Small towns and regional firms – toward a typology.

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Abstract

The dominant forms of enterprise in Small Towns are, not surprisingly, small firms. But are these small firms different to their metropolitan counterparts, and are these differences related to their location in regional towns? In addition, are these regional small firms governed by different rules and principles?

Overseas studies, generally focusing on firm start-ups, have identified differences between regional and urban enterprises, but the differences are usually small (Westhead, 1995). The explanatory variables identified vary from study to study but include access to finance, physical resources, employment levels, population density, industry structure, regional externalities, human capital, knowledge spillovers, and resource munificent regions as possible explanations for the variations (Armington & Acs, 2002; Keeble, 1997).

In this paper, the basic proposition is that regional firms in Australia may be different, but they are not necessarily disadvantaged. Focusing on issues of firm behaviour and competitiveness the paper presents a typology of firms that attempts to explain the fit between a small firm and its regional location. The typology is illustrated and discussed, using preliminary findings from a qualitative, case-based study of small, Western Victorian firms.

Introduction

Economic and social activity in many regional areas of Australia is in decline – a phenomenon that is common within many regional locations across the globe. Whilst rural areas decline, metropolitan areas continue to grow. Whether this is the result of fundamental 'deficit' factors underpinning regional enterprises and their economies or merely follows from short-term adjustment processes in the industrialisation of agriculture is part of a broader question that is not answered here.

This paper was subject to a double-blind peer review process.
ISBN number 1920948848
Published on-line by the Centre for Sustainable Regional Communities, La Trobe University
www.latrobe.edu.au/csrc/2ndconference/refereed

In the context of this study, we take the perspective that regional status may impose constraints on the potential performance of firms, but it may also provide benefits for firms where location can act as a potential resource. Analee Saxenian (1996), in one of the seminal books on regional advantage, comments 'as a native of the Boston area, I may wish that Route128 turns itself around quickly; as a scholar I know that it is likely to take decades to overcome the management practices, culture and institutions that have hindered the region in the past'. Regions have their own embedded advantages and disadvantages that may encourage or discourage the growth, development and behaviour of firms.

One view is that some locations may have a critical mass of 'factors of production', knowledge spill-overs and ancillary industries, that in some sense gives their firms an advantage over others in different locations. This may reflect the phenomena of clustering or tangible and intangible resources that are region specific and are embedded in those regions institutions. The phenomena of regional advantage or regional specific advantages now pervade the economic development literature; although empirical support is less clear (Blakely 2004). Examination of individual cases also suggests that the regional dimension provides both differential advantage and disadvantage. For instance, Chapparal Steel, an innovative mini-mill, that helped revolutionise the US steel industry derived advantage from a regional location away from other steel producers (Leonard-Barton 1995), and some large multinational manufacturing corporations, like MasterFoods, are almost wholly located at regional sites, as they access harmonious labour markets as well as the usual attractions of cheaper land and government inducements. On the other hand, many marketing and other 'services' based firms have had to move to metropolitan locations in order to continue to grow and attract appropriate staff.

To explore the issue of regional impacts on firms, this research examines a key wealth-creating component of many regional economies - the Small-to-Medium Enterprise (SME). The connections between an SME and its location may involve market, social, or resource-based interactions. SMEs are a key institution of regional competitiveness, but are these regional SMEs governed by different rules and principles to their metropolitan counterparts and, more specifically, is the organisation, strategy and performance of regional SMEs, a source of competitive advantage or disadvantage? To explore these issues, the research proposes an innovative conceptual framework based on markets, resources, capabilities, path dependencies and intangible infrastructures. By undertaking a preliminary review of a number of cases of regional firms in the light of this framework, we propose a typology that helps to explain why some firms can compete successfully from a regional base, whilst others appear to be constrained by their location.

Enterprise Development and Regional Location

In Australia, the evidence of regional disparities across a range of economic and social indicators is overwhelming. Despite the significant and sustained national economic growth since 1992, many townships, locations and regional areas have not shared in the benefits of this growth (NIER 1998). Australian Bureau of Statistics data suggests that over 30% of Australian towns sustained population losses in the period from 1986 to 1996 (ABS 1998) and more recent projections suggest that significant population decline will occur over the next two decades in many of the statistical local areas relevant to the region of interest for this study (Australian Bureau of Statistics, 2002). The population shift has in many instances been driven by the decline in the rural sector, but this has been matched by significant declines in rural banking services, manufacturing and the railways (Kenyon and Black 2001).

Yet the picture is not uniformly bleak. Countering the trend is the expansion of some regional locations that continue to grow as they act as "sponge cities" attracting the migration of business and population from smaller, declining townships. Today approximately one third of Australia's population lives in such regional locations that are growing faster than capital cities (Australian Bureau of Statistics, 2003). Thus the population shifts may more accurately be represented as a reflection of diversity (McKinsey and Co 1994) – a diversity that emerges from the ways in which firms and other institutions have dealt with globalisation, innovation and the communications revolution. It is also likely that the ICT communications revolution that is bringing better connectivity to regional areas will reduce a major barrier to regional advantage, whilst allowing SMEs to access many of the lower costs of operating in a regional location (Cairncross 2001).

Explanations of the causes of regional disparities have changed significantly over time with the traditional emphasis on physical resources, assets, income, employment and population (Westhead 1995), giving way to other factors. Current explanations are much more influenced by the potential for increasing returns (Arthur1989), network externalities (Amin and Robbins 1990), and agglomeration economies (Krugman 1998). This 'new' economic geography emphasises critical resources as dynamic, not static entities, which both create and stem from the process of dynamic clustering in which resource use generates further and more complex resources (Swann et.al 1998, Lowe and Miller 2001). Research underpinning these approaches typically proceeds on a case study basis (Porter 1990). However whilst Krugman (1998) emphasises the importance of the spatial economic dimension, he is less optimistic about the nature of possible empirical work. Nevertheless, work on productivity rates and new firm formation suggest that knowledge spillovers (Ciccone and Hall 1996), and 'thick' labour markets (Armington and Acs, 2002) can be measured and are critical to differences in regional growth rates.

A few studies have identified significant differences between regional and urban enterprises (after controlling for demographics), but the differences are generally small (Westhead 1995). Most empirical work has focused on new firm formation rates, with much of the key research published in a special issue of *Regional Studies* (28(4) 1994). Whilst the explanatory variables vary from study to study, they include access to finance, physical resources, employment levels, population density, industry structure, regional externalities, human capital, knowledge spillovers, and resource munificent regions as possible explanations for the variations. (Anselin et al (1997), Armington & Acs, 2002; Audretsch and Fritsch (1994) Keeble, 1997).

Armington and Acs (2002) confirm that there are major variations in new firm formation rates and attribute the differences to network externalities rather than agglomeration economies emphasised by the 'new' economic geography models. Critically they also find variation between regions is far greater than variations over time – emphasising the potential role of path dependencies. In addition they find strong support for the role of human capital and underlying average size of firm in a region as a determinant of new firm formation.

Although these new views of spatial economics vary from the dominant paradigm, there is still surprisingly little research that has applied the new economic geography to existing firms and particularly SMEs. Yet these firms are often the main generators of wealth and employment, as Storey (1994) argues. This is an issue of considerable importance to regional and industry policy in Australia. A basic proposition of this research is that regional SMEs may be different but not necessarily disadvantaged. And it is not only governments that are at risk of missing this point; evidence from the Venture Capital industry suggests that there are major regional disparities in the distribution of venture capital (Regional Entrepreneurship Catalyst 2002). The so-called "funding gap" for regional SMEs possibly exists less for debt capital than previously, but is still pronounced for equity funding (Dept. of Trade and Industry 1998).

Interestingly much of the debate around the parallel issue of international trade and growth acknowledges that differences in firm organisation and strategy may be at the heart of differences in national competitiveness (Porter 1990). In a recent study 'Can Japan Compete?' the nature of the Japanese firm is identified as a significant cause, alongside macro – economic mismanagement, of Japanese decline (Porter et al 2000). Similarly the specific features of Italian firms, particularly when located in clusters or districts, emphasises the specific impact location has on the nature of the firm. It is important here to note the difference between a regional firm that is successful because of its co-location with other firms in a cluster, and a regional firm that draws its competitiveness from being part of a specific region *per se.* Mcrae-Williams, Lowe and Taylor (2004), in their research on tourism and wine clustering in Western Victoria, emphasise the important role of 'place' in the intensity of clustering behaviour. Some locations, with strong social structures, facilitate enterprise interaction better than others, and this leads to improved performance – probably through its impact on both clustering and networking. Similarly Venkataraman (2004) emphasises the importance to new venture creation and growth, of 'seven intangibles' that vary between different locations. These include access to novel ideas, local role models, informal forums, region specific opportunities, safety nets, access to large markets, and executive leadership. This 'intangible' infrastructure represents the necessary and sufficient resource base that determines the success of a region in incubating technology-based new enterprises.

The overwhelming evidence is that location influences enterprise development; however there is a lack of research on differences at the level of the existing firm. To better understand the nature and performance of the regional SME we follow Storper (1997) in asserting that globally optimal best practice does not necessarily dictate the optimal form of technology adopted by a firm. Rather, production and organisational technologies come about as a result of the series of decisions, investments and processes that firms makes over time. As a consequence it may be possible for different, but still efficient, forms of organisation to co-exist in the same sector but in different locations (Nelson and Winter 1982). Storper's (1997) proposition is that a 'holy trinity' of technologies, organisations and territories determine the level of competitiveness of regional firms. A firm's competitiveness will be influenced by the key 'relational assets' that result from the interactions between firms, the evolving technology and institutions within a region. Competitive advantage is generated through the linkages between supply chains, labour markets, and close inter-firm and institutional relationships.

The basic proposition in this paper is that regional firms in Australia may be different, but they are not necessarily disadvantaged. We know very little about the nature of the regional SME and whether there are 'indigenous' standards that govern their survival, growth and competitiveness. This research will study the nature of regional firms and develop a typology for their classification.

Propositions and Typology

Relatively few studies have explored both the demographic and trait characteristics of regional SMEs and their owners, *and* the behaviour and performance of these firms. This study addresses these issues by clearly placing the level of analysis onto individual SMEs (in their regional context) to trace their development over time, identifying key events, turning points and the changing nature of regionality as it impacts on the firm.

The research proceeded by developing a conceptual framework for understanding SME performance and behaviour based on emerging paradigms of competitiveness that focus on markets, resources, capabilities, path dependencies and intangible infrustructures (see Table 1). By reviewing a number of cases of regional firms in the light of this framework, we propose a typology that helps to explain why some regional firms can compete successfully from a regional base, whilst others appear to be constrained by their location.

Specifically it is proposed that the nature of an SME's organisation, behaviour and performance can be captured by five models of firm competitiveness:

- An industry environment and organisation (I/O) model (Porter 1980, Scherer and Ross 1990) that emphasises structural conditions and competitor positioning.

- A model developed from a Resource–Based View (RBV) of the firm – (Penrose 1959, Wernerfelt 1984, Barney 1991). This approach emphasises competitiveness based on access to scarce and inimitable resources.

- A Dynamic Capabilities / Core Competence model (Prahalad and Hamel 1990, Teece, Pisano and Schuen 1997, Lowe and Taylor 1998) that emphasises the development of innovation through effective organisational processes that create competitive leverage when used with firm resources.

- An evolutionary model (Nelson and Winter, 1984, Carroll and Hannan, 1999) emphasising paths, path dependencies and lock-in.

- A model that summarises the intangible infrastructure identified by Venkataraman (2004), which may also be associated with a specific form of competitive advantage and performance.

Table 1. A conceptual framework for a comparison of regional firms

Model	Critical characteristics	Regional Environment
Competitive Markets	Size of market, Competitive position, Industry density, Population and income growth	Exogenous and stemming from relative strength of competition.
Resource-Based View	Access to financial, knowledge and physical resources. Intellectual property regimes, Infrastructure	Endogenous and secondary heterogeneous and asset specific resources
Core Competence or Dynamic Capability	Asset accumulation, Inimitability, Organisational replicability and growth	Endogenous when assets and organisational processes create advantage. Exogenous when network externalities create unique local competences
Evolutionary	Historical paths influence by changing selection environments	Endogenous except when the selection environment changes
Intangible Infrastructures	Access to novel ideas, local role models, informal forums, region specific opportunities, safety nets, access to large markets, and executive leadership.	Exogenous with strong links to regional history, existing institutions, firms and networks

The framework allows this research to focus on comparative issues of behaviour and competitiveness between regions and firms. It also provides for the development of a classification of firms in terms of their “fit” with the region in which they are based. The typology suggests that regional firms can be classified as:

Mandated – a firm’s regional location is determined by resource requirements or local market conditions.
Evolving - these firms start in regional locations for a variety of reasons but are evolving a specific regional resource base – often based on relational capital.
Discretionary - these firms could exist inside or outside the region, their location hardly influences the nature of their organisation and strategy.
Mismatched – firms that are disadvantaged by regional status and need the resources, networks, infrastructures and markets of large urban agglomerations.

We use this typology to assess the appropriateness of 11 regional firms to their regional environments.

Data collection and analysis

Data collection and analysis was undertaken at the level of the individual SME and covered eleven regional firms, tracing their development over time and their “fit” with a regional location. The sample included micro, small, and medium-sized Western Victorian firms operating in a range of industries. The detail of the cases in question, identifying key aspects of firm behaviour, performance and competitiveness appears in Table 2.

Following the initial development of the conceptual framework, data was collected through a series of in-depth, semi-structured interviews. Further information was gathered from secondary sources to enhance the validity of the interview data. From these data sources short case studies of the firms under study were developed and reviewed against the conceptual framework.

The research approach was specifically designed to assess the “fit” between the firm and its region and can be described as a combination of journalistic, armchair and case study approaches (Aldrich & Baker, 1997). It was found that the data provides some support for the essence of the basic arguments proposed by this paper.

Discussion of typology in light of the cases

This paper reports on a preliminary analysis of the cases as we attempt to answer two important questions:

- Do the strategic paradigms help explain sources of regional firm performance and the fit between a firm and its region?, and
- Do these cases provide supporting evidence for the typology proposed?

To answer these questions we use the cases as examples of firms that cope or prosper in a regional environment. The cases are examined at a specific point in time although in the context of known historical paths. In discussing these issues through the cases we need to offer a word of caution;

Table 2. Case studies: key aspects of firm behaviour, competitiveness and performance

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ISBN number 1920948848
Published on-line by the Centre for Sustainable Regional Communities, La Trobe University
www.latrobe.edu.au/csrc/2ndconference/refereed

Case	Size ($M)	Owner -Ship	Industry Sector	Dominant Market	Paradigm "Lens"	Core Processes	Key Resources & Capabilities	Business Model	Regional Status	Cluster Benefits	Barriers To Growth
A	10	Family	Agricultural Commodities	90% Exports	RBV	Supply Chain Collaboration	IPR Networks	Alliances, Virtual Firm	Mandated	Yes, Horizontal & Vertical	Market Diffusion. Capital
B	20	P/Ship	Wholesale Export	100% Exports	Core Competence	Export Document Processes	Networks	Middle Man	Discretionary	No	Manage -ment Team
C	15	P/Ship	Manufacture	50% Exports	Competitive Markets	Design, Bespoke Marketing	Knowledge Of Key Users	Integrated Manufacturer	Discretionary	Yes, Vertical	Costs Of Mass Manuf-acture
D	30?	Family	Horticultural Supply	100% Domestic	Core Competence	Quality Assurance, Constant Improvement	Tech. Application, Training / HRD	Problem-solving Middlewoman	Evolving	Yes, Vertical	Management Team
E	< 1	Family	Wine Production & Marketing	95% Domestic	Competitive Markets	Relationships	Supply Networks	Contract Manufacturing	Discretionary / Evolving	Few	Capital / Management
F	<1	Sole Trader	High Value Retail	100% Local	Competitive Markets	Selling	None?	Traditional Retail	Mismatched	None	Very Limited Market

Table 2 cont'd

Case	Size ($M)	Owner -Ship	Industry Sector	Dominant Market	Paradigm "Lens"	Core Processes	Key Resources & Capabilities	Business Model	Regional Status	Cluster Benefits	Barriers To Growth
G	50?	Family	FMPG Manufacture	60% Export	Core Compet-ence	Quality Assurance & Financial Control	Product Development & Marketing	Outsourcing Where Possible	Discretionary Mismatched?	Some – Know-ledge Spillovers	Capital, Management Capability
H	<1	Sole Trader	Marketing Services	100% Local	Intangible Infra-structure	Relation-Ships	None?	Sourcing Retailer	Mismatched	No	Market Size, Attitude
I	?	P/Ship	Engineer-ing Services	100% Domestic	Intangible Infra-structure	Competitive Tendering Abilities	Reputation, People, And Financial Resources	Affiliation Of Professionals	Evolving	Some, Vertical & Horizon-tal	Organisational Structure
J	?	Private Coy	Auto Comp. Manufacture	100% Domestic	Competitive Markets	JIT Mnfg Cost And Quality Control Systems	Reputation	Integrated Manufact-urer	Discretionary Mismatched?	No	Family Succession, Market Fragility
K	?	Family	Distribution Services	100% Regional	Evolutionary	Supply Chain Relationships Inventory Control, Distribution Systems	Location, Reputation, People	Wholesaler And Distributor	Evolving / Mandated	Yes, Down-stream	Attitude, Competition

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from a sampling perspective, we make no claims as to the representativeness of the cases under the spotlight. Rather the cases described are an example of the practice of business undertaken in a regional context. The key criterion for selection was simply an SME operating in the region of interest. Analysis of the qualitative data gathered will help to shed light on the complex nature of regional SME behaviour and performance and it is to this end that we share the following observations on a selection of the case evidence.

As our first example we focus on case K. This company is a food products wholesaler and distributor, and is one we define as mandated and evolving. It gains significant benefit from its regional location, benefits that derive from the moderating and influencing effects of the region on the market conditions under which it operates. The regional location reduces the competitive impact of large metropolitan-based competitors, and local buyers will patronise the local firm in a bid to ensure balanced supply chain relationships. In terms of our paradigm its market positioning is strongly influenced by its regional location and provides it with a form of competitive advantage that is the source of its growth and performance. This case is replicated in a number of instances; significant local players being shielded from national competition by their location, and at the same time benefiting from local loyalty. If however these firms want to expand into national markets, their advantage no longer holds.

Another mandated company is case A. It is placed at the centre of a cereal products network and relies on its regional location to develop and sustain its networks. This firm holds intellectual property rights over specific seed varieties and the nature of its business model is close and continuing contact with its supply chain partners – in some regards this behaviour lends support to the concept of SMEs developing "virtual corporations" as an effective means of competing in global markets (Grant, 1998). It gains significant advantage from the resources and networks of the region and is mandated in our classification because of this.

Case B is classified as discretionary. Its competitive advantage comes from its expertise and core competences in export fulfilment processes that it handles in a very innovative way. These competences are firm specific, not region specific, and although the firm is regional this is wholly discretionary, as it could be located anywhere as the competitive advantage is completely internalised within the firm. This case can be compared to a group of enterprises in the Victorian mineral springs region. They also have dynamic and innovative competences, but these are regional competences that provide a group of competing enterprises with competitive advantage. The pools of skilled labour in the winery regions similarly provide their regional enterprises with competitive advantage.

For the firms under study, the importance of regional location appears to differ depending upon the industry context. Using the classification identified earlier in this paper only two companies can be categorized as "mandated" or "evolving / mandated". Most of the firms in this sample can be viewed as "discretionary" or "mis-matched" firms that could, or in some instances should, be operating in other locations if they desire an expansion of activities, enhanced performance, and the development of competitive advantages.

For the mandated firms, regional location provides growth benefits through supply chain relationships; although it is interesting to note that for one firm the critical supply chain

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relationships that mandated location were upstream, whilst for the other they were downstream relationships. It would appear that in situations where the supply side characteristics have a dominant impact on the industry, a firm's location may be mandated from the start, without limiting the firm's ability to grow and compete effectively with much larger competitors. On the demand side, a large potential market may provide locational advantages when close relationship-building is an important competitive tool, or regional parochialism has an impact on business development. These drivers seem to mandate location; however it could be that they simply allow an effective firm to evolve a competitive regional presence over time.

Regional firms typically compete through a range of competitive advantages, and in this research we found that elements of each of the identified competitive paradigms contributed to the behaviour and performance of firms. Regional location provides a firm with a resource base, a set of competitive conditions, networks, localized capabilities, and evolving environments that, taken together in various combinations, can be seen to provide a basis for survival and growth. Changing environments however, may reinforce or reduce the impact of these various elements - as is the case with changes in ICT infrastructures and the impact they have on regional business operations.

Conclusions

With this paper we have attempted to do two things. First of all, we have examined whether regional influences, viewed from a range of paradigmatic positions, affect the nature of SMEs operating in regional locations. Secondly, we have proposed a typology of firms that includes those that deal well or badly with location and we have provided a preliminary discussion of the typology and its application to regional small businesses. But what does this mean for Small Towns and their need for sustainable social and economic development?

The process undertaken by this research provides a guide to assess small firms operating in regional and small town environments. Sometimes firms are disadvantaged by their location, and sometimes they are advantaged. In other cases, location provides a firm with different sources of advantage to other local firms – the firm has moved along an evolutionary path and developed into a different species. We suggest that the adoption of a multi-paradigmatic perspective provides an enhanced understanding of the performance, behaviour and growth of regionally based, small firms. It is our contention that it is important to have this greater understanding of the underlying dimensions of competitiveness impacting on these firms. Government policies, and the support measures put in place to augment the longer-term viability of small communities, need to be informed by a recognition of these dimensions, and the differences and diversity of experience exhibited in the SME sector. A dynamic small business sector is a key element in the development, and in some cases survival, of small towns. Healthy regions and sustainable towns must work through the privately-owned enterprise, as government towns have a poor record of providing sustainable regional communities.

The dominant neo-classical view of the firm has proved frustrating for researchers seeking to explain the diversity of regional growth in Australia, and whilst alliance capitalism approaches have contributed to our understanding of regional competitiveness, more empirical work is still required (Krugman 1998). Our research goes further; it acknowledges the significant impact of system - specific effects on regional growth, including thick labour markets and knowledge spill-overs, but it also tries to advance a view of the regional firm based on an eclectic paradigm of competitiveness and the fit between a firm and its region.

An underlying proposition driving this research is that there may be a 'gap' in the provision and support for regional firms. This 'gap' does not stem from a weakness in the organisation and scope of regional firms, but is based on their differences – differences that are not always recognised by public servants, bankers and investors who may misunderstand the nature of the regional firm and the risks and rewards they can deliver. Economic and social returns will stem from better-targeted investment by private investors and lenders and a policy shift by government that focuses on wealth creation, rather than deficit-focused support and selective intervention.

The significance of the research is that it provides us with a greater understanding of the mechanism of the regional SME – the vehicle through which ultimately many regional policy initiatives must work. Without a robust and operational view of the regional firm and enterprise, it is difficult to judge appropriate interventions. The research is innovative. It is at the intersection of economic strategic theories of the firm and the new economic geography. Unlike most contemporary studies it looks beyond dynamic clusters and networks and the macro infrastructure that dominate views of regional competitiveness. It tackles the issue of competitiveness at the level of the individual firm and by so doing can contribute significantly to framing regional policy.

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