Less than 5% Potential High Growth Enterprises Kept the National Economy Growth during the Crisis

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1. Introduction

In The Theory of the Growth of the Firm, which was published over fifty years ago, Edith Penrose (1959) showed that "growth equals profit". Ever since, business researchers have been studying company growth, models, motivations, growth strategies, management and business models and especially factors that facilitate or impede growth.

In the first part of the article, the authors present the results of different surveys that tried to determine growth factors of fast-growing companies. The second part of the article presents the results of the first two phases of a survey, whose purpose was to identify Slovenian companies that recorded above-average growth in the last five years despite the economic crisis or recession and have thus contributed to the economic growth by providing new jobs, increasing value added per employee and growth of sales revenue. The survey looks into their possibilities and plans for future high growth in the 2010-2014 period and the conditions in the business and financial environment that should be met in order for their fast growth to continue.

2. Factors of Dynamic Entrepreneurship

The connection between growth factors and growth was established by numerous national and international authors (Davidsson, 1989; Wiklund, 1998; Mei-Pochtler, 1999; Szerb, 2000; Duh, 1999; and others), while in terms of our survey, the findings of the majority of researchers that there are external (environmental) and internal growth factors were important. In line with some of the most renowned business researchers, we can say that enterprise growth depends on three main factors: (1) growth motivation, (2) abilities and (3) opportunities (summarised from Stenholm and Toivonen, 2009). Our survey considered an even more detailed classification of factors, which were researched on a sample of the fastest growing European dynamic enterprises by Roure (1999), Mei-Pochtler (1999) and Pšeničny (2002). They established that enterprise growth is predominantly affected by the following factors: (1) the external and internal environment of the enterprise, (2) the entrepreneur or the entrepreneurial team, (3) innovativeness and the implementation of changes, (4) the growth and harvesting strategies, (5) the business model and management system, (6) human resources and (7) growth financing.

Factors of dynamic entrepreneurship can be described by a number of attributes that affect them either from the external or the internal environment of the enterprise. Mei-Pochtler

(1999) calls them "facilitators and inhibitors of fast growth of gazelles". Numerous surveys established a high level of connection between fast growth of enterprises and environmental factors (e.g. Wiklund, 1998), especially stressing the dynamics of the environment (a growing economy, friendliness or hostility of the environment toward enterprise growth, competitiveness, etc.).

The factors, which have a decisive impact on the development of entrepreneurship, can be subsumed under the term entrepreneurship-friendly environment. This is understood in the broadest sense: from the socioeconomic order that supports or prohibits the profit motive, the cultural and religious aspects of a society and the general attitude towards work, knowledge and similar to individual elements that determine the behaviour and actions of an entrepreneur and an enterprise in a specific environment (multiple authors in Kent, 1984).

Entrepreneurial growth is also affected by numerous other environmental factors, such as health, pension and other security of employees, the labour legislation, protection of knowledge and industrial property, the level of educational attainment and access to knowledge, protection of buyers and suppliers, regulation of the capital market, the state management structure, etc. Richman (1996) for example established that a changed mindset and structure of the country's management greatly contributed to the USA's entrepreneurial orientation. The number of lawyers in the US Congress decreased, while at the same time the number of entrepreneurs, bankers, financial officers and other occupations is persistently on the rise in both the House of Representatives and the Senate. The structure of programmes at secondary and post-secondary schools is also changing, not only in business schools, but also and above all in technical and in natural sciences and engineering schools (Kent, 1990; Robinson and Haynes, 1991). In the last few decades, a number of business researchers have studied environmental factors that impact the development of entrepreneurship and enterprise growth and vice versa with the impact that enterprises and their growth have on the environment. Gabe (2000) developed an empiric model that measures the impact of active policies of the environment (the State of Ohio and others) on enterprise growth. He proved the existence of a positive correlation between a dollar invested in facilitating fast growth of enterprises and the employment rate in these companies. A similar hypothesis and prediction of results were constructed already in 1991 in Slovenia (Pšeničny, 1992) on the basis of studying a modest sample of 50 growing small companies in the 1986-1990 period. Actual growth of the number of employees in the small and medium-sized enterprises sector and the contribution to Slovenia's economic growth were measured by Vahčič, Glas, Petrin (1998), Drnovšek and Glas (2000) and Rebernik et al. (2010). Several years ago, Zahra (1993) undertook the classification of enterprise environments and specified four characteristic environments for enterprise growth: (1) a dynamic growth environment, (2) a hostile and rivalrous environment, (3) a hospitable and product-driven environment and a (4) static and impoverished environment. He established that the first and the third environment were appropriate for dynamic growth. A dynamic growth environment is required, as demand for products is at a level that marketing of products and services does not represent a problem, while a product-driven environment is necessary so as to provide opportunities to innovative enterprises that are directed towards the customer's needs.

Researchers of the European environment of dynamic entrepreneurship and authors of the Not Just Peanuts research project from the pan-European Association of High Growth Entrepreneurs Growth Plus have proven a link between the success of European gazelles and the development of (1) financial, (2) fiscal, (3) legislative and other incentives in setting up companies, the attitude towards entrepreneurship, where (4) tolerance of failure in business

and (5) willingness to take risk were among the most important together with (6) the general entrepreneurial climate and (7) a stimulating legislation for enterprise growth (Andersen, 2001).

In the last decade, this issue has been increasingly studied by both expert and political bodies of the European Commission that established already in the mid 1990s that the business environment is not conducive to entrepreneurship. The EC thus tried to facilitate the entrepreneurial sector with different programmes and declarations. The latest extensive analysis (multiple authors in EIM, 2011) has shown that 85% of newly created jobs can be attributed to growing micro, small and medium-sized enterprises, while the employment growth rate in these enterprises is twice as high than in large enterprises.

The most comprehensive analysis of the entrepreneurial environment is provided by the findings of the international research project, the Global Entrepreneurship Monitor (2008, 2009, 2010, 2011), which determines nine fundamental conditions for a dynamic and entrepreneurship-friendly environment: (1) a favourably inclined government policy and tax regulations, (2) developed government programmes that support entrepreneurial initiatives, (3) availability of financial resources, (4) a developed commercial and professional infrastructure, (5) developed education and training, (6) research and development transfer to companies, (7) internal market openness, (8) access to physical infrastructure and (9) a more favourable entrepreneurial culture and social norms. In the past, Slovenia also saw a number of in-depth analyses on the impact of the environment on enterprise growth, while we were predominantly interested in the external and internal environmental characteristics that were recognised as being significant in surveys of European and especially Slovenian gazelles. 17 environmental characteristics were recognised that have a significant impact on individual key growth factors of an enterprise, while our survey identifies whether these characteristics have an impact on enterprise growth also during the crisis (Pšeničny, 2002).

3. Survey Results

Surveys of fast-growing enterprises or potential high growth enterprises have shown that 5% or less of the fastest-growing enterprises generate 85% of revenue growth and 85% of all new jobs (Birch, 1987; Birch and Medoff, 1994; Roure, 1999; Mei-Pochtler, 1999). The results are comparable to extensive analyses conducted across the globe (Henrekson and Johansson, 2008; EIM, 2011), including the United States, where a survey followed in David Birch's footsteps and studied potential high growth enterprises predominantly from the viewpoint of sales revenue and employment growth (Acs et al., 2008). The mentioned survey established that companies in this group represent from two to three percent of all US firms, are around 25 years old and account for almost all employment and revenue growth in the studied period.

Our previous surveys have yielded very similar results (Pšeničny, 2002, 2009; Bajt, 2008). The Potential High Growth Enterprises (hereinafter referred to as PHGE) survey was aimed at verifying how the economic crisis impacted the growth of PHGE, whether PHGE managed to record above-average growth in the last five years despite the economic crisis and thus contributed to economic growth by opening new jobs, increasing value added per employee and sales revenue. The survey also looked into their possibilities and plans for future fast growth.

3.1 Survey Sample

The survey is based on a quantitative analysis of growth of all enterprises in Slovenia, 4,511 potential high growth enterprises and a sample of 131 enterprises from the database of 4,511 potential high growth enterprises.

The potential high growth enterprises (Vidovič, 2011) were chosen from the database (AJPES, 2010) of all 126,976 economic subjects on 31 December 2010 on the basis of criteria that were recognised as decisive in previous surveys of fast-growing European and Slovenian enterprises (Pšeničny, 2009; Pšeničny and Vidovič, 2011). The list of PHGE thus features enterprises that:

- had more than 2 employees in 2010 or more than one employee if the enterprise was a sole proprietor;
- generated net sales revenue exceeding EUR 100,000 in 2010;
- generated positive value added in 2006 and 2010, which amounted to at least EUR 21,000 per employee in 2010;
- operated for 12 months in 2006 and in 2010;
- had at least the same number of employees and a higher value added in 2010 with regard to 2006;
- generated more than double the average net revenue growth in the economy (2 x 11.8%) in the 2006-2010 period;
- recorded at least minimum cumulative profit in the 2006-2010 period;
- were not in the majority ownership of the state (over 50%) on 31 December 2010;
- enterprises engaged in the following activities were excluded: o L – Real estate activities o O – Public administration and defence, compulsory social security o S – Other services o T – Activities of households as employers; undifferentiated goods o U – Activities of extra-territorial organisations and bodies

In these 4,511 fast-growing companies, both value added and the number of employees grew even during the economic crisis. These enterprises generated 26,000 jobs while the economy had lost 24,000 jobs in these 5 years, the total difference in sales revenue, the total difference in value added and what is of exceptional importance for overcoming the crisis, they increased payment of salaries by 80%. From the 4,511 enterprises, about 22% are micro and small sole proprietors, 0.1% are medium-sized sole proprietors and about 78% are commercial enterprises. For the majority of these enterprises (23.3%), the main registered activity is the activity of sale, maintenance and repair of motor vehicles, 19.53% are registered in manufacturing and 17.22% in professional scientific and technical activities (Pšeničny and Vidovič, 2012).

From the 4,511 PHGE, a 3% representative sample was included in the survey (the online questionnaire was filled in by 131 PHGE), which can represent a cross section of Slovenian PHGE. When testing the representativeness of the sample, we paid special attention to comparing the activity and size of the respondents and all PHGE, while the results of the F-test confirm the representativeness of the sample. As ¾ of the respondents were owners or leading managers of these PHGE, the received answers can relatively safely be characterised as answers provided by managers of fast-growing enterprises in Slovenia, especially since over 90% of the enterprises included in the sample were set up by the entrepreneur and are thus so-called founders ventures. This is further corroborated by the fact that the majority of managers or directors have been managing these companies since their foundation.

3.2 Survey Process and Methodology

The survey is being implemented in 4 phases, while the first two phases have already been completed. In the 1st phase of the survey, we employed criteria for recognising potential high growth enterprises (Pšeničny, 2009; Pšeničny and Vidovič, 2012) that consider not only sales revenue growth but also growth in the number of employees, value added, capital and profit. The enterprises were chosen from the database (AJPES, 2010) of all 126,976 economic subjects operating in Slovenia on 31 December 2010. We thus obtained a database of 4,511 enterprises (Vidovič, 2011) that cumulatively met all the criteria.

In the 2nd phase of the survey, we sent an invitation to fill in an online questionnaire to all 4,511 enterprises. The questionnaire comprised 134 questions or over 230 attributes that describe each individual enterprise. 131 respondents answered the questionnaire that was tested in surveys on fast-growing enterprises in Europe (Žižek and Liechtenstein, 1994; Pšeničny, 2000; Roure 1999; Pšeničny 2002; Bajt 2008) and completed for the present analysis. The questionnaire was used to establish the impact of different factors on fast growth of potential high growth enterprises. The following factors were included: the business environment, the entrepreneur or the entrepreneurial or managerial team, the employees, the management system, growth strategy, innovativeness or creativeness and growth financing.

The 3rd phase of the survey is currently being implemented and will provide a detailed analysis of the impact of individual factors on enterprise growth and their business and financial success. We are establishing the potential of these enterprises for future growth and their ability to become regional heroes, local specialists or branch globalists, perhaps even international global winners (Vizjak, 2011). In the continuation of the survey, at least 20 of the enterprises will be invited to partake in further interviews and the preparation of a case study. For the needs of planning the economic policy, this phase of the survey will also provide suggestions for formulating the national industrial policy.

The 4th phase of the survey will compare the findings with the results of similar surveys that were conducted over ten years ago and establish eventual differences and similarities. The longitudinal approach is of an exceptional importance for formulating compelling proposals both with regard to the business environment and the knowledge of the entrepreneur, employees, choice of growth strategies, business models and management systems and growth financing of potential high growth companies. Our aim is to define the main reasons for fast growth of these companies and to recognise obstacles to an even faster growth and especially to establish which conditions should be met in order for these enterprises to record sustainable growth in the next five to ten years and what to do in order for the number of fast-growing enterprises to double.

3.3 Analysis of Previous Growth and Growth Predictions for PHGE for the 2010-2014 Period

The growth analysis of PHGE in the 2006-2010 period in Table 1 in the Attachment shows increased growth of fast-growing enterprises in the treated years(1). Indicators with regard to the legal form of the enterprise are shown. The table shows that PHGE record substantially higher values than other companies in all indicators. Considering all 4,511 PHGE, the largest gap is found between the net profit/loss index, where the index stood at 0.62 with all enterprises and at 148.12 with the 4,511 PHGE. A related gap is found also between the total net revenue from sales in the external market and total net sales revenue. PHGE record better

indices also in salary costs and value added, while the indicators of value added per employee in PHGE only slightly differ from indicators of value added per employee in all companies, which even additionally stresses the simultaneous growth of employment and value added in PHGE on the one hand and the drop of employment and smaller increase of value added in all companies on the other. As evident from Table 1, growth indices of previous periods thus confirm Birch's and other findings that there are always about 5% of fast-growing enterprises that generate a substantial part of the total economic growth. In the dynamic part of the economy, sales thus at least double in five years, while the number of employees increases by at least fifty percent. The same has been established by recent international surveys (Acs et al., 2008), so that the indicated results confirm this rule to apply also to Slovenia. Based on the analysis of the situation in the 2006-2010 period, growth for future years was predicted. The 2010-2014 period was chosen and the predictions considered the fact that we are facing a period of crisis. The 2006-2010 period was initially a period of high growth that was followed by a steep decline of the economic activity in the second part of the observed period. We therefore estimated similar growth for the 2010-2014 period without any bigger risks. The fact that such predictions pose low risk was undoubtedly supported by the already prepared growth estimations for future years for the 2003-2007 and 2004-2008 periods (Pšeničny, 2010) together with even older analysis, i.e. the 1990-1993 survey (Žižek and Liechtenstein, 1994) and the 1996-2000 survey (Pšeničny, 2002).

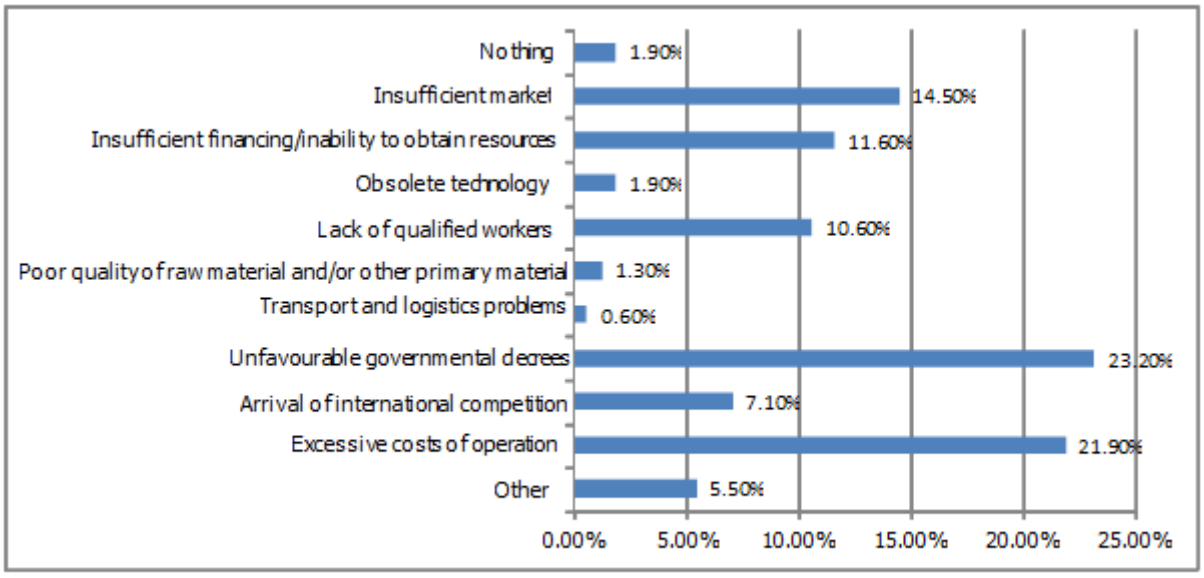
Growth predictions for future years thus indicate that up to 5% of the fastest-growing enterprises can generate up to 40 thousand new jobs by the year 2014 and EUR 32 billion of sales revenue, of that EUR 13 billion in international markets. We estimate that by the year 2014, PHGE can generate EUR 55 thousand of average value added per employee. This prediction can be tested as soon as the data on the operations of the 2011th will be published.

3.4 Attitude of PHGE towards Future Growth and Their Plans

The estimated growth potential from Table 1 is influenced by a number of circumstances that we verified with our questionnaire. We asked the respondents about the obstacles and plans of entrepreneurs for future growth.

The next segments show the chosen answers to the questions directly relating to the estimation of current conditions for the operation of PHGE. Currently, the biggest obstacles that PHGE are facing are predominantly unfavourable governmental decrees (23.20%) and excessive costs of operation (21.90%). The figure below shows also other factors that the polled PHGE see as impeding their operation.

Figure 1: Which are the biggest problems that currently affect your business?



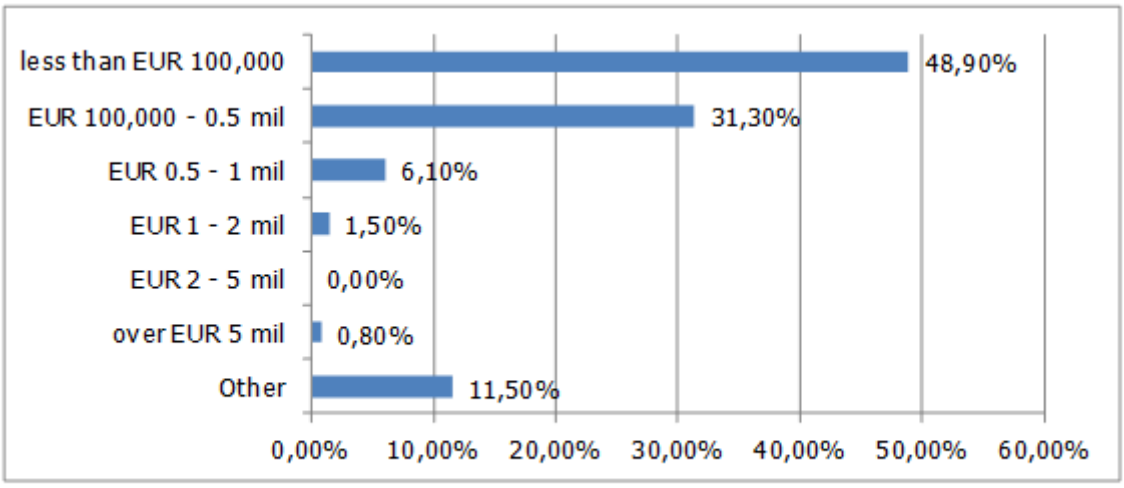
Source: Own survey, 2012

The figure shows that in addition to the previously mentioned factors, insufficient market (14%) and insufficient financing or the inability to obtain resources (11%) also have a negative impact on the operation of PHGE. In a separate question, the respondents stressed the uninspiring tax environment for the reinvestment of profits as a major problem. As much as 89% of the polled PHGE namely believe that the tax policy does not stimulate the reinvestment of profits.

Even though this is a problem that PHGE in other European countries also face, it is alarming to learn about the unfavourable governmental decrees. Within the framework of measures for improving the competitiveness of the Slovenian economy, this will have to be especially emphasised. Possible governmental measures, within the framework or more favourable governmental decrees, might include less strict conditions for the setting up and operation of companies, removing restrictions on capital inflows as well as the introduction of temporary guarantees, which would facilitate investments in companies, and the implementation of additional stimulations for the reinvestment of profits. In order to test the growth predictions presented under 3.3, the survey explored the plans and vision of PHGE for future operation. We were first interested in investment plans of PHGE.

As seen in Figure 2, the majority of PHGE are planning investments for the next years, of that 49% of the respondents are planning investments of under EUR 100,000 and 31% are planning investments in the amount of EUR 100,000 to EUR 0.5 million. As the majority hold a product or service with which they can generate the majority of revenue in the growth or early maturity phase, it is understandable that the majority of companies (80%) are planning investments of under EUR 0.5 million, while only 3% of fast-growing enterprises included in the sample will invest in an amount exceeding EUR one million. This means that a sample of 131 companies in these five years will invest over EUR 30 million and create over 1500 new jobs.

Figure 2: Is the company planning any major investments for future years and to what extent?

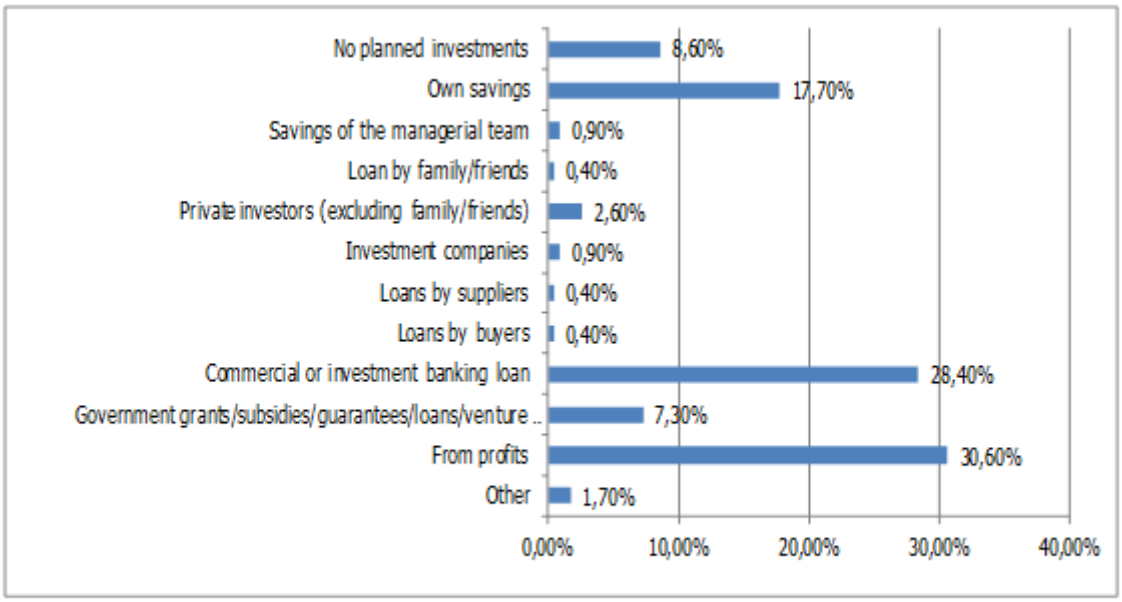


Source: Own survey, 2012

The thus obtained results are alarming, especially considering the answers to the same questions posed years ago (Pšeničny, 2002), when almost one fifth of PHGE planned investments between EUR 1 and 5 million. Now, only 1.5% of PHGE are planning such investments.

The extent of the investments is predominantly affected by access to financial resources, so we were interested in the resources for the planned investments.

Figure 3: Which resources does your company plan to use in financing investments?

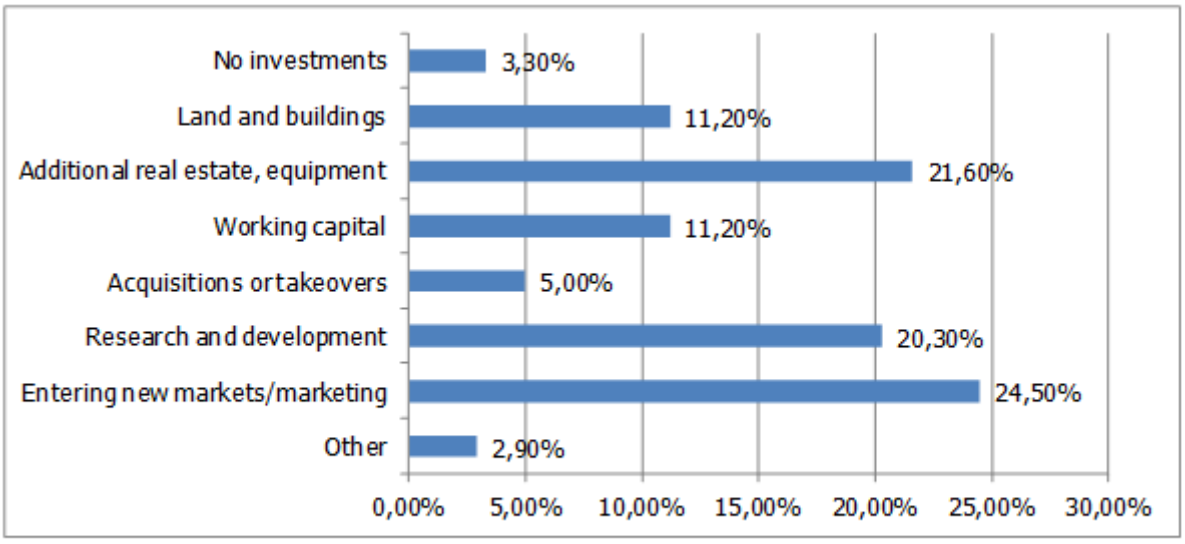


Source: Own survey, 2012.

Figure 3 shows that PHGE plan to finance their investments with retained earnings (31%) and with the help of commercial or investment banking loans (28%). 17% of the respondents plan to finance the investments with own savings (sole proprietors) and approximately 8% plan to finance the investments with the help of government grants, subsidies, etc. The latter is also

disquieting, as budget funds for these purposes will be severely limited this and the next year. We were also interested in the PHGE' investment plans for the next five years.

Figure 4: How are you planning to use additional resources in the next five years?

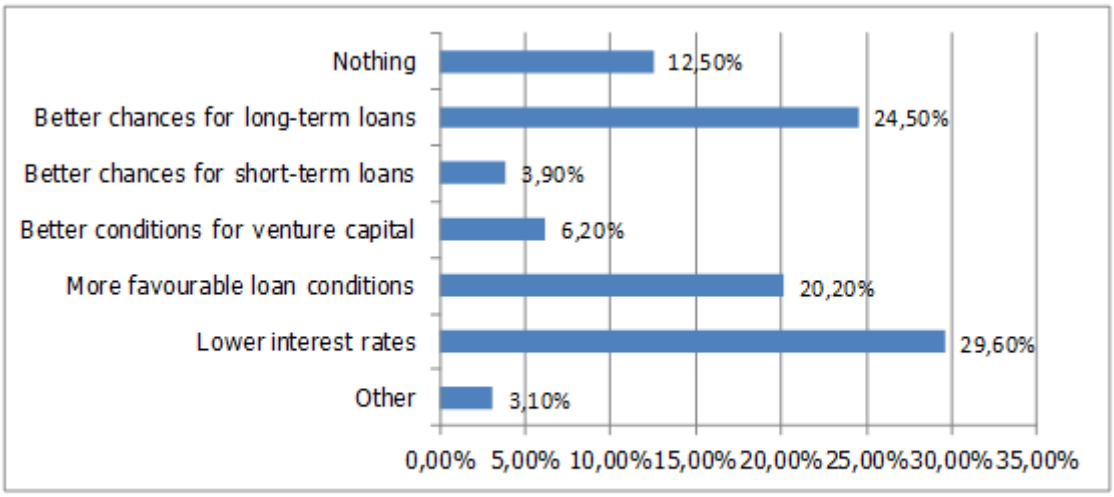


Source: Own survey, 2012.

The results (Figure 4) show that the enterprises will predominantly invest in entering new markets (24%), 22% of PHGE plan to use additional resources for additional real estate and equipment and 20% for research and development. Comparing the results with a shorter period, it is evident that the plans of PHGE for the next two years are very similar to plans for the next five years. In the next two years, 24% are planning to use additional resources for entering new markets, 21% for additional real estate and equipment and 18% for research and development.

Among the financial environment factors (Figure 5), which might motivate PHGE to increase activities and investments, PHGE stressed lower interest rates (30%), better chances for long-term loans (24%) and more favourable loan conditions (20%).

Figure 5: Which changes in the financial environment would motivate you to increase your activity and investments?

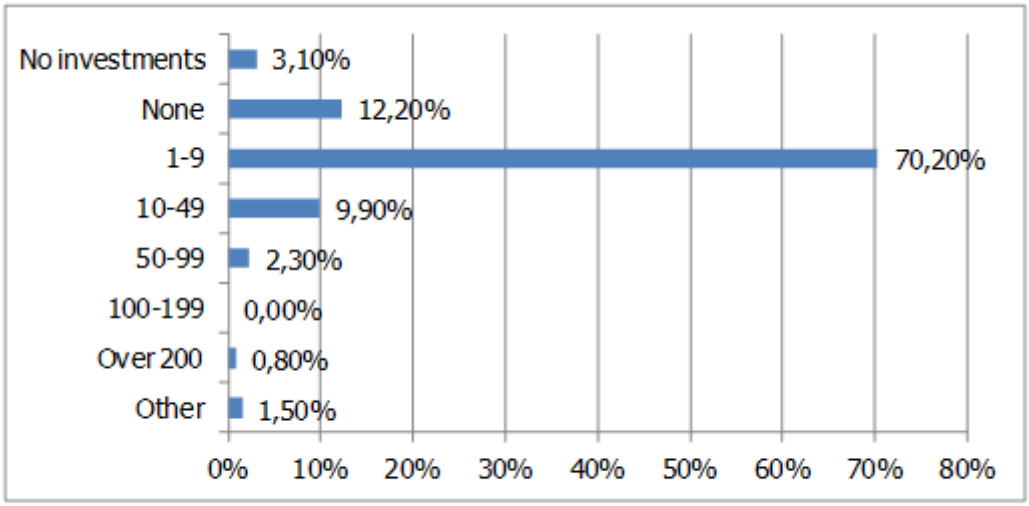


Source: Own survey, 2012.

The provided answers show the poor efficiency of the Slovenian capital market (the current credit crunch) and indicate possible solutions that might have a positive effect on improving possibilities of financing investments and consequently on the increase of investments and growth of PHGE and thus also the economy.

Fast-growing enterprises generate a disproportionately large share of new jobs and are as such especially important for the labour market. This was already proven by numerous authors (Birch, 1981; Birch and Medoff 1994; Storey, 1994; Pšeničny, 2002; Acs et al., 2008; Hanrekson and Johansson, 2008; and others), while our survey looked into the plans of PHGE regarding new employment in the next five years. The survey namely established that in addition to full-time employees, PHGE also employ a number of outsourced workers under different contracts and that they have not generated only 26,000 new jobs in the last five years but also almost 6,000 casual jobs. In light of previous surveys, the entrepreneurs managing fast-growing enterprises have provided rather pessimistic answers (Figure 6).

Figure 6: How many new jobs will the investments create in the next five years?

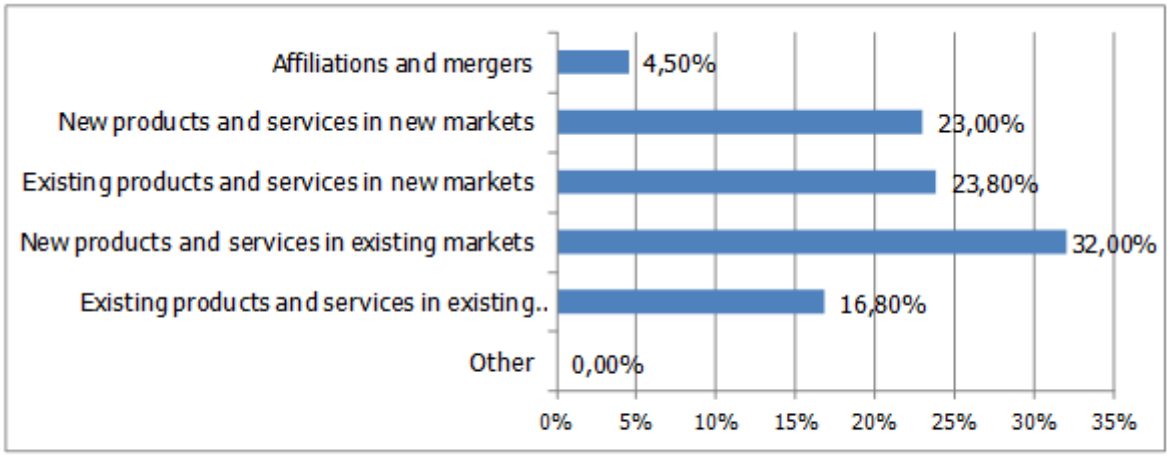


Source: Own survey, 2012.

It is rather encouraging to learn that only 15% of PHGE are not planning to employ any new people in the future, while on the other hand 70% of the respondents answered that they will create from 1 to 9 jobs in the next 5 years. 10% of the respondents said they were planning from 10 to 49 new jobs in the next 5 years. These results confirm our growth predictions for PHGE by the year 2014, as we anticipated 40,000 new jobs by the year 2014.

According to PHGE, the most important reasons for enterprise growth are the customer satisfaction approach of the employees (average 4.52 on a 5-stage scale), knowledge of market trends and needs (a 4.35 average) and efficiency of the production process (4.2). Other important aspects are also the quality of suppliers (4.14) and keeping up with technology advances (4.11). We also asked PHGE about their growth strategy for the next three years.

Figure 7: What is your prevailing growth strategy for the next three years?



Source: Own survey, 2012.

The prevailing growth strategy (Figure 7) for the next three years is product development or growth with new products and services in existing markets (32%), market development or growth with existing products and services in new markets (24%) and growth with new products and services in new markets (pure diversification) (22%). Since as much as 26% of the polled enterprises are among the top 3% of enterprises (market leaders) and over 30% are in the top 10% in the activity (pursuers), the prediction of future growth might be realistic or even pessimistic.

4. Conclusion

The survey, whose partial results have been presented in this article, shows that almost total growth of net sales revenue (EUR 8 million) in the 2006-2010 period was generated by only 4,511 or 3.55% of all economic subjects. These enterprises generated 26,094 new jobs in five years (a 46% increase compared to 2006), which was more than the loss of jobs in the economy in the same five-year period. They increased value added by EUR 1.6 million (or by 71%), which equals the total increase of value added in the 2006-2010 period. They increased the value added per employee by 17%, however we need to stress that the average value added per employee in 2010 in potential high growth enterprises stood at EUR 47,582, which

is substantially above the economy's 2010 average that stood at EUR 35,152 per employee (the Statistical Office of the Republic of Slovenia, 2012).

The presented results confirm the findings of different authors, who studied growth potential of PHGE in the past and who had established that 5% or less of the fastest-growing enterprises generate at least 85% of revenue growth and 85% of all new jobs (Birch, 1987; Birch and Medoff, 1994; Roure, 1999; Mei-Pochtler, 1999; Henrekson and Johansson, 2008; Acs et al., 2008).

Growth predictions for PHGE for future years show an optimistic picture for the development of the Slovenian economy in the future. However, in order to realise this estimated growth, obstacles that were pointed out by the PHGE that comprise our survey sample will need to be considered and overcome. The current obstacles to growth, as seen by these enterprises, were the unfavourable legislation for entrepreneurship, especially the tax legislation, excessive costs of operation, insufficient demand and the inability to obtain appropriate financing.

To sum up, two sets of measures are required in future years in planning the growth of the Slovenian economy. The first set encompasses measures that will provide enterprises with normal operating conditions (especially tax breaks and financing) and thus prevent a drop of employment. The second set relates to establishing appropriate conditions for the growth of dynamic enterprises, which eliminate the obstacles that PHGE are facing. If we manage to establish an entrepreneurship-friendly environment in all aspects in this respect, we can anticipate at least 1,000 additional new PHGE by the year 2014 and thus an additional facilitation of growth of the Slovenian economy.

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Attachments

Table 1: Analysis of Enterprise Growth in the 2006-2010 Period

Group/ legal form/ index/year			Net sales revenue	Total net sales on the external market	Average number of employees based on working hours	Equity	Payroll costs	Ne
			2010/2006 index	2010/2006 index	2010/2006 index	2010/2006 index	2010/2006 index	201
All enterprises 31 Dec 2010	s.p. m&m	71,231	99.16	120.34	87.57	102.46	112.19	
	med. s.p	11	84.73	120.29	59.99	75.90	68.27	
	c.e.	55,734	112.88	113.74	96.62	119.50	118.59	
	total	**126,976**	**111.87**	**113.87**	**95.55**	**118.43**	**118.04**	
PHGE -4,511 enterprises 2006-2010	s.p.	1,004	191.07	267.59	165.69	157.77	232.94	
	med. s.p	6	336.92	214.78	182.86	121.06	232.73	
	c.e.	3,501	177.80	215.93	144.94	158.49	177.42	
	total	**4,511**	**178.50**	**216.90**	**146.21**	**158.39**	**179.32**	
131 polled enterprises – Dec 2011	s.p.	24	183.51	195.13	147.18	198.19	215.05	
	med. s.p	0						
	c.e.	109	159.75	169.05	112.90	183.70	133.34	
	total	**133**	**160.01**	**169.13**	**113.40**	**183.75**	**133.82**	

Source: Vidovič, 2011.

(1)The Analysis of fast-growing enterprises was made for the chosen 4,511 PHGE, the 131 PHGE, which represent our survey sample, for 500 chosen gazelles (Dnevnik, 2011) and PHGE in international or mixed ownership. This article however focuses only on the chosen 4,511 PHGE and 131 PHGE.

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