

# SME INNOVATION & DIGITAL READI- NESS TO 'BUILD BACK BETTER'



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## Summary

**Small and Medium Sized Enterprises (SMEs), start-ups, and entrepreneurs have been hit hard by the Covid-19 pandemic. Digital readiness and the ability to adapt through digital tool uptake has represented a lifeline for some – shifting their business models through resilience and innovation. Others have struggled to follow suit. In order to ensure SMEs are not left behind, and in the search to ‘build back better’ - policy and regulation must boost emergency response and recovery, and look towards long-term sustainable change based on digitalisation, SME resilience, and new business models and entrepreneurial ecosystems.**

## Entrepreneurs & SMEs Hit Disproportionately Hard

Small and Medium Sized Enterprises (SMEs) are the backbone of Europe’s economy. They account for 99% of EU businesses and with over 24 million SMEs across the EU, generate more than half of the EU’s GDP.<sup>1</sup> Employing almost 100 million people, not only do they represent an integral part of European innovation, job creation, and the design and application of new products and patents – from an economic perspective their impact amounts to a value-added contribution of over 4 trillion euros.<sup>2</sup>

However, despite their huge importance SMEs have been negatively affected in particular by the impact of Covid-19, exposing their greater

vulnerability when compared to larger firms and companies. This is largely due to the fact they are overrepresented in sectors hit hardest by confinement measures and lockdowns, ranging from retail and wholesale trade, to accommodation, real estate, tourism, and personal services.<sup>3</sup> Over 90% of SMEs in Europe saw a decrease in turnover as a result of having to either stop their activities completely or partially. Moreover, at the beginning of the crisis almost 20% of SMEs across Europe lost 100% of their turnover for several weeks.<sup>4</sup> This negative trend continued, with 70% of SMEs consulted in France, Germany, Italy, Spain, and the UK losing significant revenue, one in five showing concerns about defaulting on loans, having to lay off employees, or cancel growth projects, and more than half with very real worries about not being able to survive for longer than 12 months.<sup>5</sup>

### Vulnerability Factors

Alongside being concentrated in sectors most directly impacted by pandemic response measures, SMEs on the whole are typically more credit constrained than larger and more well established businesses.<sup>6</sup> With smaller cash buffers, they find it harder to tap into different funding streams, and are more reliant on retained earnings. Small companies are also hindered by supply chain constraints. With smaller inventories and supplier networks, SMEs have less bargaining power, are more vulnerable to disruptions and price increases, and as a result are hit harder and more quickly than their larger counterparts.<sup>7</sup> Between February and

<sup>1</sup> European Parliament. (2021). Covid-19: how the EU can help small businesses. Economy, 14-01-2021.

<sup>2</sup> Vodafone. (2020). SME Digitalisation – charting a course towards resilience and recovery. Vodafone Public Policy Paper, September 2020.

<sup>3</sup> OECD. (2021b). One Year of SME and entrepreneurship policy responses to COVID-19: Lessons learned to “build back better”. OECD, 8 April 2021.

<sup>4</sup> Huemer, G. (2020). The economic impact of COVID-19 on SMEs in Europe. Report. SME United.

<sup>5</sup> Dimson, J et.al. (2020). COVID-19 and European small and medium-size enterprises: How they are weathering the storm. October 22, 2020, Article.

<sup>6</sup> Gregurec, I et.al. (2021). The Impact of COVID-19 on Sustainable Business Models in SMEs. Sustainability 2021, 13, 1098.

<sup>7</sup> OECD. (2021b).

May 2020, this saw significant increases in SMEs reporting late payments squeezing their liquidity, alongside having to accept longer payment terms. This in turn saw over 40% at risk of insolvency, rising to over 50% for the most hard hit sectors including hospitality, retail and construction.<sup>8</sup>

SMEs also lag behind larger business in the adoption of nearly all technologies, with some of the largest gaps seen in the digitalisation of internal organisational processes.<sup>9</sup> Key in building resilience, the significant gap in digital tool uptake between small firms and larger ones (roughly half as much) further contributes to their vulnerability. This is coupled with SMEs prone to having less managerial capacities, and the knowledge and skills to be able to navigate new regulatory frameworks, and to innovate their business models.<sup>10</sup>

### Response Mechanisms

Based on the unprecedented and numerous challenges faced by SMEs, countries across the EU and internationally adopted a wide array of stimulus and support measures. Geared towards sustaining short-term liquidity, these ranged from more general policies and interventions to cushion the blow, with for example central banks supporting lending by alleviating monetary conditions allowing commercial banks to provide more loans to SMEs (e.g. the European Central Bank), to more SME specific policies.<sup>11</sup> These specific policy responses ranged from liquidity support measures to structural support mechanisms. The former included interventions like job retention and wage subsidy

schemes, payment deferrals, and financial support and direct lending, while the latter focussed more on helping SMEs adapt, including a focus on:<sup>12</sup>

- Digitalisation (teleworking and e-sales)
- Innovation and technological development
- Upskilling and reskilling
- Start-up support
- Sustainability and alternative markets

## Digital Tools as a 'Safety Net'

Digitalisation on the whole helps businesses in a number of areas crucial to their development. It can help them optimise finances, improve productivity, expand to new markets and customers, and foster innovation. Digital tools like the Internet of Things (IoT), data analytics, and cloud computing create a wealth of opportunities for smaller businesses to overcome size-related barriers. However, even before the onset of the pandemic SMEs lagged behind in the digital transition, with many lacking the capacity to adopt new digital practices.<sup>13</sup>

In responding to the challenges faced through Covid-19, the most digitalised SMEs have been able to adapt best, identifying new business opportunities in the 'pandemic economy' at more than double the rate of less technologically advanced ones.<sup>14</sup> Moreover, SMEs operating in sectors like the financial and professional services were able to see new business options. This is

<sup>8</sup> Huemer, G. (2020). The economic impact of COVID-19 on SMEs in Europe.

<sup>9</sup> Vodafone. (2020). SME Digitalisation – charting a course towards resilience and recovery.

<sup>10</sup> OECD. (2021b).

<sup>11</sup> OECD. (2020). Coronavirus (COVID-19): SME Policy Responses. Tackling Coronavirus (COVID-19): Contributing to a Global Effort. OECD, 15 July 2020.

<sup>12</sup> OECD. (2021b).

<sup>13</sup> OECD (2021a). The Digital Transformation of SMEs. OECD Studies on SMEs and Entrepreneurship.

<sup>14</sup> Deloitte. (2020). Digitalising SMEs: The role of digitalisation and digital policy in supporting the SME economic recovery.



compared to SMEs in less digitally advanced sectors like hospitality or construction that saw the greatest hits to their business models. While SMEs based on their diversity varied in their ability to adapt, the availability, capacity, and capability to digitalise was a fundamental challenge seen across the board. Some of the biggest challenges were in implementation, with issues arising in the set up and integration of new technologies with current systems, while planning and initiating new tools, requiring training and upskilling, and the cost and availability of the right digital solutions were further key challenges faced.<sup>15</sup>

As Covid-19 fundamentally altered customer's needs, buying habits, purchasing trends, decision-making, and events and gatherings to name a few – SMEs were impacted differently and as a result had to adapt differently. Despite this, and even with the different transformation drivers and technology solutions present, SMEs that embraced digital tools were able to leverage the 'Digital Safety Net'. This meant that more digitally advanced SMEs saw 80% better sales and 60% revenue when compared to their less advanced counterparts, and were more likely to be job creators and hire new employees.<sup>16</sup>

What has become clear is that regardless of the size, profile, sector, service and product type, or behavioural characteristics of SMEs, their digital readiness will play a key factor in their ability to adapt to the new normal. Different degrees of change will need to take place to make sure those more vulnerable do not get left behind, and the

digital divide does not further exacerbate gaps in SME resilience.

## The European SME Strategy

Even before the onset of the pandemic, the EU was aware of the diversity of SMEs in terms of their business models, sizes, entrepreneurial profile, and diverse talent pool. Ranging from microenterprises in the services sector and middle-range industrial companies, to traditional crafts and high-tech start-ups – the SME Strategy put forward reiterated the different needs of SMEs to grow and scale up, and to be competitive, resilient, and sustainable. With this in mind, the strategy put forward three key pillars to unleash the power of Europe's SMEs<sup>17</sup>:

1. Capacity-building and support for the transition to sustainability and digitalisation
2. Reducing the regulatory burden and improving market access
3. Improving access to financing

Despite being published just before the onset of the pandemic, calls are being made for the European Commission to update its Strategy in light of Covid-19. This includes a need to focus on innovation and market access, the removal of bureaucracy, and the alignment of an updated strategy with wider policy frameworks including the European Green New Deal, the European Data Strategy, and the Industrial Strategy. This is seen as a key step in not only helping SMEs survive, but to move towards a green and digital Europe.<sup>18</sup>

<sup>15</sup> Vodafone SME Understanding survey results from over 1,200 SMEs of varying sizes and present in different markets across the UK, Spain, Germany and Italy. Conducted between May and June 2020.

<sup>16</sup> Connected Commerce Council. (2021). European Small and Medium-Sized Enterprises (SMEs). Digitally Driven Europe.

<sup>17</sup> European Commission. (2020). An SME Strategy for a sustainable and digital Europe. Brussels, 10.3.2020 COM(2020) 103 final.

<sup>18</sup> European Parliament. (2021). Covid-19: how the EU can help small businesses. News, European Parliament. Economy, 14-01-2021



## Building Back Better

Agility is critical for SMEs, allowing them to be better prepared and able to navigate the economic, political, social and psychological challenges large-scale shocks like Covid-19 pose. They need to be able to cultivate the skills and competencies required to alter and innovate their operations, and based on the specific sector they operate in and the market context, be prepared and willing to adjust and transform their business model. Based on this, it is crucial that policymakers support SMEs in this regard. With lessons already learned, it is clear that the right interventions are crucial to respond to both the short-term challenges, as well as the structural long-term challenges. These should range from ensuring the rapid delivery of SME and entrepreneurship interventions through simplified access to support and easier to navigate digital delivery systems, to boosting start-up rates in recovery packages and by preventing and avoiding SME over-indebtedness.

Based on the integral role digital readiness and digital tools have played in allowing SMEs to adapt, a specific focus needs to be placed on supporting SME digitalisation in both the short and long term. Targeting the digital divide between smaller and larger firms, and boosting teleworking, e-commerce and digital infrastructure and skills is another key step, alongside the wider aim of boosting SME resilience through their capacity to improve and update business models, products, and work processes.

Policy frameworks themselves also need to become more resilient, with huge shocks to the system like this one acting as a stress test on SME and entrepreneurship regulatory frameworks. A key element of this is in learning from SMEs themselves, involving the stakeholders and primary beneficiaries of interventions in recovery packages, and adapting to their experiences and needs as necessary. Data analysis and continued monitoring and evaluation will further ensure that response mechanisms are agile, flexible, and targeted towards the areas that are most crucial.

With the above in mind, the following questions could be taken into consideration:

- How can the EU Recovery Fund be used best at the national level to support SME resilience and recovery?
- What steps can be taken to make sure the SME 'digital divide' is not exacerbated and further entrenched?
- What drives SME transformation across different sectors in light of Covid-19, and what technologies and digital tools are having the biggest impact?
- How can the EU, national governments, and policy makers ensure the right regulatory frameworks are put in place to not only allow more digitally advanced SMEs to continue to adapt, but to make sure less well adapted SMEs are given the tools, assistance, and training required?

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<sup>19</sup> Gregurec, I et.al. (2021). The Impact of COVID-19 on Sustainable Business Models in SMEs. Sustainability 2021, 13, 1098.



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