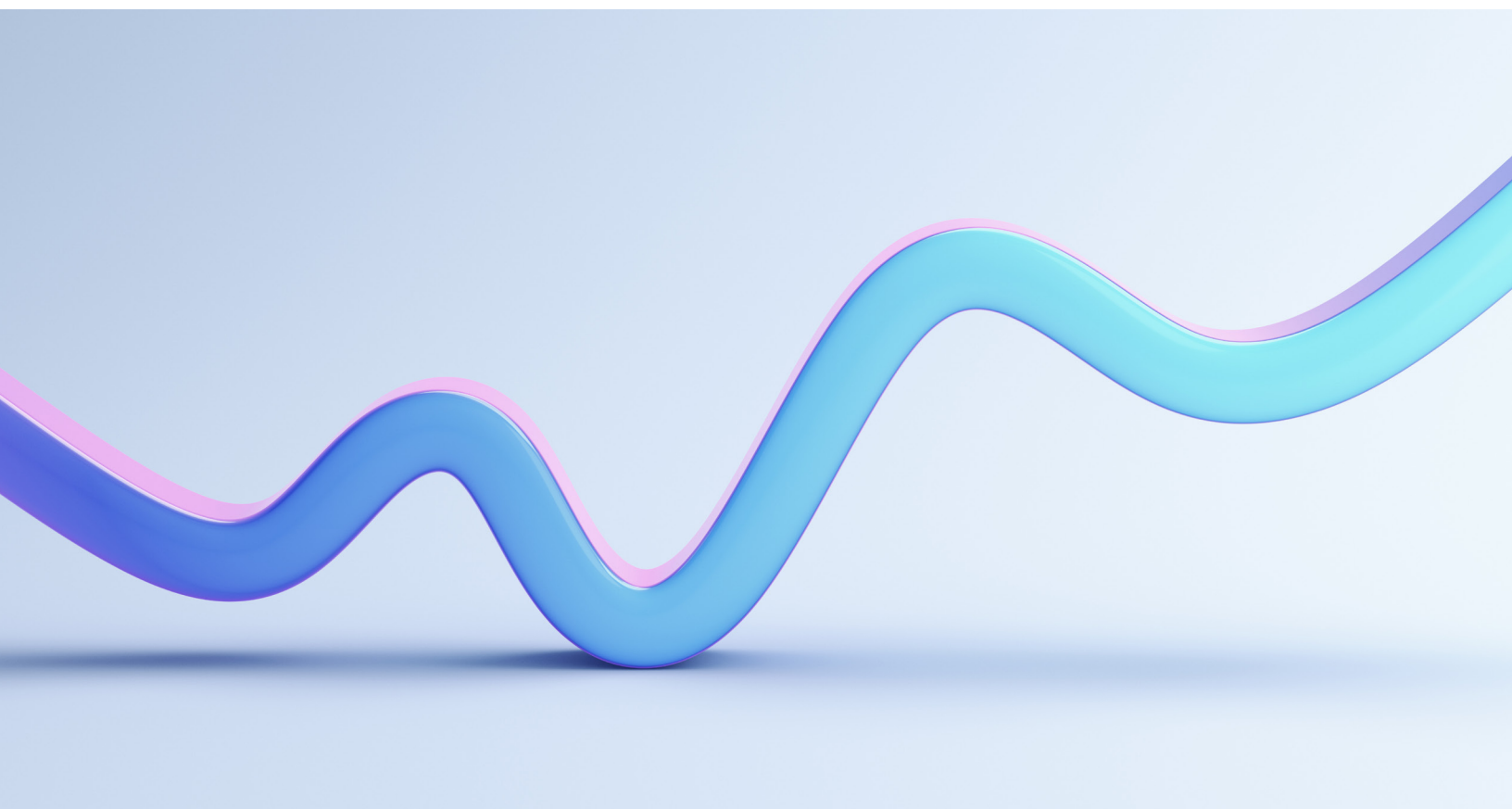


Public Sector Practice

Setting up small and medium-size enterprises for restart and recovery

Small and medium-size enterprises are a critical engine for the global economy. In the wake of the pandemic, governments can take four actions to maximize the impact of existing support measures.

by Abdulaziz Albaz, Tarek Mansour, Tarek Rida, and Jörg Schubert



Governments' economic responses to the COVID-19 pandemic have included an array of measures to help people and businesses weather the storm. Small and medium-size enterprises (SMEs) are in an especially difficult position. Plunging demand has forced them to lay off workers, and many don't have the financial resources to survive in this climate. In many countries, up to one-third of SMEs could go bust within three months of when the pandemic began in their countries.¹ But their viability will be critical to any postcrisis recovery: SMEs account for two-thirds of global employment and half of global GDP. A failure to protect them could put the entire global economy at risk.

Since the onset of the pandemic, governments have implemented a sizable number of programs aimed at addressing the needs of SMEs. The overarching goal has been to provide business owners with critical funds and support in the immediate term. These actions are critical, but to maximize their impact, policy makers could consider four additional actions: easing SME access to government support, enabling the support ecosystem through an 'SME nerve center,' sharpening focus on building sustainability and resilience, and replanning for the next normal.

SMEs have the potential to be an economic and employment engine after the crisis, but an effective government response now will be critical. The prospects of an eventual recovery depend on it.

Why SMEs are more vulnerable to the crisis

While all companies have had to quickly adapt to disruption and greater uncertainty, SMEs are particularly susceptible. Three factors increase the potential fallout from the crisis for SMEs compared with larger companies.

Plunging demand and liquidity challenges

Demand has declined dramatically since the onset of the pandemic. According to 15 surveys

in Organisation for Economic Co-operation and Development (OECD) countries, more than half of SMEs already face severe losses in revenues, with many having only a few months of reserves. In Portugal, 37 percent of SMEs reported a more than 50 percent drop in production.² At the start of the outbreak, two-thirds of SMEs in China reported having enough cash to cover fixed costs for no more than two months. In the United States, an average small business has only 27 days of cash flow. This combination of factors puts SMEs in a vulnerable position, and many are at risk of a permanent closure.

Inflexible supply chains and operations

SME management teams don't have the bandwidth that large companies have in core functional areas to manage commercial pressures and respond to the pandemic. This lack of capacity manifests itself in an inability to quickly adapt their supply chain and production processes. SMEs frequently source inputs from supply chains that have become longer, more complex, and more global. The pandemic has disrupted these supply chains, leaving many SMEs without the materials they need to maintain operations. In addition, measures meant to slow the disease's spread have also disrupted SME production processes. Factory floors of small enterprises are not designed for physical distancing, and the companies typically do not have the expertise and resources to quickly reconfigure their operations.

Disproportional SME representation in hardest-hit sectors

According to our analysis, some industry sectors will be hit harder than others in the crisis and will take longer to recover due to long-term demand and supply disruptions. These sectors, which include retail, hospitality, food service, entertainment services, and construction, have an overrepresentation of SMEs due to the local nature of the demand and lower barriers to entry. For example, in the OECD, 60 to 70 percent of SMEs do business in these sectors, making SMEs more affected by the crisis.

¹ *Coronavirus (COVID-19): SME policy responses*, OECD, oecd.org.

² *Coronavirus (COVID-19): SME policy responses*, OECD.

Why protecting SMEs is important

In nearly every community, SMEs are a critical part of the economy: they are not only employers but also customers to larger companies across the supply chain. Their survival and ability to restart operations quickly will be a bellwether for the economy as a whole.

Sizable impact on unemployment

SMEs account for 45 percent of total employment in emerging countries and about 70 percent in OECD countries. The sudden, dramatic loss of demand severely affects the ability of SMEs to function, and the resulting shutdown increases unemployment. In the United States, 50 percent of all SMEs and 78 percent of small businesses (those with revenues of less than \$20 million) have laid off employees recently, leading to record-breaking unemployment rates.

Long-term systemic risk

A failure to protect SMEs will have a ripple effect on the broader economy and put the speed of any recovery at risk. First, as individuals face loss of income and elevated uncertainty, the reduction in spending and consumption will have a compounding effect on large companies. Similarly, the crisis is likely to call into question regional economic-development efforts. Smaller towns rely heavily on SMEs for employment and economic activity and could face significant hardship and migration if small businesses were to close down.

Obstacles to a more effective pandemic response

To address immediate disruptions, governments have announced unprecedented stimulus packages. Our analysis catalogued more than 1,300 stimulus measures in 51 countries approaching \$11 trillion dollars. These measures earmarked a portion for SMEs, with a focus on providing direct and immediate cash relief (for example, government fee waivers and cash transfers to firms) as well as longer-term balance-sheet support (such as credit-guarantee programs). Approaches to support are

constantly evolving, and certain governments are considering additional support for SMEs.

Despite the effort, the effectiveness of government support to date has been limited by the following three important elements:

Constrained support capacity and complex administrative procedures

Complex procedures and lack of capacity hinder efforts to support SMEs. In many governments, the rollout of SME support programs has been subject to glitches and other delays that slowed the approval process, last-minute changes in application procedures, and ambiguity about eligibility criteria to receive support.

Lack of integrated approach and coordination

Now more than ever, SMEs need comprehensive support based on a coherent strategy. However, the SME support ecosystem tends to be complex: it includes policy makers, banks, public- and private-sector technical-assistance providers, nongovernmental organizations, and international donors. Currently, the majority of governments are unable to mobilize this ecosystem because they lack a single dedicated orchestrator to ensure that all efforts are oriented toward the same goals.

A focus on short-term survival rather than future growth

Government responses have concentrated on helping SMEs survive the crisis. Nearly all measures introduced by governments aim at improving liquidity through postponement of payments, value transfer to businesses (for example, payroll support and reduction in government fees), and balance-sheet support (for example, loan-guarantee programs).

Fewer initiatives tackle the longer-term challenges that SMEs will face in adapting to the postpandemic landscape if demand has yet to recover when the government stimulus runs out. Thus, helping SMEs ride out the pandemic is critical, but it's not enough: they need help envisioning a next normal for doing business. They need a long-term plan for restart and

recovery focused on exceeding, not just returning to, their precrisis performance.

Four actions to elevate impact of existing measures

The scope of the pandemic and the resulting economic fallout have led many government officials to question whether their response to date is sufficient to protect SMEs and provide the foundation for a recovery. The goal is to get the greatest possible impact from existing efforts and set up SMEs for a stronger recovery after the crisis.

In our experience, four actions are critical. The first two focus on the immediate response to the pandemic, the last two on how SMEs can emerge stronger.

Ease SME access to support

To increase SMEs' participation in response measures, policy makers should work directly with them, helping them identify the right assistance programs, navigate application processes, and secure assistance. Countries that have successfully carried out such interventions have established a single, integrated point of contact for SMEs. For example, the Australian government built a

dedicated section on their website with information for businesses about available support measures and set up an SME hotline.

Once informed of the most relevant support, SMEs need fast and easy access to services. For example, loans, grants, and guarantees that require elaborate applications can be deterrents, especially for the smallest enterprises, which don't have the staff or resources to dedicate to lengthy submission processes. By easing administrative processes, governments can increase SME participation in assistance programs. For example, the German state of Bavaria offered immediate aid of €5,000 to €30,000 to affected SMEs. Similarly, the Business Development Bank of Canada (BDC) offered a small-business loan of up to CA \$100,000 that can be obtained online within 48 hours from time of approval.³

Orchestrate and focus the support ecosystem through an 'SME nerve center'

SMEs now need comprehensive support. To maximize the impact of government response measures, governments should create an 'SME nerve center' to serve as a single orchestrator, activate the full ecosystem, and ensure that all efforts are aligned with the overarching goals.

³ *Coronavirus (COVID-19): SME policy responses*, OECD.

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Necessary first steps include addressing the interests of different parties, increasing information accessibility, and matching demand with supply.

In addition, the SME nerve center can act as a control tower that closely monitors the uptake and impact of programs and establishes a feedback loop. These insights enable policy makers and SME-support-ecosystem participants to adapt rapidly and focus their assistance. Currently, most governments are unable to track progress, which creates blind spots that limit their ability to take corrective action to enhance the effectiveness of programs. The nerve center also provides information about SME participation in government support programs at the segment and regional levels; these insights are essential to mobilizing the relevant ecosystem stakeholders.

Sharpen focus on building sustainability and competitiveness

The speed of recovery will depend on the ability of SMEs to return to sustainable operations postcrisis after current stimulus measures run out. Policy makers should direct their focus to delivering three foundational interventions that are of highest impact and relevance to SMEs: access to local demand, support for internationalization, and enhancement of productivity.

First, SMEs' share in public procurement remains lower than it should be in many markets. Public procurement remains the avenue for sustainable SME development with the most impact, given its share of total demand (for example, 30 percent in OECD countries and more than 50 percent in developing countries). Governments can consider easing administrative burdens that have limited SME participation in public procurement to date. For example, South Korea's Ministry of SMEs and Startups has implemented a measure to simplify the processes and administrative burden in public procurement by limiting on-site inspections. Governments in many countries have offered advanced payments for procured goods and services.

Second, SMEs thrive when they are integrated into global value chains. The pandemic has disrupted supply chains and international trade, and SMEs don't have the resources to rebuild the broken connections on their own. As such, putting SME internationalization at the heart of national export strategies is critical.

Finally, productivity-enhancement programs will be essential for the survival of SMEs and their ability to compete internationally. While many SMEs have fought through the crisis by, for instance, introducing rapid e-commerce solutions, there's ample need for more innovation and digitization to further enhance their economics and assure their survival. Governments can accelerate the introduction of productivity programs as well as maximize the effectiveness of existing programs by prioritizing the SMEs most in need (by size, sector, and growth potential) and matching them with the right technology, infrastructure, and capability-building solutions. The Singapore government agency Workforce Singapore supports SMEs and employers through multiple programs that aim to help businesses adopt lean management practices as well as industry 4.0 technologies. This program increased the productivity of participating SMEs by 40 to 70 percent. In Ireland, Local Enterprise Offices in every county will be providing vouchers of €2,500 to €10,000—with a 50-50 funding match—to support business-continuity preparedness, innovation, and productivity.

Replan for the next normal

Policy makers and SME authorities could consider reassessing their existing strategies and adapting priorities to the current environment. Beyond the current stimulus response, governments could explore three areas.⁴

First, policy makers can prioritize sectors that have been heavily affected but will be quick to recover (for example, maintenance and construction) by introducing customized interventions. This approach can help to increase economic activity while continuing to safeguard public health.⁵

⁴ *Coronavirus (COVID-19): SME policy responses*, OECD.

⁵ Andres Cadena, Felipe Child, Fernando Ferrari-Haines, and Juan Franco, "Restarting national economies during the coronavirus, part two," May 11, 2020, McKinsey.com.

Second, governments could accelerate efforts to support high-performing and innovative companies with scale-up potential. According to our analysis, this category accounts for only 2 to 3 percent of SMEs in most countries but generates more than 60 percent of economic and employment growth. As such, governments could aspire to more than double their scale-up density—the share of scale-ups out of total SMEs—in the medium term. Targeted and scalable technical-assistance programs and national platforms that spur product innovation, technology adoption, digitization, and the creation of new business models are essential to increase scale-up density. In 2016, BDC established its scale-up program, Growth Driver Program, to support high-growth SMEs to optimize their growth strategies, financing structure, and internal controls. Companies enrolled in this program will have access to BDC internal expertise and its network of entrepreneurs. To date, the program has supported more than 140 businesses.

Finally, while the governments' response is focused on supporting the survival of existing SMEs, these efforts should be complemented with promoting a culture of entrepreneurship aimed at enhancing business creation in priority industries, increasing the number of high-quality jobs, and improving the socioeconomic resilience and competitiveness of SMEs.

Governments recognize that SMEs will be a vital engine for the postcrisis economic recovery, and many have already implemented programs in response to the pandemic. But ensuring that aid reaches SMEs and makes the desired impact requires a more comprehensive approach. Governments that take four targeted actions will accelerate their recovery and set up SMEs for sustained success.

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