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# The distributional role of small business in development

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**Keywords** *Small enterprises, Economic development, Distribution, Democracy, Decentralized control*

**Abstract** *Economic growth, without distributional measures and policies, engenders inequality and concentration. National income may be distributed either through the establishment of a proper welfare system, or by the encouragement of and incentive for economic activities and policies with built-in distributional factors. The prerequisites for sustainable income distribution are fair distribution of assets, investments and power. The main outcome of the growth-based developing theories and activities are concentration of production, people and financial and political power. These concentrations are the sources of many problems of both developing and industrialised countries. Although there have been countless studies about development, few have made an attempt to investigate the social and economic interactions of small business with sustainable development. Small business' contributions to the process of development, in terms of distribution of economic and non-economic resources, are substantial. This article will explore the economic and political distributional power of small business and their roles in the process of socio-economic development.*

## Introduction

An economy consisting largely of small firms has a broader dispersion of economic power than one in which output and employment is concentrated in a small number of large units (Bannock, 1981, p. 10).

The traditional growth-based economic development, although successfully achieved by some industrialised countries, is neither environmentally sustainable nor socially desirable. Consideration of growth as development resulted in the concentration of income, assets, investment, and political power. The present global political, social, ecological and economic conditions are explosively dangerous, and require urgent attention. There are arguments against growth-based development suggesting that, at best, it is a trade-off between economic and social values (Trainer, 1988, pp. 15-16). It has been found that, much of the widespread criminality, violence, corruption, and psychic misery in capitalist industrial societies are caused by large-scale unemployment (Sarkar, 1999, p. 208) that has been created by capital-intensive investment and labour-saving technology (Ashton and Laura, 1998).

## Distributional power of small business

The distribution of economic power through a system of small firms leads to a more favourable distribution of power in society in general (Rothwell and Zegveld, 1982, p. 1).



Small businesses are not only generators of jobs and income. Owing to their extremely flexible structure and varieties of activities, they can also provide opportunities for almost everyone interested. They also make use of resources that would otherwise be wasted (Marsden, 1981). There is evidence indicating that small business has a major role in economic stabilisation, and any decline in the small business sector will sooner or later affect the rate of economic growth (Bannock, 1981, p. 104).

### Income distribution

It is not the level of income alone that matters - it is also the use that is made of this income (United Nations, 1994, p. 17).

Small industries are diverse. They can be established for any business activity, in urban or rural areas, in big cities or very small villages. Promotion and development of small businesses is recommended not only for economic improvement, but is also one of the main vehicles of social and political stability in search of excellence (Peters and Waterman, 1982). Job-creativity has an inverse relationship with the size of a business (Bannock, 1986, p. 16), and small businesses provide more job satisfaction than their larger counterparts (Talachchi, 1960; Curran and Stanworth, 1981). Research indicates that people working in small business are happier, despite lower wages and poorer work conditions, than those in large enterprises (Brown *et al.*, 1977, p. 19). Job-creation benefits of small business go beyond the employment contribution, for a significant number of new jobs are associated with new small investments – an indication of distribution of both income and assets.

Small business performance is related to two macro-economic aspects: the growth rate and the level of development of the country. It is suggested that small businesses contribute more to employment in countries with low levels of income (Mead, 1994). The job-creation capacity of small business declines as countries become richer. Perhaps this is the result of the increase in economic capacity which allows more significant roles for large and medium-sized business. Mead (1994) also argued that, in a stagnant economy, supply-push forces are effective, but in a growing economy demand-pull forces would be more prevalent. A recent study about small business concluded that, although the younger (than ten years) enterprises make a higher contribution to employment, stabilised small enterprises of a variety of ages have also contributed to employment generation, especially in rural and outer metropolitan areas. In England, small firms in rural areas achieved the best employment performance, 51 per cent net increase, and London the worst, 7 per cent net increase (Smallbone and North, 1995). These two studies indicate that small businesses, in terms of employment and distribution of income and investment, could even be more effective in developing countries than

industrialised countries. This is an indication of the vital role of small business in the process of sustainable development of developing countries.

According to Balkenhol (1990), small businesses have advantages in utilising production factors more economically than large enterprises, through their exploitation of unskilled labour in developing countries. Small businesses transform unproductive small family savings to constructive investment, and they represent the best practical training grounds for future national entrepreneurs. By their nature they can react to market fluctuations faster than their counterparts, they have advantages in creating jobs, labour shortage is their number one concern (Heneman *et al.*, 2000), and they consider labour cost more as a fixed cost rather than a variable. Consideration of wages and salaries as a fixed cost in small businesses is an indication of a higher degree of business and social sensitivity. Employment is a means of sustainable income distribution particularly with the absence of social welfare in almost all developing countries.

What is less recognised is the relationship between prosperity and the proportion of small businesses in a given society. Geoff Wood, director of Sheffield Polytechnic's Centre for Innovation and Productivity, compared cities in which the proportion of workers in small businesses was higher than 30 per cent (Leicester – 44.6 per cent, Northampton – 41.6 per cent, Leeds – 41.3 per cent, Greater London – 40.4 per cent) with those cities at the lowest level (Barrow – 8.3 per cent, Teesside – 15.8 per cent, Flint – 17.2 per cent, Preston – 18.7 per cent), and concluded that, prosperity and small businesses go together (cited in Brown *et al.*, 1977, p. 19). Also Drever *et al.* (1999, p. 2) indicated a positive relationship between small firms and prosperity in some regions (such as Emilia Romagna) in Italy.

Some researchers suggest that, a “widespread, numerous and prosperous small business sector is more likely to be associated with relatively equitable income distribution than a smaller number of large enterprises” (Harper, 1987, p. 19), regardless of whether publicly or privately owned. The nature of small business is distributive and supportive of the less fortunate. The sector not only provides jobs and associated financial benefits, but it also generates “the prideful sense of being independent” (Pradhan, 1989, p. 157). In the absence of smaller businesses, their share of income would probably be collected by and concentrated in larger enterprises.

The primary problems of developing countries are the concentration of people and unemployment in urban areas and continuous rural-urban migration. A direct confrontation with these problems is the creation of jobs and opportunities, but not in the metropolitan areas. Relatively simple workplaces, minimised skill demand, maximised use of local resources and local markets must be the principles of new job-creating projects (McRobie, 1981, p. 27). One of the major sources of unequal distribution of income in both developing and industrialised countries is unequally distributed resources

(Saeed, 1994, p. 117; Trainer, 1995, p. 180). Narrowing the extremes between rich and poor should be an explicit goal (United Nations, 1999, p. 11), because concentration of wealth and investment eliminates the possibility of fair income distribution. Provision of a limit to extreme wealth is fundamental to eliminate abject poverty (Abdu'l-Baha, 1982, p. 132).

### Investment distribution

Decentralised investment strategies can increase economic participation (United Nations, 1993, p. 77).

Some economists and development specialists have suggested an adverse relationship between concentration of wealth and income distribution. For example, Todaro (1989, p. 322) suggested that:

[...] in most countries the highly unequal structure of the land ownership is probably the single most important determinant of the existing highly inequitable distribution of rural income and wealth.

Distribution of wealth and assets in developing countries is politically very sensitive, especially if it is directly associated with the development activities. It was traditionally believed that when the poor outnumber the rich, certain political attention, in terms of income and asset distribution, is required (Birdsall and James, 1993, p. 340). Today, the interests of the rich and the poor, nationally and globally are becoming less and less related. Therefore, development strategies require creative visions and institutional changes (Morgan *et al.*, 1993).

The continuing challenge for national and global development is not only economic growth (Abedian, 1996). It is already clearly recognised that economic expansion and development progress, even if interrelated, are two different issues (Holliday, 2001, p. 15). As is now generally agreed, development should promote an equitable distribution of economic and non-economic factors (Sivard, 1991, p. 9). If concentration is caused by the capital-intensive large investment, then small and labour-intensive businesses are a good means to prevent concentration of investment. More small businesses in a community indicate larger number of asset owners, therefore, higher level of income and investment distribution.

According to Bechhofer *et al.* (1971), small businesses have been supportive to many communities, during hard times. For example, the years before 1939 saw the establishment of many small businesses with very limited capital. Although many of these businesses failed to survive, in these years the number of the so-called "*petite bourgeoisie*" increased. A major advantage in small business is the low level of capital requirement, that is why small businesses are considered to be more appropriate "not only in the large cities but also in the smaller towns and more remote areas, thus enabling more balanced dispersion of industrial activities" (Paterno, 1979, p. 133).

External investors usually are more concerned about their returns than local needs. Most of the environmental damage ensuing from industrial development is related to the lack of direct relationship between investors and local environments within which their investments operates (Robertson, 1990, p. 45). According to the United Nations (1991, p. 4), development requires socially purposeful investment. A socially purposeful investment is an investment which is related to the needs and capacity of people, and allows people to work towards their personal and social requirements. It is small businesses that have the capacity to serve these purposes, and have the flexibility to match the needs (Gordon, 1979).

The Canadian Federation of Independent Businesses found that more knowledge- and skill-intensive manufacturing, new rural industry, more independent retailing, and more decentralisation are the major issues that the Federation is arguing for in its aim to build a new economy for Canada. Peterson (1997, cited in McRobie, 1981, p. 168), who was commissioned to make a study regarding this plan, in his research which became a classic work argued that, "we must ensure that our governments pursue a goal of the fair dispersion of wealth and power, and not income. Fixation on income encourages too many of us to become employees, dependent ultimately on 'someone else'. Widespread acceptance of the goal of dispersion of wealth and power would lead to greater individual freedom, have a snowballing effect on Canadian creativity, and provide opportunities for a far larger proportion of us to become self sufficient".

In political terms, democracy means the power of the majority. Economic democracy is the same – the power of the majority, and it may not be realised if the investment power is concentrated in the hands of a few (United Nations, 1994, p. 19). The most democratic society is the one in which the economic and political power are relatively fairly distributed. Distribution of income and investment can only be realised in morally advanced and socially democratic societies (Abdu'l-Baha, 1982, 102), and development of large-scale industries increasingly tends to enlarge the scope of authority (Sarkar, 1999, p. 22).

### Power distribution

The existence of small firm has positive effects on political and social stability (Rothwell and Zegveld, 1982, p. 1).

According to Godelier (1986, pp. 3-4), society has always existed as articulated group relations and functions, all of which are vital to its existence and sustainability, but their reproductive power is variable. That is why the reproduction of any kind of society is impossible, beyond certain variations or alterations in the social relations which constitute it, and the material bases which it depends on. Social requirements are not only material goods, and jobs are more than the economic productivity of, and income for, workers (Ingham, 1970).



There are two ways to co-ordinate the economic activities of people: to control people's behaviour by the use of central coercion or to prepare and educate people for voluntary cooperation (Friedman, 1982, p. 13). The major threat to freedom is the power to coerce. Friedman (1982, p. 15) suggested that, removing the control of political authority from economic activities generates the opportunity for the market to eliminate the sources of coercive power. Sarkar (1999, p. 175) argued that "the fundamental belief that in the final analysis the market produces the best result for all concerned" is a tragedy. Government policy should help to provide long-term stability and continued commitment to the economic agenda (Saeed, 1986, 1990).

To preserve democracy, prevention of the extreme concentration of economic and political power is required. Political and financial power are both interconnected and unfairly distributed:

The spreading of wealth and decision-making are the basis of a free society and their dispersion is epitomised by small businesses with the alternative they offer to the pervasive power of the Socialist state (Brown *et al.*, 1977, p. 8).

Small business has been viewed politically as central to economic development and increasing employment opportunities (Kempnich *et al.*, 1999, p. 1). Therefore, promotion of small businesses, based on local requirements, is expected to improve wealth distribution, participation and democracy.

Democracy at work is vital to the development of political education, and the role of the working class in promoting democracy is substantial (Rueschemeyer *et al.*, 1992, p. 3). Therefore, without democracy at work there can be no full democracy in society and the attitude of individuals will depend to a large extent on the authority structure of their work. Workers' participation in decision making is vital to increasing productivity. Individuals can relate better to a small identified group than to a large and impersonal organisation, "they do feel better about their work if their participation controls decision-making" (Carnoy and Shearer, 1980, p. 177) and their productivity increases.

Polanyi (1967), comparing the present to the past, considered present economies as historically unique and resulting from the great transformation. Trainer (1996, p. 132) argued that, this is neither great nor transformation and is caused by the lack of social, religious, political and ecological consideration. The predominant factors of decision making in the ancient economies were not profit maximisation of a particular organisation or individual. Trainer (1995, p. 150) noted that, in the absence of a social sense of responsibility, the more individuals are freed to pursue their own advantage, the more social cohesion will be undermined. Sen (2000, p. 149) suggests that individuals must put the state's, or social, rights before their own.

Development is not increasing productivity, it is creating an economic and political environment in which people can expand their capability and choices. When growth and progress are not connected, the unemployed and workers in insecure and poorly-paid jobs feel alienated from the growth of their national



economy (Gallop, 2000, p. 15). Distribution of investment increases the diversity of economic activities and, as a result, liberation of workers' initiatives and choices. It is the economic and social distributional power of small businesses that provides this opportunities and "constitute a powerful contribution to the formation of a democratic society" (Weiss, 1988, p. 137).

Concentrations of economic power in large corporations and concentration of workers in unions and labour organisations have been generated under the tabernacle of social democracy. Now, many socialists are suspicious that these fundamental products of democracy are being used for the short-term interests of politicians or union leaders (Archer, 1995, p. 85). The organisational structure and the concentration of economic and political power can be considered as a danger to democracy, because although it is a collective power, it does not necessarily represent the majority. Recent studies concluded that "the more democracy, the more equal the distribution of income" (Ersson and Lane, 1996, p. 64). In a society in which wealth and income are concentrated, democracy may not be realised.

The majority of economists paid little attention to social relations and the satisfaction of non-material needs, in their economic models (Hidy, 1970). In recent years, there has been a growing interest in this area. An early attempt was made by Harbinson and Myers (1964) to establish strategies for human development under the triangle of education, manpower and economic growth. Lutz and Lux (1979) expressed the challenge of humanistic economics, and Schumacher (1989, p. 6) referred to education as "the greatest resource" and the base for every great civilisation. Ogwang (1994) concluded that, life expectancy is the most reliable single variable to be used for human development measurement. This conclusion confirmed Schumacher's suggestion which was made 21 years earlier. Therefore, the prerequisites of power distribution are income, investment and education distribution. Small businesses are suggested to be effective means of economic distribution and social stability (Brown *et al.*, 1977, p. 19; Balkenhol, 1990). The focus on small business as a means of economic development is closely allied with political economic issues and job-creation potential (Kempnich *et al.*, 1999, pp. 1-2).

### Small business and decentralisation

Small businesses allow an economy to be more adaptable to structural change through continuous initiatives embodying new technologies, skills, processes, or products (Ibielski, 1997, cited in Kuratko *et al.*, 2001, p. 293).

The problem of concentration was recognised by Mill (Principle of Political Economy, 1848, cited in Bannock, 1981). Mill foresaw that the increasing return to scale resulting from capital-intensive investment would lead to concentration of many industries in a few large firms. It was in 1930 that economists recognised the existence of concentration and developed the theory of imperfect

or monopolistic competition. This theory indicated that in many industries, one or a few firms controlled a large proportion of market (Bannock, 1981, p. 80).

The decade of the 1980s was a period for the re-examination of business practices. This led to the discovery that eliminating workers is not the only possible means of improving competition. The competitiveness of an organisation may be improved through decentralisation of financial and political powers such as profit sharing and active engagement of workers in the operation (Walton, 1985). Many large organisations are more sceptical about size advantages and are becoming more concerned about the liabilities of scale (Peters, 1992). Disaggregation of the Italian textile industry (Mariotti and Cainarca, 1986), vertical disintegration of many foodstuffs, printing, clothing, shoemaking and others in England and the subsequent increase of small businesses (Wilkinson, 1983), the big shake-up of the auto industry in the USA (Naisbitt, 1994, p. 56), and many other examples indicate that the traditional understanding and approach were defective and not more than a productivity dilemma (Abernathy, 1978).

Most large organisations are seeking new ways of organising and reconstructing their workplaces. Firms have rediscovered the competitive model of micro-economic theory, as well as cost cutting, fewer managerial restrictions, and favourable government lobbying (Powell, 1990). Firms have focused all their attention on becoming more competitive and flexible by reconstructing their nature of production. Although, the main intention is to improve the financial performance of the large businesses, sometimes reconstruction in businesses has an aim to balance their social and economic responsibilities (Thurow, 1996, p. 27). These changes are intended to make firms "lean and mean", which requires some form of vertical disaggregation or "down-sizing of the large corporations". Therefore, the traditional concept of "economies of scale" has already given way to the "economies of scope" (Peters, 1992), and there is growing evidence that the industrial era has already ended (Ikerd, 1996).

Decentralisation may not only be based on efficiency or improving the productivity of a particular business size. Some Eastern transnational corporations are extremely large and wield considerable global influence (Lall, 1983). Therefore, decentralisation of large Western corporations may have been based on hidden political and economic agendas that require further research. For sustainable development, decentralisation is essential, regardless of what large businesses thought in the 1950s or why they changed their minds in the 1980s:

Attitudes to concentration have been too permissive for too long, there is now an overwhelming, and indeed generally accepted, presumption that some shifts in policies in favour of small-scale enterprises is necessary (Bannock, 1981, p. 101).

Unless these realities are realised and reacted to, development at best will be the generation of "poisonous gases and gaps".

According to the United Nations (1993), the majority of governments are distanced from people and their needs. This is the result of both bureaucracy and lack of touch. Centralised decision making does not allow participation. Decentralisation is not only important because it is cost efficient and improves the way resources are used, but also because it encourages people and improves their participation and contribution. If local residents are convinced that their cooperation, participation and contributions such as tax and social services are beneficial to their own community they will be more generous. Perhaps, some people do not contribute due to their lack of social responsibility and understanding. Others do not contribute and cooperate because they are uncertain whether their contribution will be used to build the country or to destroy it. Local politicians are more accessible and expected to be more accountable to the people they represent. In fact, they live with people and have personal feelings for the local communities. "Decentralising government – from capital cities to regions, towns and villages – can be one of the best means of promoting participation and efficiency" (United Nations, 1993, p. 66). The same principle applies to local businesses producing for local or regional needs (Sarkar, 1999, p. 222). Factors vital to the survival of small business often depend on strategic support which is at odds with national or state priorities (Kempnich *et al.*, 1999, 3). Therefore distribution of political power should be supportive to small farm and non-farm business in localities, and also to the process of economic decentralisation.

Most governments are not attending to many of their responsibilities. At best, they can only cope with their national problems, but their structures are too large to comprehend local requirements and too small to handle global issues. National powers are inefficiently concentrated, and could be distributed to both the local and global levels. Decentralisation should not be delegation of power from the national to the local élites, who normally have both little interest in the development of local people, and conflicts of social political and economic interests with the local poor. Decentralisation should not be selling off public assets for short-term budgetary gains or contracting core activities to the more influential private sector (Gallop, 2000, p. 12). "Decentralised investment strategies that promote small-scale industries and make better use of local resources, grow materials and skills" (United Nations, 1993, p. 77), increase local cooperation, and generate public expenditure by creating jobs, higher quality service, and higher government support for local entrepreneurs.

There is evidence that very little, if any, trickle-down occurred from centralised "top-down" development activities based on gross national product (GNP) (Arndt, 1983). Improved growth was recognised and appreciated by the statisticians and the rich who measured and received it, but not "by actual people who find themselves oppressed by increasing frustration, alienation, insecurity and so forth" (Schumacher, 1989, p. 25). Alternative progress indicators have shown little improvement in people's quality of life despite a

sizable increase in gross domestic product (Gallop, 2000, p. 12). Apart from the shortages of local resources and the capacity of the environment to cope, the lack of participation in decision making and as a result, cooperation of people is a major shortcoming for “top-down” development strategies. Failure may have been avoided by decentralised approach, concentrated on small business based on local capacity and requirements.

The primary task in developing countries is to prevent rural-urban migration and to reduce urban unemployment. Creation of jobs in urban areas will encourage further migration (Todaro, 1969). Job-creation through small business establishment in rural areas prevents rural-urban migration, and increases the local production, consumption and as a result further jobs. Labour-intensive industries with simple production methods should concentrate on local resources and demands (McRobie, 1981, p. 27).

The decentralisation of production is essential for the geographical distribution of people and power. Technological innovation is no longer to be found principally in large firms. The “model of flexible specialisation” suggested that “within a productive system characterised by the decentralisation of various stages of the production process, the small and medium sized firms will tend towards specialisation in a limited number of phases of production but for many different types of goods” (Guido, 1989, p. 70). According to the model of flexible specialisation, the progressive decrease in economic and social performance of economies of scale has created a growth opportunity for small businesses. The decentralisation of production, people and power is the essential element in the process of social and economic development, and history teaches us that “excessive concentration of economic power has unfavourable and destabilising effects in the long-run” (Rothwell and Zegveld, 1982, p. 1) and “decentralisation can be equated with small business – in all industry sectors” (Meredith, 1993, p. 41).

## Conclusions

Small businesses have a competitive nature, and promotion of small businesses has a substantial influence on the economic and social stability. Small businesses play a significant role in financial and political distribution, and they are an effective means of participation and decentralisation. Small business contribution, in terms of distribution of income and investment, is higher in countries with a relatively low level of income.

If the relationship between economic prosperity and the proportion of small businesses in a given society is true, then a larger number of small businesses represents a relatively more equitable income and investment distributional mechanism than a smaller number of large enterprises. Small business investment can easily be related to the needs and capacities of regional and local communities. Individuals can relate better to a small and identified group than to a large and impersonal organisation.

Political participation generates democracy, and economic democracy is based on economic participation. There are interrelations between economic and political power. Distribution of one is neither possible nor desirable without the other, especially in the process of sustainable development. An individual's attitudes depend, to a large extent, on the authority structure of the work, and the happiness of men and women at home, at work and society are interrelated. Small business provides a better environment for cooperation and participation of workers, and it is an appropriate and effective means for women's involvement in the socio-economic activities.

Investments must be encouraged and directed towards the requirements of local communities. Small enterprises can efficiently and effectively devote the productive capacity of a region to the needs of residents. With the required political and economic supports people are encouraged to make their own decisions, direct their economic activities towards their immediate requirements, and focus on improving local capacities and capabilities in order to improve their quality of life.

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