

Policy, Delivery and Impact a decade of New Zealand small business failure

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INTRODUCTION

Consistent with the theme of this conference the paper stretches the boundary of what might be considered free and frank evaluative comment. By its nature is born out of a political agenda, yet the political opportunities and political risk is not traditionally considered evaluation. In the discussion following the policies relating to small medium enterprises in New Zealand are considered within a political economy model. The economic framework is conventional transaction economics and the market research using questionnaires, interviews and focus groups is mainstream. The question addressed is necessarily political in part, at least, and the problem identified is political in terms of bureaucratic capture.

The small to medium size enterprise (SME) sector, of the New Zealand economy, is very significant however its contribution is measured. Public policy concerned with the sector provides opportunities to achieve multiple objectives and outcomes that impact significantly upon the whole nation. It is surprising therefore, that government policy towards SMEs has not been subject to rigorous evaluation at the macro or micro level and when it is analysed fails the conventional requirements for sound public policy. In this paper comment is passed upon what has happened and the lessons which may be learned through reading these entrails. The findings are not encouraging and a fresh look at policy towards the sector is necessary.

SMALL MEDIUM ENTREPRISES IN NZ ECONOMY

The proportion of SMEs to all business in New Zealand is according to Cameron et al (1997) over 99.4% and the workforce engaged by SMEs relative to the total number of employed is also large at 60%. Figures relating to the contribution to gross domestic product are not available, however, it is likely to represent a significant component. There are, not surprisingly, several definitions of what constitutes a SME and a widely accepted approach is to include businesses with not more than 50 employees.

While SMEs play a significant role in the economy and have the potential to add significantly more, they also fail at alarming rates.ⁱ Anecdotal evidenceⁱⁱ points to a significant number of business failures resulting in the personal bankruptcy of the owners. On the surface this appears less than efficient. It is a concern in economic terms due to both the loss of productive efficiency and the extent to which there is transference onto the public purse through welfare payments. If the high level of SME failure is the result of information asymmetry, poor signalling and classical market failure conditions, then there is potentially sound reasons for government to intervene in the market place.

HISTORY OF SME POLICY

The decade of the 1990s saw the replacement of the Regional Development Councils with the Business Development Boards (BDBs). These BDBs were restructured three times between 1993 and 1997 and finally disestablished in 1998. A new BIZ Programme initiative was launched in 1999. Recent indications of a new pragmatism indicate ad hoc initiatives based on Irish,

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Finnish and Israeli experience will be introduced, including such concepts as clusters, incubators and networks similar to the Joint Action Groups (JAGs) supported by TRADENZ.

The lack of consistent policy is surprising. Given the sheer number of people involved in SMEs it is surprising that there are not more votes to be bought. While there is heterogeneity of political positions represented within the SME sector it is perhaps the lack of cohesion as a lobby, which leaves them under politicised. By comparison to the farming lobby or the French peasants, who are almost always revolting, the New Zealand SME sector lacks cohesion. The exploitation of political advantage is fraught with danger in this context and any policy is inherently difficult. SMEs seem to know not what they want other than handouts, lower compliance costs and the winding up of the IRD. The policy, therefore, needs to have a significant degree of parentalism associated with it. However, as the rotten kid would suggest this is not an equilibrium gameⁱⁱⁱ. However, while a rotten kid is self-interested if he/she has enlightened self interest, ie not just short-term gain, then this will be far more “rewarding than short-sighted piggishness” (Hirshleiffer 1985, p 57). Lobby groups such as the Chambers of Commerce do have a role. However, they are a long way from being either politically astute or proactive in achieving political unity and have not been successful in achieving maintenance of government resources in the sector.

The funding of programmes by the Crown for 1999-2000 is marginally less than for 1992-3. The objective for the vote Business Development reads impressively but neither the funding nor the actions indicate there is a strong probability of significant outcomes being achieved. *“The services to be purchased under Vote Business Development will be directed at improving the growth prospects of firms, in particular small and medium enterprises (SMEs), by assisting in the development of SME management capabilities, and facilitating the provision of information on training and business assistance options”* (Estimates 1998/9, p 144.)

YEAR	ALLOCATION (\$M)
1992/3	16.0
1993/4	32.4
1994/5	22.2
1995/6	22.5
1996/7	18.3
1997/8	17.1
1998/9	20.5
1999/2000	15.7

GOVERNMENTS' APPROACHES

Successive governments have failed to utilise the potential for SME related policy in support of its fiscal policies. The opportunity to use targeted interventions as an instrument of full employment and growth policies has been passed over. The purist ideology of level playing fields, not dissimilar to Flanders, has driven government forward and it is only now in the light of the new (Bill) English curriculum such policies are being examined. It appears that there will be a significant rethink of policy in relation to SMEs (and also the whole Public Goods Science Funding scheme) as government moves to promote commercial interests that serve national priorities.

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It seems inevitable that there will always be some form of government policy toward SMEs. Given purely the number of people involved with this sector it is unlikely any government could completely abandon the area. Although there is a lack of political cohesion reflected among those who are participants in the sector there will remain opportunities for endeavouring to pitch vote winning strategies into the SME arena. The party manifestos of Labour and New Zealand first present some quite different options to the electorate.

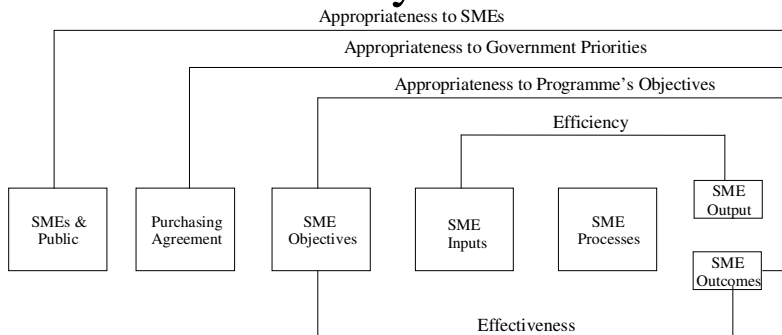
On purely efficiency grounds there are persuasive arguments that may be mounted supporting active government policy for SMEs. Suggestions include the apparent informational asymmetries, externalities and possibilities for enhanced fiscal targets of growth full employment and improved balance of trade. However, any government initiative to overcome market failure must overcome tests for government failure.

ANALYSIS OF POLICY

Four criteria, based on public choice theory, were used as benchmarks for the evaluation, viz (1) credible; (2) sustained; (3) support for institutional form; and (4) support for policy choice.

1. The analysis of government policy through the 1990s indicates it is not **credible**. Four factors lead to this view. First, the direction of policy keeps changing. Major tombstones on the path included the winding up of the Regional Development Councils and their replacement with Business Development Boards. These BDBs were subsequently revised in terms of charter three times before being scrapped. In the economic game theory framework, like the rotten kid theorem which holds out the possibility of longer-term self interest driving good results, the BDB were subject to a McCully equilibrium^{iv}. The Ministry of Commerce (MOC) just kept changing the goal posts. The BIZ Programme has been in place for 6 months but many components have not yet come on stream. Information on the nature of the services is presented in Locke (1999) and is also available through its web site. There appears also to be a new pragmatism emerging with ad hoc announcements of ideas or proposals, which might find their way into the SME policy folder.
2. Second, the policy has not been **sustained**. Even before announcements of change there was intermittent signalling that meant there was always uncertainty as to what was perhaps the most transparent feature of the policy being conducted through the BDBs was a massive file, library and archive search and

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3. Third, the lack of **support for an institutional form** raised concerns at the client level. In part this may have flowed through from the worries of those directly involved. The inability to find a governance regime in which the government could have confidence or alternatively quieten MOC's grasping for a recovery of the power role resulted in unstable institutions.
4. Fourth, the low level of support from the SME sector for the changes reflects **poor policy choice**. Given the low level of understanding of the new programme and the dissatisfaction expressed by those involved as SME clients suggests political positioning will want further changes.

Surveys

Two surveys^v conducted as part of an ongoing project relating to SMEs highlighted problems. The Management Research Centre SME Benchmark Study^{vi} March Quarter 1999 asked proprietors about the closure of BDBs and the introduction of the replacement scheme.

AWARENESS OF THE WINDING UP OF THE BUSINESS DEVELOPMENT BOARDS

<i>Awareness</i>	<i>Percent</i>
Aware	41.87
Not aware	58.13
Total	100.00

A supplementary question to those who were aware of it indicated that over two thirds of those who knew about the winding up of the BDBs were opposed to it.

AWARENESS OF THE GOVERNMENT'S NEW INITIATIVES FOR SMEs

Awareness	Percent
Aware	26.60
Not aware	73.40
Total	100.00

Exit Interviews

A further study^{vii} in May 1999 interviewed 10 of the 21 ex-managers of the closed BDBs. While recognising that this sample would not be likely to be inclined toward supporting the replacement initiatives, they were considered reliable in regard to specific factual matters. In particular none were aware of a formal evaluation of the BDB outcomes. The unanimous view was that the 8-9 years invested in developing a credible brand supported by relationships was now discarded and that it would take quite a while to rebuild those relationships from scratch. This view is supported by the first survey that indicated that over 2 months after the closure of the BDBs nearly three-quarters of the SMEs surveyed were unaware of any new programme.

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The final theme observed from the analysis is the positioning of MOC. It seems that the Ministry engaged in a programme of bureaucratic capture. In part this may be the result of normal bureaucratic tendency emphasising process and specifically control rather than a clear enunciation of outcome and outputs. Lack of progress in these latter regards may relate to capacity or more likely the desire to regain control of the process. Although models of governance had been developed and were being implemented in other Crown agencies MOC could not seem to put the energy into making it work for BDBs.

Biz Programme

The current programme has been operating for less than six months and it is not feasible to evaluate deliverables. However, it is appropriate to evaluate internal consistency issues such as: (1) timeliness, (2) transparency, and (3) accountability.

1. The BIZ programme got off to a bit of a rocky start with unrealistic time lines. MOC required rapid submissions and responses from tenders for service contracts but could not perform themselves in terms of timelines set. The final allocation of the reduced pool of money may or may not reflect a regional per capita base and it will be interesting to see what figures do become available. The evaluation criteria for the programme have not been made public.
2. Within this programme both the policy and the purchaser branches are located within MOC. While it is presented as being two separate units there is no information yet available on whether staff may apply for jobs, eg promotion or transfer, between these two branches. The extent to which real separateness can be achieved is as yet unknown. This of course is fundamental to credible evaluation. The potential for uncontrollable agency costs, in an economic sense, exist when monitoring is to be done by work mates. The likelihood of clear objectives, accountability and transparency is very remote when it is colleagues looking after each other. This is especially true when one might want a job with the other in the future.
3. The danger that this analysis highlights is the likelihood that the new programmes will be placed under heavy duty MOC surveillance without the development of acceptable evaluation protocols. Given the lack of evaluative criteria promulgated with the policy proposals which Cabinet adopted it suggests these are still being developed. Accordingly, the loop has not been closed and probably expediency and capture will work against clear analysis and evaluation as it has done so for the last decade.

SUMMARY

The Management Research Centre, an independent profit unit at the Waikato Management School, has been conducting interfirm financial studies, known as BPCs (benchmarking performance comparisons, for nearly 25 years and has an extensive database on how SMEs perform over time and between industries. It was the lack of an aggregate picture showing real growth through the last decade in revenue per employee or profitability that first raised concerns as to whether the SME policy was contributing to national strategic result areas.

The evaluation of SME Policy considered three levels of concern. These levels subsume within each the traditional issues of appropriateness, effectiveness and efficiency. The intention was to stretch the boundary of the framework. The issues considered related to the aspects of: (1) Political; (2) Public Choice; and (3) Efficiency. The findings suggest there is room for improvement.

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ⁱ The extent to which the failure of SMEs translates into bankruptcy is the topic of a current research project.

ⁱⁱ Currently we have a researcher looking at the SME failures in 1995 onwards and tracing these, in aggregate, through to determine the proportion ending personal bankruptcy of the owner(s) and the size of the debts written off. If the results are available before the conference these will be interpolated into the presentation.

ⁱⁱⁱ Rotten kid theorem, as discussed by Hirshleifer (1985 p57) suggests that “Golden-Rule motivations can be functionally profitable”.

^{iv} Mc Cully equilibrium requires participants to guess what the Minister wants, without it being clearly signalled, and then ensuring that it is achieved. This is in contrast to Nash equilibrium whereby there exists a set of strategies such that each participant’s response is as good a decision as any other in response to another participant’s actions. The difference relates to not only informational asymmetry but also the bonding and monitoring components of agency cost.

^v Based on a sample of 900 contacts.

^{vi} NZ Business Magazine publishes the quarterly results of the SME Benchmark Index survey.

^{vii} Ethics Committee clearance within the University was sought and obtained before engaging these human subjects.