

► Small goes digital

How digitalization can bring about
productive growth
for micro and small enterprises

EXECUTIVE SUMMARY



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Addressing the economic realities of micro and small enterprises (MSEs) has never been more important. MSEs – defined as enterprises with 2 to 49 employees – contribute close to 40 per cent of jobs worldwide and play a crucial role in efforts to implement the 2030 Agenda for Sustainable Development and achieve the Sustainable Development Goals, yet they often remain trapped at low levels of performance and growth. Many MSEs are informal, making them particularly vulnerable to economic shocks such as that caused by the COVID-19 pandemic.

The present report deals with an urgent knowledge gap concerning such enterprises, specifically their ability to use digital technologies (email, mobile applications, cloud computing and so on) to increase productivity. It seeks to clarify why only exceptional MSEs have managed to fully exploit the opportunities offered by digital technologies, and it explores the specific benefits and barriers that the digital revolution has created for the average MSE. The report bridges between hitherto siloed policy debates on the global digital revolution and on informal enterprises and MSEs. Drawing on a broad review of empirical evidence, it puts forward two models of how digitalization affects MSE performance, with a focus on productivity as the central outcome of interest.

The analysis conducted for this report builds on the notion of *capabilities* to capture the intangible assets within an MSE that influence its susceptibility to, and ability to benefit from, digitalization – notably the collective skills, attitudes and expertise of the enterprise's owner and staff. Five types of MSE with different overall capability levels are distinguished: (a) microenterprises, such as traders and subsistence farmers; (b)

locally oriented small enterprises, such as shops and restaurants; (c) export oriented small enterprises, such as those in the agroprocessing sector; (d) knowledge-based small enterprises, such as health clinics and media agencies; and (e) start ups, such as delivery apps and biotechnology ventures. Environmental factors that affect MSE digitalization are also taken into account, such as the strength of local digital ecosystems or an MSE's position in the supply chain.

The report condenses the results of a wide range of studies from diverse contexts into two chapters dealing, respectively, with digitalization opportunities and barriers for MSEs. The opportunities discussed are: (a) increased access to information and an improved ability to communicate; (b) the ability to trade and to access markets more easily and over greater distances; (c) access to a variety of financial services with low barriers to entry; (d) new pathways to enterprise formalization; (d) digital transformation and entrepreneurship as fundamental shifts in value creation; and (e) synergies with the development and diffusion of green businesses and technologies. As for the digitalization barriers faced by MSEs, the report covers: (a) digital divides and locally incomplete digital infrastructures; (b) multifaceted digital skill shortages among MSEs; (c) low adoption readiness, risk averse cultures and gender barriers; (d) MSEs' often marginal positions in value chains and platform markets; and (e) challenges in implementing appropriate cybersecurity and data protection measures. For both opportunities and barriers, the report takes into account established knowledge about the role of supply chains but also newer studies on the emergence of digital platforms as increasingly important market intermediaries for MSEs. From a

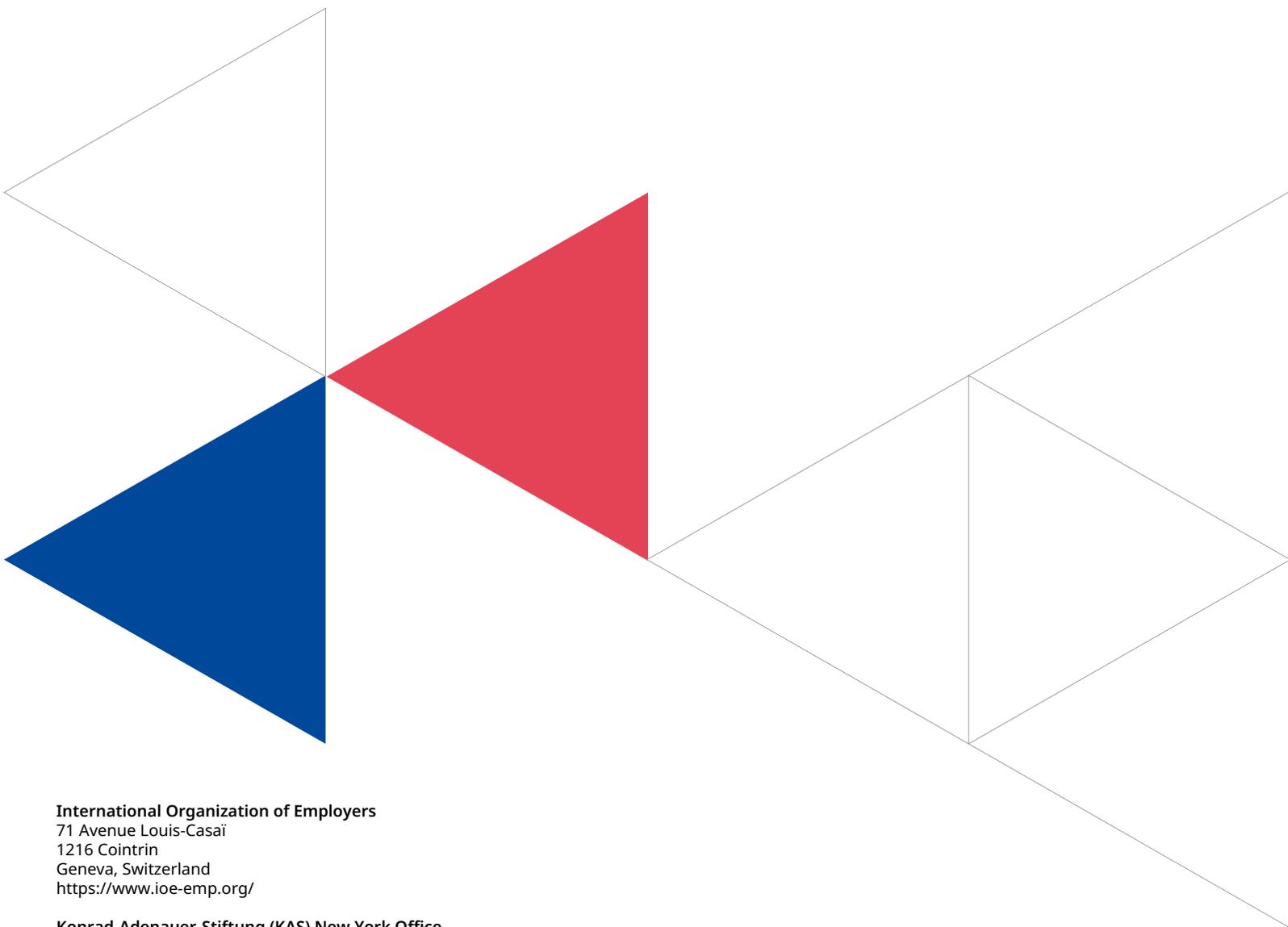
detailed discussion of opportunities and barriers, four key observations are distilled:

1. MSEs do not digitalize “automatically” and by default; instead, digitalization is driven by deliberate decision-making on the part of MSEs, which may be hampered by incomplete information and risk-averse attitudes.
2. The extent to which MSEs are able to increase their productivity through digitalization is determined by their internal capabilities: depth of digital adoption, digital skills, innovation orientation and flexible management.
3. The potential depth of digitalization and the associated capability levels depend on an MSE’s size, degree of formalization, export orientation and the information intensity of the sector in which it operates.
4. MSE digitalization is affected by three sets of external influences: the local digital ecosystem, an MSE’s business network, and its broader social and policy environment. Microenterprises are more directly dependent on their environment than other types of MSE.

As a major novel contribution, the report puts forward two models of how digitalization can lead to productivity gains in MSEs: one based on an enterprise’s internal capabilities, the other on external (environmental) influences. The capability model emphasizes

that moving from a simple to a sophisticated digital adoption strategy has virtually no impact unless this shift is complemented by improvements in other capabilities. Beyond digital adoption, MSEs need to have a minimum level of digital skills, innovation orientation and (in the case of more advanced enterprises) flexible management if they are to achieve significant productivity gains. The environmental model outlines how the local digital ecosystem, an MSE’s business network, and societal and policy influences affect such enterprises in various ways.

Finally, the report offers recommendations for policy and support approaches that can help to promote MSE digitalization. Measures to bridge digital divides, to enhance digitally enabled formalization programmes, and to assist MSEs in improving their positions in supply chains and platform markets are discussed. The overall conclusion is that policymakers and support organizations should not overestimate the immediate benefits that digital technologies can bring to MSEs; rather, they should facilitate investment in assets that are relevant to specific types of MSE and are complementary to digital adoption, such as skills, mindsets and managerial abilities. The approaches recommended in this report should be seen as key tools not only for strengthening MSEs, but thereby also for paving the way towards implementation of the 2030 Agenda for Sustainable Development.



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