufficient evidence to suggest that smaller firms in general are
22 more likely to be susceptible to regulatory burden than larger ones. The argument
23 that high growth small firms are more likely to experience regulatory burden might
24 seem persuasive. Business growth, after all, involves risk, uncertainty and additional
25 learning costs associated with new products and markets as well as internal changes
26 that might be “new” to the firm in question (business processes associated with
27 expanded employment, health & safety, etc.). Yet the available evidence indicates
28 that managers of fast growth small firms vary considerably in their attitudes towards,
29 and their responses to, regulation.
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38 In addressing this issue, we suggest that possible causes of differing responses of
39 fast growth firms to regulation might relate to the *characteristics of growth* and also
40 the *nature of product markets* that form the basis of that growth. A number of
41 propositions can be made in this context. There are reasons to suggest first of all
42 that there may be systematic differences in attitudes toward regulation depending on
43 whether business growth is led by strong new product development rather than
44 process-innovation. Product innovators are more likely to view regulation positively
45 as a means of protection of markets. Secondly, product innovators that experience
46 growth in relatively new emerging markets are much more likely to recognise the
47 competitive advantages of gaining regulatory knowledge and seeking to influence
48 regulatory outcomes in markets where product standards are as yet relatively
49 underdeveloped. It is suggested that firms experiencing growth in these
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3 circumstances are much more likely to see regulation as an opportunity than a cost,
4 and be more proactive in seeking regulatory knowledge.
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7 A simplified framework for this analysis is shown in Figure 1. This summarises the
8 relationship between business attitudes to regulation and the way in which growth-
9 oriented SMBs might respond to the regulatory challenge. In simple terms, this
10 creates four broad categories:
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14 A – Reactive and negative about regulation: These businesses view
15 regulation largely as a cost to be minimized and where the approach to
16 managing regulation tends to be reactive. In this category, businesses are
17 likely to emphasise conflicts between regulation and growth plans.
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21 B – Reactive but positive about regulation: businesses are mainly reactive to
22 regulatory requirements but they recognise the business benefits that can be
23 derived from good regulatory environments. Businesses in this category, for
24 instance, may highlight the importance of regulation as a means of controlling
25 sub-standard traders and protecting markets.
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29 C – Proactive but negative about regulation: These businesses view
30 regulation largely as a cost to be minimized but they recognise the benefits of
31 a proactive response to such costs by finding ways to manage compliance
32 more efficiently and proactively seeking to engage with the regulatory
33 environment.
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37 D – Proactive and positive about regulation: These businesses seek to
38 engage with regulation in order to maximise opportunities for the business.
39 This can involve collaboration with trade bodies and regulatory authorities in
40 setting industry standards and defining new markets and products.
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49 FIGURE 1 ABOUT HERE
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51 **Research method**

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53 Many previous studies have relied on aggregate data or survey evidence to draw
54 conclusions about the relationship between regulation and business growth. Our
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3 literature review suggests, however, that the relationship between regulatory
4 environment and business performance may be more complex and contradictory
5 than implied by responses to generalised questions in sample surveys. The
6 questions posed here therefore require a methodology that enables the researcher
7 to explore the reasons why business managers hold certain views regarding
8 regulatory burden. While a case study approach is limited in terms of its basis for
9 generalisation, it is appropriate to this investigation that seeks to understand how
10 specific characteristics of growth influence owner-managers' attitudes to regulation.
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16 To explore these issues, we use a case study approach targeted on high performing
17 SMBs operating in the north-west region of England. The case studies cover a range
18 of sectors and types of products and services. Selection of cases involved identifying
19 firms that shared common characteristics in relation to experience of business
20 growth. They are all *proactive* in seeking new business opportunities and *innovative*
21 in terms of product development and/or business process. As a consequence, it was
22 anticipated that these businesses would have experienced new regulatory
23 challenges inherent in these processes of change. Interest lies in documenting the
24 characteristics of business growth and the nature of the product-markets involved
25 and understanding how these characteristics might influence business responses to
26 regulation.
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35 Using the regional knowledge accumulated by university managers involved in
36 enterprise development in North West England, twenty-five high growth small
37 businesses were identified. These were businesses employing less than 50 workers
38 that had made recent attempts to achieve growth through various forms of
39 diversification and innovation in product and process and representing a range of
40 sectors to capture varied experiences. This long-list was then reduced to 15 on the
41 basis of publicly-available information on patterns of investment and change (web-
42 based information as well as reports in the media).
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49 Approaches were made to interview these 15 companies. Of these, interviews were
50 conducted with nine businesses. Preliminary analysis of these cases, however, led
51 us to eliminate one of these cases on the grounds that the business did not meet our
52 criteria as a growth-oriented business with recent experience of proactively seeking
53 to grow the business through accessing new markets or diversification. The analysis
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3 that follows is therefore based on eight useable case studies. All of the interviews
4 were conducted at the business premises of the case study firm involving detailed
5 face-to-face discussions with owner-managers. As is typical of such businesses,
6 these individuals possessed knowledge of the history of the firm as well as a good
7 understanding of current strategy and operations.
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11 The interviews were conducted during February and March 2015 each lasting at
12 least one hour and several involving discussions closer to two hours. Interviews were
13 guided using an interview schedule that itemised themes for discussion. The
14 interview schedule covered six major themes as follows: Background of the
15 interviewee and the current business; Recent growth and development; Impact of the
16 regulatory environment; Awareness of regulatory requirements; Effects of regulations
17 on growth plans and general perception of regulatory burden.
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21 In the early stages of the interview, attention was devoted to understanding the
22 current business, its products services and customers as well as recent changes in
23 output and markets, new investment and recent product and process changes.
24 Interviewees were given an opportunity to explain how these changes had impacted
25 on the business and the challenges associated with business growth. The second
26 half of the interview involved discussion of regulatory impacts and the extent to
27 which growth had either enabled or impeded innovation and change. Interviews were
28 documented manually and interview notes were used as a basis for the analysis
29 using tabulation that enabled cross-referencing between themes and comparison
30 between cases. Using this content, an attempt was made to place each case within
31 the analytical framework proposed in Figure 1. Table 1 lists these firms in
32 employment size order. In terms of sectors, the case studies are very varied
33 including fairly traditional product-markets such as food and drink manufacture and
34 wholesale supply of materials and equipment as well as emerging markets for design
35 and manufacture of specialist equipment as well as providers of specialised business
36 services where regulatory frameworks are currently being evolved.
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51 TABLE 1 ABOUT HERE
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53 The interviews with owner-managers confirmed our expectation that these
54 entrepreneurs have recently been striving to be innovative in sustaining and growing
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3 their businesses. As shown in Table 1, the nature of innovation varied between firms.
4 However, there are several shared characteristics that are particularly pertinent to
5 this study. These eight businesses are all proactive in seeking new business
6 opportunities and innovative either in terms of product development or business
7 process. These characteristics have led to crossing boundaries of various kinds
8 (from the familiar to the less familiar), including diversification from one sector to
9 another, expansion into new market areas either nationally or internationally as well
10 as relocation between sites. Interest focuses in our analysis on the regulatory
11 challenges inherent in these processes of change.
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18 **Business growth and the regulatory environment**

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21 The core of the interview schedule focused on the effects of regulation on the case
22 study businesses and the way in which regulatory issues were addressed as part of
23 their growth plans. The responses indicate that there were some aspects of
24 regulation that impacted *routinely* on these firms and in general these appear to be
25 regarded as necessary and integral to business processes. Some aspects of
26 regulation, however, bore specific relationship to particular business growth
27 strategies and represented *new regulatory challenges* to businesses. The analysis
28 below considers these two aspects of the regulatory challenge separately.
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34 Interviewees were asked to explain how regulations routinely impact on their
35 businesses. This question was initially unprompted and this invariably provoked a
36 discussion of health & safety. This is not surprising given recent data from the
37 business perception survey which suggests that this particular aspect of regulation
38 demands above average numbers of days in compliance activity and is also
39 perceived as a higher burden on businesses (NAO/BIS 2014, p.28; 33). On health &
40 safety, there was a general acceptance of the need for regulation and, indeed, the
41 benefits that businesses derive from this, including the protection of markets against
42 rogue traders. So while burdens are recognised, these are balanced by significant
43 benefits. Several interviewees (again unprompted) made the point that their
44 customers, clients and supply chains in many instances demand even higher
45 standards of care than required by law. Similar points are made about trading
46 standards where customers and clients were viewed as a more powerful and severe
47 critic of the business than the regulators.
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3 Several interviewees raised issues related to the burden of compliance with
4 employment law. HR issues were particularly relevant to those small businesses
5 employing more than 20 workers. This generates workload in some cases and the
6 costs of seeking external advice in two cases. Even so, interviewees in general
7 regarded employment law as a basic requirement in running a business and saw no
8 conflict between business objectives and compliance with regulation.
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13 These initial discussions about regulatory impacts also raised issues that were
14 sector-specific. Under environmental law, safe control of weeds in a water
15 environment had been an issue for one business (tourism accommodation) while in
16 another case, recycling of waste materials was addressed through outsourcing. The
17 microbrewery had needed to address issues connected with licensing laws and
18 responsible drinking (underage drinking, drink-driving, vulnerable groups). In many
19 such cases, the potential harm to the business created by loss of reputation that
20 might be consequent upon failing to comply with industry-specific rules appeared to
21 be a much stronger influence on behaviour than the regulatory system itself and so
22 the outcome was to raise standards well above statutory minimum levels.
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30 The preliminary conclusion from these discussions seems to support the view that
31 while businesses may make demands for simpler procedures, regulations are
32 considered necessary and mostly consistent with the objectives of business in that
33 they are *“important for fairness”* and create *“a level playing field”*. They also *“protect*
34 *customers”*.
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39 **Regulation and business growth plans**

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41 The discussion surrounding the impact of regulation on the business in general was
42 followed by a more detailed investigation of the regulatory challenges that were
43 confronted arising from recent growth experiences. Growth in employment placed
44 additional burdens on businesses in terms of HR practices (such as monitoring
45 sickness, dealing with maternity entitlements, health & safety at work, compliance
46 with equalities and discrimination law) as well as health & safety (staff induction,
47 training, safety awareness). One consequence of this is that informal or reactive
48 approaches to regulation that might be effective (and even appropriate) with a small
49 number of employees quickly becomes a source of inefficiency. This suggests that
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3 the relationship between growth and regulatory burden is not necessarily linear or
4 pre-determined but may vary and be dependent upon the business response.
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7 Interviewees were asked whether their investigation of relevant aspects of regulation
8 had caused them to adjust or even scale back their plans for growth. It is significant
9 to note that in four of the eight cases, regulations had never been a barrier to growth
10 nor a reason to adjust plans. Indeed, for several firms, it can be said that business
11 expansion plans exist because of regulation, not in spite of them. As one company
12 observed:
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17 *“We have never changed a plan due to regulation.... tend to develop business out of*
18 *regulation.... It’s beneficial for the market”*
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21 This implies that in some growth markets, the impacts of regulations on client groups
22 creates business opportunities for specialist suppliers of goods and services. The
23 regulatory landscape is therefore a market environment to which business plans are
24 constantly being adjusted. In some of our case studies, regulation has created a
25 market niche where knowledge of regulation and compliance is a key business
26 asset.
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32 The interviewees operating in these markets were highly conscious of the
33 significance of regulatory knowledge for their entire business and the competitive
34 advantage that can be accrued from acquiring such knowledge in a timely fashion.
35 Understanding of regulation extends well beyond the “letter of the law” and includes
36 knowledge of the regulatory environment, how rules are likely to be interpreted and
37 the processes of decision-making involved in implementing regulation.
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42 In other cases, however, businesses have altered details of their growth plans in
43 response to their evolving knowledge of regulatory requirements surrounding their
44 new venture. Two such examples relate to product mix and food safety standards.
45 Our case study of a food producer altered recipes and product range in response to
46 compliance costs associated with nut allergies. The business withdrew some product
47 to avoid the cost and complication associated with use of nut ingredients (food
48 labelling, packaging, food allergy training, cross-contamination).
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3 A second example illustrates how regulatory issues can affect decisions on
4 internalisation and externalisation in the supply chain. A tourist accommodation
5 provider initially supplied a free welcome pack for visitors containing various foods
6 including home-made cakes. However, this product enhancement raised concerns
7 about food safety liabilities even though the product was supplied “free of charge”.
8 The tasks involved were also more time consuming than anticipated. A decision was
9 therefore made to substitute local food and drink producers (butchers, bakery, wine
10 merchant) to provide welcome goods as well as an order form. The business does
11 not generate revenue from this but considers that it adds value to the 5* experience.
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18 In another case, regulation appears to have had the effect of demarcation between
19 different product-markets and different producers or service providers. Business
20 plans had been adjusted to account for differing risks and regulatory challenges
21 associated with related activities. In this particular instance, a business involved in
22 developing aerial surveying technologies faced decisions on how the business might
23 grow that included options to operate aircraft and use the technology to collect and
24 analyse data on behalf of clients. It is clear that regulatory considerations played an
25 important part in the decision to out-source. Instead, this business has developed in-
26 house capacity and capability to collect and analyse data which includes relatively
27 sophisticated software development alongside checking observations on screen that
28 is highly labour intensive and difficult to manage due to intermittent demand. The
29 business manages this demand using flexible terms of employment, including use of
30 part-time and zero hours contracts.
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40 The above cases illustrate situations where shifts in growth plans led to higher levels
41 of externalisation than first anticipated as well as examples where the reverse
42 proved true. It was concern for regulatory compliance that reversed another
43 business’ decision initially to outsource work to a third party. Over time, the owner
44 recognised the risks involved in not having direct control over aspects of the
45 business that directly affected the safe use of equipment in the leisure industry.
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50 **Businesses’ Responses to Regulatory Knowledge**

51 A key aspect of our analysis concerns the reasons why growth-oriented SMBs might
52 vary in their response to regulation, in particular the extent to which they actively
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3 seek knowledge of regulation and recognise the competitive advantages that might
4 be associated with such knowledge. Interviews suggest that firms are well aware of
5 sources of information on regulation specific to their sector through involvement with
6 relevant trade organisations. Reference to these formal channels of communication
7 of regulation was found throughout the case studies (see Table 2). This was
8 frequently linked to industry standards in general. Firms in more well-established
9 product-markets in particular tended to rely on industry standards recommended by
10 relevant sector bodies (e.g. machinery suppliers, food preserves, brewing). This
11 implies that many small firms do not necessarily distinguish between industry
12 standards and government regulation. They appear to make the assumption (not
13 unreasonably) that those that define industry standards in mature markets will
14 ensure compliance with formal regulatory requirements.
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23 Pro-active approaches to seeking regulatory knowledge appeared to be associated
24 with cases involving relatively new or emerging product-markets. The clearest
25 example of this related to Firm F (environmental technology) where the interviewee
26 stressed that the market they serve is relatively new and highly driven by emerging
27 patterns of regulation. As a consequence, there is clear competitive advantage in
28 acquiring knowledge of regulation. The owner-manager commented that such
29 knowledge gives the firms “*a unique position*” and that to acquire this, they “*needed*
30 *to speak to a lot of people to get it right – finding the right civil servants is not easy.*
31 *Need to know how rules are interpreted and applied. Written documents are*
32 *important but not the whole story. How [do they] made decisions – who is involved –*
33 *what are they trying to do?”*
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42 Firm E (leisure equipment) also displayed proactive approaches to regulatory
43 knowledge and here again, this involved an expanding and relatively new market for
44 specialist leisure facilities where compliance with regulation involves challenges
45 associated with bringing together standards for working with metal structures,
46 construction alongside sport and leisure services. This product market has involved
47 a relatively new combination of existing products and services and their related
48 regulatory requirements. The interviewee clearly stated that knowledge on the range
49 of UK regulations covering the product enabled to business to compete with
50 overseas competition in particular: “*The manufacturing side of our business is*
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3 *covered by the British and European Standards for climbing walls and also has to be*
4 *compliant with all its sector standards..... for structural steel work. Accreditation*
5 *with government regulations and trade body standards are fundamental for the*
6 *business as we compete against the two main foreign competitors in the sector”*
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10 TABLE 2 ABOUT HERE

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12 Our case studies reveal a more nuanced approach to regulatory learning and
13 awareness of compliance issues which suggests that business managers find ways
14 to navigate the complexities of regulation and to deal with the sheer volume of
15 information by combining formal sources with various “proxies” that indicate
16 likelihood of compliance. What this appears to illustrate is the fact that our
17 interviewees rarely rely solely on formal channels of communication but also make
18 use of tacit forms of knowledge concerning regulation – i.e. knowledge acquired by
19 interacting with clients, suppliers, customers and other businesses.
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26 To illustrate this further, some interviewees suggested that if customer expectations
27 are fully met, then the practices of the business are likely to be compliant, or possibly
28 even exceed, regulatory requirements. Another example suggests that other small
29 firms rely on supply chains to alert them to regulatory change. Again, it appears that
30 an assumption is made that compliance with these instructions is likely to be well
31 within the bounds of regulatory requirement. Indeed, the business arguably has no
32 need to (nor interest in) distinguishing between statutory and non-statutory
33 requirements as long as both are met.
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40 Of course, these approaches to compliance do not necessarily impinge on all
41 aspects of the internal operations of businesses and in some cases, recommended
42 industry practices may be overlooked or even ignored. In particular, expanding small
43 businesses may encounter new issues related to employment and the need for more
44 systematic and formal approaches to recruitment, selection, training and HR
45 practices. Owner-managers, however, tend to rely on general awareness via the
46 media and through networking with other businesses to alert them to changes in
47 employment regulation.
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54 There was a perception that public sector bodies (local authorities, health sector and
55 education) create unnecessary burden in recording information that appears
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3 unrelated to the ability of firms to deliver contracts. While some of these
4 requirements may be statutory, there is an impression that many reflect non-
5 regulatory practice that create regulatory burden ('tick box'). Business owners
6 argued that this generates internal administration costs and can lead to external
7 costs - *"They push responsibilities onto us...so... we have to pay an external*
8 *consultant to say that we do what the council wants"* (Machinery supplier).
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13 To varying degrees, firms maintained conversations across their networks on
14 regulatory practice with all of their stakeholders. This ranged from knowledge
15 acquisition through trade bodies, developing regulatory knowledge through the
16 supply chains as well as highly proactive approaches involving influencing of new
17 regulatory standards at sector level nationally through membership of panels and
18 committees. Business owners need not only to be aware of regulation but they also
19 have opportunities to develop their understanding of how these regulations are
20 interpreted and applied in specific circumstances. This was often the case around
21 planning regulations where the firms would negotiate the interpretation of the
22 regulations with various stakeholders in an attempt to gain a successful outcome for
23 the firm.
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32 While many regulations are, to some extent, built into the routine processes of any
33 business, the case studies also demonstrate that growth sometimes presents
34 challenges to these accepted routines due to the need to accommodate changes in
35 the business. Growth exposes owner-managers to new regulatory issues but also
36 has an impact on existing practice across the whole business. The interviews
37 provided an opportunity to discuss with owner-managers how they were made aware
38 of the regulatory implications of their growth projects and how they made use of the
39 different sources of knowledge of regulation.
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46 Growth plans sometimes lead entrepreneurs to adopt quite pro-active approaches to
47 regulatory learning but pro-active approaches, however, were not apparent in all
48 cases. Other examples suggest that owner-managers can be caught out by
49 unexpected regulatory demands that have not emerged from networking or trade
50 body advice. This approach is particularly likely in cases where new product markets
51 are emerging and new standards are being set. As one interviewee observed, we
52 become aware of new regulations sometimes only when they *"slap us in the face"*.
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3 The need for owner managers to engage with stakeholders over regulatory
4 requirements appeared to vary between cases depending on the maturity of the
5 product. In some cases, industry standards are quite well-developed and
6 communicated through well-established trade associations and business networks.
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8 There are many channels through which business owners can learn not only about
9 regulation but also how it applies to their business. In other instances, however,
10 *particularly where growth is associated with product innovation and the emergence*
11 *of relatively new markets*, several interviewees faced challenges associated with
12 under-regulation or perhaps an absence of clear interpretation of regulatory
13 requirements due to the newness of the product. Interviewees recognised both
14 advantages and disadvantages in this situation. On the one hand, lack of clarity
15 might hinder growth, but on the other, there are opportunities to influence regulatory
16 developments that might, in time, reap competitive advantage.
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24 **Business perceptions of regulation**

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27 The final section of the interview gave an opportunity to explore the general
28 perceptions of owner-managers concerning regulatory burdens on businesses,
29 particularly those that are experiencing, or planning, growth. In particular, interest
30 focuses on how cases vary in the extent to which owner-managers regard regulation
31 as a cost to the business or as a source of opportunity. Of course, it is likely that
32 individual interviewees will accept that both arguments might be true, but it is the
33 balance between these that is of interest. As noted earlier, the NAO surveys show
34 that small businesses generally regarded regulations as a burden and the NAO/BIS
35 2014 study and BIS (2015) studies specifically show that a high proportion of SMEs
36 regard regulation largely as an obstacle to growth. To a degree, this has also been
37 borne out in our case studies (see Table 2) with most stressing the time required to
38 keep informed about new regulation and then implementing changes to processes or
39 products made.
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49 It is the time burden that contributes the most to their perception that regulatory
50 burden falls disproportionately on small firms. Interviewees perceived that small
51 businesses tend not to have staff specifically dedicated to managing the impact of
52 regulation. This task is therefore usually undertaken by the owner/manager. Some
53 find that in specific areas like HR/employment issues, they have the option to
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3 contract out this aspect to an outside firm such as a regulatory services firm or
4 solicitor to ensure their compliance with regulations but this generates significant
5 costs in subcontracting.
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8 While some comments indicate that owner-managers believe that small businesses
9 experience a greater burden from regulation in terms of their use of available time
10 and resources, there were as many comments related to feelings associated with
11 fairness. This was expressed in terms of the frustration and annoyance that arises
12 from the lack of a “level playing field”, weak enforcement of regulation on sub-
13 standard traders and inconsistent enforcement between small and large firms. It
14 would appear that regulatory burden is not just related to measurable costs but
15 encompasses wider aspects associated with anxieties and frustrations linked to
16 equity.
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19 While these negative perceptions exist, interviewees also recognise significant
20 benefits for their business derived from regulation and knowledge of regulation.
21 *These benefits are commonly derived from the indirect effects of regulation on their*
22 *business (i.e. the impacts of enforcement on competitors, suppliers and customers).*
23 *Knowledge of the regulatory environment of client groups was particularly significant*
24 *for competitive advantage for several firms.*
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26

27 While the interview focused on the effects of regulation on growth, it became
28 apparent that growth itself also affects the business approach to regulation. It is clear
29 that in several cases the experience of growth itself has led to a more positive and
30 proactive approach to managing regulation. The case studies show examples of
31 businesses becoming more systematic about compliance, more proactive in their
32 learning about regulation and more strategic in their use of regulatory knowledge.
33 Some case study businesses clearly adopt a positive view of regulation as a
34 necessary means of defining and protecting markets, ensuring fair competition as
35 well as providing protection to the public and employees. Such business owners see
36 no conflict between business objectives and regulation. However, other case study
37 interviewees appeared more sensitive to what was regarded as over-complex
38 bureaucracy and seemingly irrelevant requests for information. This was most
39 apparent for firms that depended at least in part on public sector clients.
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3 As regards the impacts of regulation on growth plans, some growth firms are
4 essentially quite proactive in pursuing their growth objectives and therefore most
5 tend to approach regulation in much the same way - by being proactive and
6 innovative in the way that they deal with regulatory burdens. In some cases,
7 additional burdens are dealt with temporarily by outsourcing, for instance, until
8 employee numbers are high enough to justify internalisation. Indeed, growth itself
9 can induce a more systematic and proactive approach to regulation because growth
10 can test the limits of existing business processes. So while the question as to
11 whether regulation inhibits growth assumes one direction of causality (the former
12 inhibits the latter), our cases suggest that the reverse is also possible – that growth
13 can influence business approach to regulation.
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21 The case studies illustrate that growth can create additional regulatory burden
22 though this relationship is not a simple one. We have cases where growth in
23 employment and/or turnover has led to a perceived increase in the time and cost of
24 compliance. However, we also have examples of where growth has raised
25 awareness of the need for a more systematic approach to managing compliance and
26 in such cases any increase in regulatory burden is minimised. Some case study
27 businesses respond to this positively by finding ways to make it work as part of their
28 growth plans. In other instances, the problem is not regulation *per se* but the
29 unintended consequences of regulation, inconsistent enforcement and in some
30 cases even under-regulation. Owner-managers' perceptions and personal feelings
31 about these issues appear to contribute towards regulatory burden in its broadest
32 sense. In some cases, part of this response has involved adopting a more *proactive*
33 approach to regulation. This proactivity can take different forms in different cases. It
34 can involve engagement directly with regulatory bodies, but also greater levels of
35 engagement with industry bodies, supply chains, better use of customer feedback
36 and networking to inform on acceptable practice.
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48 **Regulation and growth of SMBs: Synthesis of findings**

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50 The analytical framework described in Figure 1 can be used to locate the relative
51 position of our case studies (see Figure 2). Two business case studies (Machinery
52 supply, Brewery) tended to view regulation largely as a business cost. Firm H
53 (brewery) responded to this proactively in order to minimise this cost and reduce risk
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3 while in the light of growth experience, Firm A (machinery supplier) had recognised
4 that a proactive approach to managing regulation could be beneficial for the
5 efficiency of the business and they were taking steps to address this. Two other
6 cases (Firm C: Land surveys, Firm G: Tourism accommodation), while generally only
7 reactive to regulation, recognised significant benefits in regulation in protecting their
8 market and controlling rogue traders.
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16 FIGURE 2 ABOUT HERE
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21 The remaining four cases were all characterised by highly proactive stances towards
22 the regulatory environment combined with recognition of the competitive advantages
23 associated with knowledge of regulation. It seems significant to note that all of these
24 cases involve product innovators (as opposed to process innovators). In two of these
25 cases, (Firm D: Food preserves, Firm E: Leisure equipment), the reason for investing
26 time and resource in regulatory matters concerned the advantages to be gained from
27 being able to influence emerging industry standards and protect markets. The other
28 two cases (Firm B: Safety engineering, Firm F: Environmental technology) involved
29 businesses whose markets are fundamentally linked to regulation (design of
30 equipment for use in hazardous environments and innovative technologies applied to
31 environmental impact assessments). These cases, in particular, displayed highly
32 proactive behaviour with regard to the *indirect* impacts of regulation on their
33 businesses through the regulatory requirements imposed on their clients. Knowledge
34 of regulation in these cases is indistinguishable from knowledge of markets.
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44 It is also possible to capture changes in regulatory response induced by the growth
45 process itself. Evidence from Firms C (land surveys) and D (tourism
46 accommodation) suggests that their experience of seeking to grow their business
47 has increased their awareness of the positive aspects of regulation as they seek to
48 grow and protect their product-market. As a consequence of growth, Firm A
49 (machinery supplier) has begun to recognise the need to be more proactive and
50 systematic about regulation in order to increase efficiency. Finally, the four product
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3 innovators have all embraced the need for a positive and proactive engagement with
4 the regulatory environment affecting their own business and that of their clients.
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6 **Conclusion**

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9 This study has shown that owner-managers of growth-oriented SMBs are aware of
10 the costs associated with compliance with regulation in terms of management time
11 and purchasing specialist external advice. While these negative perceptions exist,
12 interviewees also recognise significant benefits for their business derived from
13 regulation and knowledge of regulation, but recognition of these benefits varied
14 depending on the nature of innovation that lay behind business growth. In fact, the
15 case study comparisons in this article suggest that businesses where growth is
16 strongly led by product innovation, in particular in fairly new or emerging product
17 markets, more clearly articulated the benefits of regulatory knowledge and the need
18 to be proactive in searching for such knowledge. In addition, businesses that
19 provided goods and services to customers involved in such emerging markets
20 placed a higher premium on acquisition of regulatory knowledge affecting their
21 clients and tended to see regulation as a source of competitive advantage rather
22 than as a cost.
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33 While the interviews focused on the effects of regulation on growth, it became
34 apparent that growth itself also affects the business approach to regulation. It is
35 clear that in several cases the experience of growth itself has led to a more positive
36 and proactive approach to managing regulation. So while the question as to whether
37 regulation inhibits growth assumes one direction of causality (the former inhibits the
38 latter), our cases suggest that the reverse is also possible – that growth can
39 influence the business approach to regulation.
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45 This conclusion – that growth can affect the business approach to regulation –
46 suggests that there is reciprocity between the business environment and regulatory
47 environments. This conclusion certainly seems consistent with recent research
48 reported by Kitching *et al.* (2008, 2015) that suggests it is too simplistic to argue that
49 regulation either impedes or enables growth. Our cases suggest that regulation can
50 clearly do both (or either) depending on circumstance *and also on the nature of the*
51 *business response*. However, our findings indicate that proactive responses to
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3 regulatory knowledge are particularly associated with businesses engaged directly or
4 indirectly in product innovation in relatively new product-markets. It would be useful
5 now to test this hypothesis with a larger sample of businesses that not only covers
6 high growth firms, but also firms whose expansion plans faltered and other small
7 businesses that remained small or experienced low growth.
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11 This study provides evidence to suggest that the acquisition of regulatory knowledge
12 is particularly significant for growth-oriented SMBs involved in relatively new
13 emerging product-markets. This points to a number of implications for monitoring the
14 level of “red-tape” and its effects on businesses. If this association holds true in
15 general, changes in the reported level of regulatory burden on SMBs may not be
16 related to deregulation policies but to variations over time in the structure of markets
17 and the significance of product innovation in emerging markets. It also suggests that
18 policymakers need to be more aware of the competitive advantages that SMBs could
19 exploit through timely acquisition of regulatory knowledge. The findings also provide
20 yet another argument to support the conclusion that careful design and clear
21 presentation of new regulations working through appropriate business support
22 programmes could actually do more to reduce reported regulatory burden than
23 conventional approaches to deregulation.
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Table 1: Characteristics of Case Study Firms

Firm	Product / Service	Sector	Empl	Start date	Growth and Development Path
A	Machinery suppliers	Wholesale	35	1979	Well-established family business seeking to <i>grow dealership</i> with global machinery manufacturer. Recent <i>investment in relocation</i> .
B	Safety engineering	Business Service	25	2011	<i>Diversification</i> from safety case management into safety engineering design in related sectors
C	Land surveys	Business Service	22	2002	<i>Process innovation</i> -investment in unmanned aerial vehicles and associated software
D	Food preserves	Manufacture and retail	20	1999	<i>Product and marketing innovation</i> – local foods in export markets
E	Leisure equipment	Design and manufacture	20	1993	<i>Product innovation</i> – specialist equipment for indoor climbing activity
F	Environmental technology	Design and manufacture	18 (+50)	2009	<i>Product innovation</i> - specialist equipment and skills in data interpretation for oceanic environmental audits
G	Accommodation	Tourism	6	2007	<i>Investment in product improvements</i> - to obtain 5* grading for all “lodges” aimed at short break market.
H	Brewery	Manufacture	2	2007	<i>Diversification</i> of local traditional pub into beer production – micro-brewery

Source: Authors' survey- interviews conducted February/March 2015

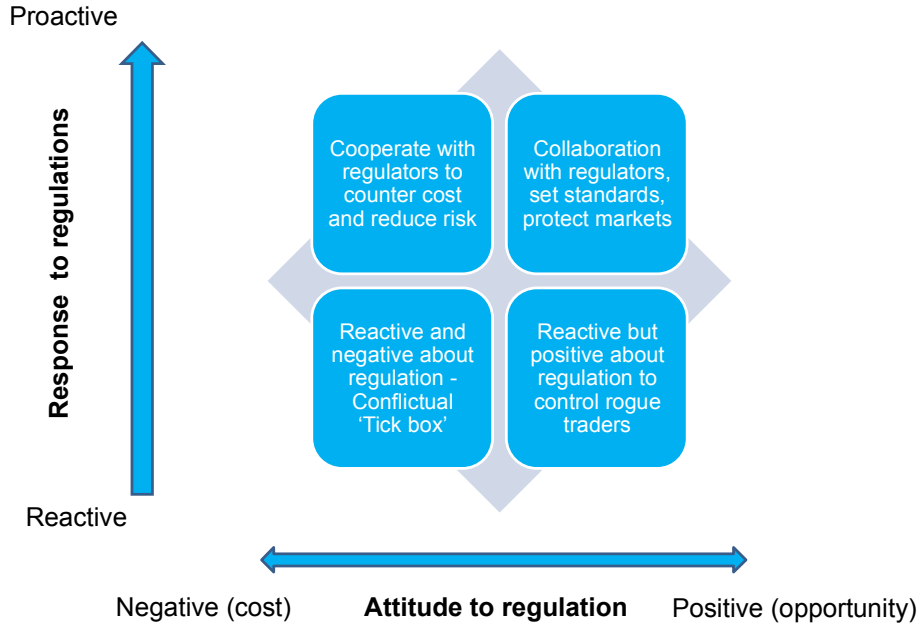
Table 2: Businesses' response to, and attitude towards, Regulation

Firm	Product/Service	Response to regulatory knowledge (proactive or reactive)	Attitudes towards regulation (cost or opportunity)
A	Machinery supplier	Tend to be passive and rely on signals in the supply chain. Makes use of external consultants to address issues. React to regulatory issues when they arise.	Largely viewed as a cost. Burden is exacerbated by the interpretation of the regulations by public sector clients. Part of the burden is the lack of a central point where all regulatory information for the business can be accessed.
B	Safety engineering	Regulation vital to whole business – tend to actively seek latest developments. Seek regulatory advice when necessary from other sources such as HR advice from local solicitors.	Regulation is vital for generating market opportunity but there is also considerable burden related to varied interpretation of regulations by the governing national and international bodies of the sector.
C	Land surveys	Rely on information from sector-based bodies. Seek regulatory advice when necessary from other sources such as Chambers.	Mainly concerned about lack of specific regulatory control over the sector means that the burden is not equally distributed between all firms. Different interpretations of local regulatory bodies within the UK add to the burden.
D	Food preserves	Tend to seek to influence regulatory environment. Industry standards are disseminated via sector bodies. Need to actively seek regulatory knowledge in export markets.	Regulation seen as a definite source of competitive edge especially in export markets. Complexity and variety of rules however creates burdens. There are also different national and local regulatory bodies <i>within the UK</i> which adds to the burden.
E	Leisure equipment	Compliance ensured by industry standards and accreditation from the sector body. Owner networks across various trade and regulatory bodies to try to influence interpretations.	Knowledge of regulations is viewed as an advantage. The business is cooperating with the sector bodies to create 'regulations' that will be equally distributed between all firms working in this sector. Over regulation tends to reduce self-responsibility.
F	Environmental technology	Highly proactive in engaging with regulators and seeking to understand	Knowledge of regulations is viewed as a vital source of competitiveness. The burden is associated with the varied

		interpretations.	interpretations of the regulations by the sector's industry standards and by customers.
G	Tourism accommodation	Tend to be fairly reactive to regulation. Pay much more attention to customers on social media – set standards well above minimum regulation.	View regulation not so much as an opportunity but as a definite benefit in terms of protecting a 5-star marketplace. Negative views of regulation relate to poor or inequitable enforcement.
H	Brewery	Tend to be reactive rather than proactive. Regulatory compliance is sector led via sector bodies' newsletters and training courses. Tend to seek regulatory advice when necessary, not routinely.	Regulation is a cost, but important to protect the market. Not so much viewed as an "opportunity". A perception exists that the burden is not <i>equitably</i> distributed between all firms working in this sector.

Source: Authors' survey- interviews conducted February/March 2015

Figure 1: Business Response to Regulation



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Figure 2: Case Study Responses to Regulation

