

Public & Social Sector Practice

Unlocking growth in small and medium-size enterprises

With the right support, small and medium-size enterprises could significantly boost economic growth. Governments can help capture this opportunity.

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Sluggish productivity growth is one of the biggest threats to overall economic growth in developed and developing economies alike, with serious implications for citizens' well-being such as lower income growth, increased inequality, and challenges with loan repayment. In recent years, productivity growth has stalled in many places; a 2018 McKinsey Global Institute (MGI) study of seven Organisation for Economic Co-operation and Development (OECD) countries found a drop in average productivity growth, from 2.4 percent per year between 2000 and 2004 to 0.5 percent per year between 2010 and 2014.¹

Small and medium-size enterprises (SMEs) contribute to the productivity problem. Within the same sector or within countries of similar size, the productivity gap between large companies and SMEs can vary by a factor of two or more. In construction, for example, McKinsey research found that the productivity gap between SMEs and large companies is 26 percent in France, 41 percent in Germany, and 54 percent in Italy. In the food-services and accommodation sector, the gap is smaller for Italy, at 29 percent, compared with 39 percent for France and 41 percent for Germany. These productivity differences reach 60 percent in Turkey and 80 percent in Greece in many sectors. And a large share of the world's population works for an SME—between 50 percent and 90 percent of the labor force, depending on the country.²

Improving the productivity of SMEs is therefore a worthwhile endeavor. Indeed, SMEs can spur a country's growth for two reasons. First, integrating proven practices and technologies is faster and safer than testing new ones, and SMEs have a large adoption gap to close. In the same way that emerging markets can grow faster than high-income markets by adopting tested technologies,

SMEs can grow faster than large companies by adopting the proven technologies and practices of larger enterprises. Second, start-ups, which are a critical subsegment of SMEs, have become important sources of innovation. Because they are unhindered by legacy systems and outdated strategies, new market entrants are often able to rethink established practices and cut through traditional industry boundaries.

Halving the global productivity gap between SMEs and large companies would amount to about \$15 trillion in corresponding value added, or roughly 7 percent of global GDP.³ Governments around the world can and are helping close this gap through ten approaches tailored to meet SMEs' most pressing needs.

The need for a thriving ecosystem of small and medium-size enterprises

When enabled by a business-friendly environment and open markets, large companies can thrive; meanwhile, SMEs have a broad range of unmet needs. The limited size of many SMEs means they have difficulty accessing capabilities and resources that would make them more productive, including talented individuals with the latest knowledge of technology, finance, and managerial practices.

Furthermore, many SMEs are young enterprises, which, when combined with their small scale, makes them a weaker counterpart for many standard market players, not only in terms of funding access but also for customers who might perceive small suppliers as too risky. Nonstandard market players such as crowdfunding platforms and venture-capital funds are still in the early stage of development in many OECD countries and often cannot fulfill the needs of SMEs.

¹ For more information, see "Solving the productivity puzzle," McKinsey Global Institute, February 2018, on McKinsey.com.

² For example, Canada, Korea, and China have more than 80 percent of private sector employees working in SMEs, according to OECD enterprise statistics.

³ Based on the weighted average of the productivity gap between SMEs and large companies for countries where OECD data are available. The weight used has been the number of SME employees in each country. Ireland has been excluded as an outlier due to large companies establishing regional headquarters in Ireland and shifting profits for tax purposes, showing an artificially high productivity gap between SMEs and large companies of over 70 percent.

Given the challenges facing SMEs and the size of the opportunity, most G-20 countries have created a national agency fully or primarily focused on supporting their growth.⁴ However, operating these government agencies is challenging for the same reasons that markets have struggled to meet SMEs' needs: their small scale and diversity of circumstances.

Our research, analysis, and experience working with SMEs and SME-development agencies suggests that governments and nongovernmental organizations (NGOs) seeking to serve SMEs' unmet needs would benefit from two actions: first, understanding and improving the SME ecosystem

and second, pursuing a targeted approach to serving various SME subsegments.

Specifically, they should focus on promoting three characteristics of a healthy and well-performing SME ecosystem: boosting the business confidence of SMEs, enabling the growth of SMEs—in general and for high performers—and increasing the competitiveness of SMEs (Exhibit 1). Establishing these three characteristics requires a segmented execution approach. It is therefore important that government agencies design their menu of services after identifying the subsegments prevalent in their country and the differences in their needs. We have identified ten approaches that are used across the world to help meet these needs.

⁴ India, Indonesia, and South Korea have established dedicated ministries to support SMEs. Other countries have established entities and agencies with the same purpose: Saudi Arabia established the General Authority for Small and Medium Enterprises, the United States has the long-standing Small Business Administration, and countries such as Canada and France have development banks mandated to develop the SME ecosystem.

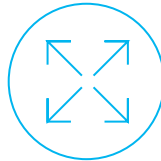
Exhibit 1

Governments could help small and medium-size enterprises (SMEs) by focusing on three characteristics.



Confidence

Increase SME business confidence by supporting ease of doing business and by promoting a culture of entrepreneurship.



Growth

Support the growth of SMEs by facilitating access to local and global markets, providing technical assistance that drives innovation, and ensuring availability of tailored financial products to support business expansion.



Competitiveness

Create a globally competitive SME pool by providing required business support infrastructure and actively supporting productivity and technology adoption.

Identifying and prioritizing SME subsegments

In our experience, SMEs typically fall into one of six categories: early-stage innovative start-ups, established successful start-ups, growing medium-size companies, stagnant or struggling medium-size

companies, locally focused small businesses, and informal microbusinesses (Exhibit 2).

While it is important to consider the totality of all SME subsegment needs, we believe that SME-development agencies should focus their limited

Exhibit 2

The six subsegments of SMEs have varying characteristics and needs.

	SME subsegments	Core characteristics	Areas of biggest need
1	Early-stage innovative start-ups	Groups with an innovative idea in the prototype or proof-of-concept stages Groups with an early business plan before incorporation	Cultural and educational ecosystem that fosters entrepreneurship Access to multiple services and competencies
2	Established successful start-ups	Groups that have established a minimally viable product or service and business model	Established processes (eg, production or service delivery, supply and delivery chain, marketing and sales strategy) Access to financing and managerial capabilities
3	Growing medium-size companies	Mature companies with annual revenues of \$10 million–\$200 million Business models that provide a competitive edge and moderate growth Not very disruptive	Advisory and tactical business support (eg, through scale-up programs) to enable growth (eg, through access to foreign markets, increased operational efficiency, technology adoption)
4	Stagnant or struggling medium-size companies	Mature and sizable companies that have ceased to grow or are struggling by measures such as revenues or profitability	Support in turning around their business and avoiding bankruptcy (eg, through productivity-enhancing activities, strategy support, product redesign) Emergency loans and dispute-resolution support
5	Locally focused small businesses	Businesses with potentially fewer than ten employees, yearly revenues under \$1 million, and low or negative productivity per worker Growth potential constrained by local consumer incomes and limited managerial, technological, and financial skills Businesses with nontradeable service component (eg, restaurant, hair salon, dentist office)	Unclear: efforts to support this subsegment have proven difficult for governments and often result in dispersed resources Potentially local complementary currencies to increase demand and access to credit
6	Informal microbusinesses	Freelancers and independent workers in diverse areas (eg, home-based businesses, repair shops, grooming services, taxi services) Account for 70 percent of employment in emerging markets Low productivity, tax revenues, and worker wages	Formal lending (eg, inexpensive credit to grow business) Support for workers, customers, suppliers

resources on those with the highest potential for impact, with programs tailored to their specific situations.

Medium-size companies are often priority subsegments. According to our analysis, even though medium-size enterprises make up only 2 percent of all companies, they account for about 30 percent of GDP and employment in most countries.

This can vary by country, of course. A country such as India, for instance, has a low urbanization rate, with hundreds of millions of people employed in the informal sector or in small businesses in rural areas. It is difficult to neglect these segments in India, however, a highly urbanized country with a lower level of informality could have a more targeted approach and focus only on innovative start-ups and medium-size companies.

A country's economic-development strategy should therefore guide the prioritization. For example, if export growth is a priority, medium-size companies

operating in tradable goods and services could take precedence. While such ranking can be difficult, scattering resources among too many recipients may severely diminish their impact.

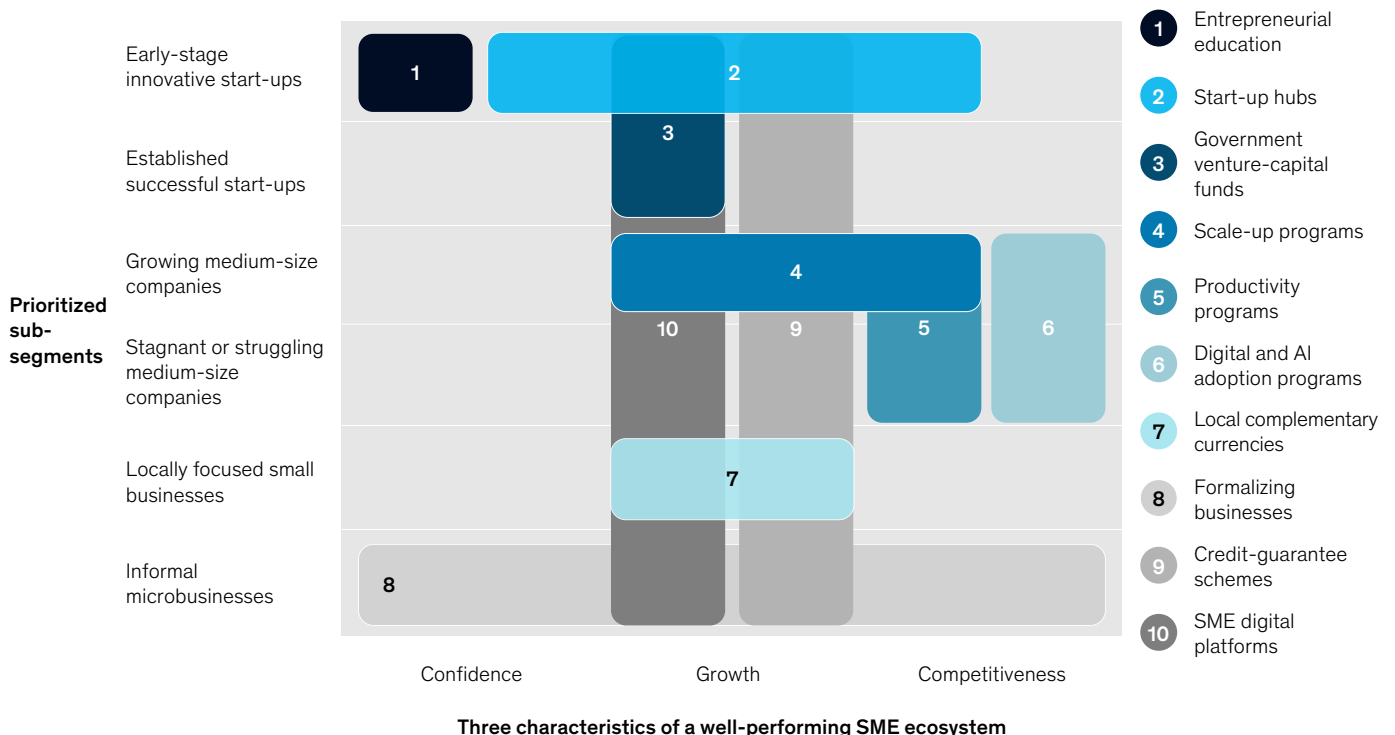
Providing the right levels of support to small and medium-size enterprises

Government agencies and NGOs with a good understanding of SME subsegments can better tailor their programs to meet SMEs' unmet needs. We have researched SME support programs across the world and categorized them into a matrix of ten approaches. Some are tailored to a single subsegment while others address one of the six unmet needs for all or most subsegments (Exhibit 3).

For all these categories, the specifics of how they are implemented matter, therefore it is difficult to draw universal best practices from them. However, it can be instructive to consider the following ways these programs are helping to close the productivity gap for SMEs.

Exhibit 3

Global SME support programs fall into ten categories that address one or more ecosystem subsegments.



Entrepreneurial culture and education

Besides institutions, regulations, and facilities, the attractiveness of an entrepreneurial career and citizens' entrepreneurial capabilities are also important in increasing the development and survival rates of start-ups. Many ideas are never prototyped or converted into a business plan. Risk aversion, fear of failure, and lack of capabilities can be just as significant barriers as lacking the regulatory and institutional support. Several governments have attempted to develop an entrepreneurial mindset among their citizens.

Inculcating entrepreneurial skills through formal education is often part of the solution. Poland, for example, teaches elements of entrepreneurship in primary-school core subjects, such as history and math, and upper-secondary students are required to take "Introduction to Entrepreneurship."⁵

Entrepreneurial education is also thought to promote equity, and many organizations have focused on developing an entrepreneurial mindset and capabilities in young residents of low-income communities. In the United States, for example, the Network for Teaching Entrepreneurship (founded in 1987) delivers multiple entrepreneurial programs and extracurricular activities through 1,882 partner schools. The programs have reached more than 23,000 students across states and approximately 50,000 more internationally. Additionally, 75 percent of the network's alumni have enrolled in college and 25 percent have started at least one business.⁶

Start-up hubs

Entrepreneurs around the world have chosen major start-up hubs to launch their enterprises, seeking an innovative environment, access to financing, and business support. Many governments have prioritized turning one or more of their cities into a start-up hub, by either branding the city as a start-up hub or supporting start-up campuses. As governments attempt to enable or develop start-up hubs, they can focus on some of the toughest

challenges entrepreneurs typically face—navigating the administrative requirements to start and run a company, accessing the competencies needed to run a business, and being able to afford the launch of a start-up as well as the costs of living in a start-up hub.

In the 1960s, federal laboratories settled in Boulder, Colorado, and partnered with the University of Colorado to fund and conduct research on energy, environment, and climate topics. Since then, the city has established numerous important assets, including leading research institutions. Boulder currently boasts 12 active start-up accelerators and incubators.

Moreover, the Colorado Office of Economic Development and International Trade (OEDIT) works closely with the governor of Colorado to offer financial support services—including grants and tax incentives—to selected start-ups. The OEDIT also hosts the Colorado Small Business Development Center Network, which provides technical business support through mentorship, consulting, and training.

Today, Boulder ranks as one of the best 30 start-up ecosystems globally.⁷ Companies in the tech sector employ 9.7 percent of Colorado's total workforce and make up 14 percent of its economy.⁸

Government venture-capital funds (GVCFs)

Government funds for start-ups first appeared in Europe following World War II. Today, governments in high-income countries are paying more attention to the start-up sector, hoping to boost innovation and stimulate economic impact through venture capital (VC). Setting up a GVCF can contribute to this objective while also providing adequate financial returns for the government. Some ecosystem prerequisites can increase the impact of a GVCF, including a well-developed capital market to maximize exit options (for example, secondary stock market, later-round exits, strategic acquisitions, and openness to foreign ownership).

⁵ *Entrepreneurship education in Poland*, School Education Gateway, August 2015, schooleducationgateway.eu.

⁶ *2018 Annual report: Preparing the next generation—youth entrepreneurship and the future of work*, Network for Teaching Entrepreneurship, January 2019, nfte.com.

⁷ *Global startup ecosystem report 2019*, Startup Genome, May 9, 2019, startupgenome.com.

⁸ "Colorado tech workforce added 6,500 jobs in 2017, boosted contribution to state's economy," CompTIA, March 27, 2018, comptia.org.

One important component of a successful government-led ecosystem is the ability to attract investors from the private sector. In many cases, public investment in VC crowds out private-sector investors, given that GVCFs often have more leverage and access to funds as well as limited accountability on costs (see sidebar “The Business Development Bank of Canada: Activating the Canadian VC industry and initiating a growth-driver scale-up program”). A GVCF’s design can also influence its success in important areas such as aligning GVCF objectives with national development goals and aligning the fund governance and operations with its mandate and investment strategy.

The South Korean government, for example, founded the Korea Fund of Funds as part of the Special Measures for the Promotion of Venture Business Act in 2005 with the purpose of providing stable capital for the venture-investment ecosystem. The \$2.8 billion fund has a passive investment strategy, focused mainly on seed- and early-stage start-ups. The fund has made approximately 6,000 investments in start-ups and 722 investments in other funds to date, with total fund size growing from 1 trillion won (approximately \$840 million) in 2009 to 4 trillion won in 2018.

Following the development of the Korea Fund of Funds, the government established four more dedicated funds: to invest in growth-stage SMEs with high job-creation potential, to support and coinvest with angel investors and minimize equity gaps for start-ups, to finance technology SMEs, and to create a foreign VC fund to support South Korean start-ups that plan to operate overseas.

The South Korean government created a large database and network of angel investors. All funds are invested only in South Korean companies to ensure local development of the start-up segment and the venture capital industry without focusing on any specific sector and are managed by a third party,

the Korea Venture Investment Corporation. The South Korean government witnessed a 178 percent increase in seed deals through coinvesting with private players in early stage start-ups.

By measures such as share of GDP, South Korea’s VC investments are the fourth-largest of the OECD countries, behind only Israel, the United States, and Canada. At 0.36 percent, its VC investments more than doubled between 2010 and 2017 while other OECD countries’ VC investments declined significantly.⁹ A notable sign of success for the government-led initiative is the 9 percent increase in private-sector VC investments due to participation by crowding in investors, which corresponds with a greater number of VC firms and investment managers.¹⁰

Scale-up programs

Many governments have launched scale-up programs that help medium-size businesses unlock their potential and grow faster. Some programs provide comprehensive support, facilitating SMEs’ access to finance, networking, consulting, and mentorship. Others follow a more targeted approach, focusing on specific sectors or predefined support services (see sidebar “The Business Development Bank of Canada: Activating the Canadian VC industry and initiating a growth-driver scale-up program”).

TURQUALITY, a state-funded scale-up program in Turkey that was launched in 2004, is led jointly by Turkey’s Ministry of Trade and the Turkish Exporters’ Assembly. The program aims to support promising Turkish companies with strong brands, established business capabilities, and high economic potential—to ultimately transform top Turkish businesses into global players that have well-known global brands and generate high value-added exports.

The program is open to all Turkish companies, which must apply online and undergo an on-site inspection of their performance by the ministry and accredited evaluators. At the end of this assessment,

⁹ OECD data highlights that VC investment increased from \$527 million in 2010 to ~\$1.9 billion in 2018; Kim Gang-rae and Lee Eun-jo, “S. Korea’s venture investment accounted for 0.36 percent of GDP in 2018: private council,” Pulse, June 5, 2019, pulsenews.co.kr.

¹⁰ Taehyun Jung and Jonghoon Lee, “Policy-driven expansion of venture capital industry: An empirical examination of contexts, factors, and effects behind the recent surge of Korean venture capital industry,” *Academy of Entrepreneurship Journal*, 2017, Volume 23, Number 1, abacademies.org.

The Business Development Bank of Canada: Activating the Canadian venture-capital industry and initiating a growth-driver scale-up program

The Canadian government established the Business Development Bank of Canada (BDC) in 1944 and repurposed its mandate in 1995 to support the growth of Canadian entrepreneurs and start-ups. It serves as an example of a successful government venture-capital fund and scale-up program.

Venture capital (VC)

The investment arm of BDC, BDC Venture Capital, shows that government VCs can be profitable while spurring economic development. As of December 2017, BDC Venture Capital had invested more than \$500 million in their portfolio companies and exited 95 investments; companies BDC invested in had raised about \$4 billion by 2017 and created more than 5,800 jobs.¹

BDC Venture Capital employs two approaches: active direct investment and passive investment in various funds through BDC capital fund investments and BDC capital direct investments. The approaches have different investing processes and commitment levels from an investment board that oversees and assures high quality of investments. Beyond typical investment activities, BDC Venture Capital offers investees several support services, including networking with experts, training sessions, and seminars to develop their VC-fund capabilities.

BDC has also succeeded in two important ways. First, it created a healthy deal flow. A relatively broad focus toward healthcare, IT, industry, and energy has allowed for

a pool of high-quality deals. The core team of BDC Venture Capital prioritizes investments in start-ups established mostly in Canada, on the condition of having a solid business model, a clear competitive advantage, and management with an entrepreneurial spirit.

Second, BDC Venture Capital has been able to attract talented VC professionals. One of BDC's latest strategies to attract talent has been the option to spin off internal funds to talented managers. In the 2018 strategy release, BDC announced the spin-off of the Information Technology Fund, letting the two partners comanaging the arm lead the new independent fund, Framework Venture Partners. That fund ultimately raised \$100 million, half of which is matched by BDC Capital. The model provides a significant career opportunity for talented investors and bolsters the quality of the Canadian VC ecosystem.

Scale-up program

BDC established its Growth Driver Program in 2016 to help high-potential domestic firms overcome common challenges and barriers to scalability. The program aims to harness BDC's internal expertise and professional network to place entrepreneurs at the center of a multidisciplinary support system that guides SMEs through each phase of enterprise growth, driving economic growth and supporting job creation. Since the program was founded, it has supported more than 140 businesses with combined revenues of \$4.7 billion.²

Companies must formally apply to the Growth Driver Program, providing information regarding their financial performance and internal skills and team capabilities along with the key growth challenges. If they are selected, they will be offered to invest money in the program to showcase commitment. The money spent kicks off a two- to three-year program during which the business is given professional and developmental support from the BDC core team and dedicated consultants, who work with the companies to optimize their growth strategies, financing structures, and internal controls.

Meanwhile, senior leaders are enrolled in courses at top executive training schools. At its core, the program seeks to accelerate growth trajectories by injecting and transferring BDC's knowledge of industry best practices, enabling them to avoid the organizational flaws that typically limit SME expansion.

The initiative is industry agnostic and targets medium-size businesses that are deemed potentially high impact. These firms have a minimum of \$15 million in revenues, strong management, and feasible growth plans that can be quickly rolled out. BDC deploys public resources only on businesses that are intrinsically robust enough to generate sustainable returns at scale but lack the required experience and executional expertise to do so alone.

¹ "Higher number and greater diversity of entrepreneurs now calling on BDC for financing and advice," Business Development Bank of Canada, July 26, 2018, bdc.ca.

² All figures from Canada's BDC case study are in Canadian dollars.

each applicant receives a score along with a well-documented report on their current performance and development areas. Companies with mature business processes and capabilities, high brand value, and a certain level of exports are accepted into the program and become eligible for support. Primary areas of support include international brand building activities, overseas store openings, talent acquisition, and large-scale corporate transformation projects.

TURQUALITY initially focused on the textile and ready-to-wear sectors, which have a clear competitive advantage and high branding potential. Ultimately, the program expanded to other manufacturing and service sectors. The program has supported more than 300 companies across about 20 industries that now generate more than 5 percent of Turkey's exports, make branded exports to more than 150 countries, and have achieved double the export trade value compared with the national average.

Productivity programs

Using a model akin to scale-up programs, governments have also launched support programs that aim to enhance and accelerate the productivity of SMEs. In these programs, expert coaches in operational excellence and capability building help participating medium-size companies gain awareness of best practices and translate them into customized improvement initiatives. Many such programs rely on lean management practices, as well as on model factories, facilities that are optimized with the most efficient operational practices and latest technologies—providing SME employees a hands-on learning environment.

In Morocco, for example, the government launched a model factory in 2011 to help SMEs adopt the latest lean manufacturing principles through experiential training. The initiative, the Moroccan Micro-enterprise Support Institution (INMAA), was

established with an investment of 20 million dirhams (approximately \$5.5 million) by public institutions, financial institutions, and private-sector players.¹¹ INMAA aims to enroll 100 SMEs annually for a six-month program in which change agents spend a few days each month at the model factory for theory and practice modules, with the remainder of the month spent implementing the lessons learned.

The program starts with a diagnostic phase in which participants evaluate their current operations. The second phase involves the participants and experts envisioning the ideal future state. The implementation phase takes three months and equips change agents with the essential lean-manufacturing tools while practically implementing them in their own operations. The experts from the model factory continue to advise and guide change agents and conduct field visits to assess and aid the overall transformation, even after the participants graduate.

To date, INMAA has trained 650 change agents from 340 SMEs across seven sectors—achieving a 40 percent increase in productivity of participants on average. The program aims to transform the top 800 SMEs in Morocco, achieving a 25 percent increase in productivity.¹²

Digital and artificial intelligence (AI) adoption programs

The MGI has estimated an increase of productivity growth from digital adoption of 1.2 percentage points per year for some countries, representing the main contribution to productivity growth overall.¹³ Much of the impact relies on or is enhanced by AI applications. For SMEs, the theoretical opportunity is likely higher, but the corresponding implementation challenges are also more difficult.

Limited awareness of AI, limited access to digital talent, and limited capital to invest in AI applications can significantly hinder the uptake of these

¹¹ "INMAA, a model factory for Moroccan SMEs," Invest in Morocco, May 6, 2011, invest.gov.ma.

¹² "INMAA," accessed March 3, 2020, inmaamaroc.ma.

¹³ For more information, see "Solving the productivity puzzle," McKinsey Global Institute, February 2018, on McKinsey.com.

technologies by SMEs. Governments have started expanding their productivity programs toward digital adoption or setting up dedicated programs to help SMEs deploy AI technologies in their processes and products. Similar to productivity programs, digital- and AI-adoption programs also rely on centers of excellence and model factories for demonstrations. These programs depend on an ecosystem of different players and professionals to enable SMEs to deploy AI in their companies. The Mittelstand 4.0 centers of excellence in Germany, for example, are the first of 26 AI competence centers, staffed with 20 AI coaches to train 1,000 SMEs each year.¹⁴

In Finland, the Ministry of Economic Affairs and Employment and several technology industries have launched an accelerator dedicated to helping firms deploy AI. The accelerator offers six-month programs for companies that have already piloted an AI application on products or services. About 15 Finnish companies provide funding and technical support to the accelerator. In an initial phase, companies benefitting from similar AI use cases are batched together. Then, these organizations work with service providers, AI start-ups, and academics in short sprints to develop and deploy the AI applications to their processes or deliverables. The first batch of companies from the accelerator, for example, worked together to deploy Finnish speech-recognition technologies.¹⁵

Over the years, Singapore government agency Workforce Singapore has launched a series of productivity-enhancing programs to help medium-size companies adopt lean management practices as well as digital and Industry 4.0 technologies. One such program uses a field-and-forum approach, which alternates between forum sessions and in-field application. During the forums, SMEs come together to understand the fundamentals behind lean and Industry 4.0 adoption and experience the impact on a model factory at the Digital Capability Center Singapore. They then apply these

lessons in the field for a few weeks, supported by lean and digital experts, and exchange observations during the follow-up forum. This process allows companies to identify opportunities for improvement and implementation at their facilities. Moreover, SMEs will learn how to roll out progressive human capital practices and job redesign to augment their transformation.

To date, this Workforce Singapore program has been deployed successfully across multiple sectors, including food and beverage, hospitality, manufacturing, medical technology, and precision engineering. For example, ten precision engineering SMEs have participated in an Industry 4.0 transformation and job redesign program to enhance human capital and productivity. The 20-week program involved approximately 150 change agents and resulted in a 40 to 70 percent increase in machine and manpower productivity as well as an improved workplace environment.¹⁶

Local complementary currencies

Numerous NGOs and private-sector players have attempted to launch a local complementary currency restricted to a certain community (see sidebar “The 85 years of the Swiss WIR franc”). It could be as large as Switzerland (which has the WIR franc) or Sardinia, Italy (Sardex), or as small as the Bangladesh community in Mombasa, Kenya (Bangla-Pesa). Thousands of local currencies—which are typically digital-only and pegged to the legal tender—have emerged in areas where the legal tender and its connected monetary policies cannot provide enough credit to small businesses or enough purchasing power to local consumers.

Given that producers within the community are also consumers, a local currency can increase both the volume of transactions and the utilization of resources. Users can use this currency to settle payments between SMEs in the community. The community nature of the plan limits the need for

¹⁴ “Artificial intelligence strategy,” German Federal Ministry of Education and Research, Federal Ministry for Economic Affairs and Energy, and Federal Ministry of Social Affairs, November 2018, [ki-strategie-deutschland.de](https://www.ki-strategie-deutschland.de).

¹⁵ *Leading the way into the age of artificial intelligence: Final report of Finland’s Artificial Intelligence Programme 2019*, Finland Ministry of Economic Affairs and Employment, June 12, 2019, julkaisut.valtioneuvosto.fi.

¹⁶ Based on an interview with Digital Capability Center (DCC) Singapore.

The 85 years of the Swiss WIR franc

Started in 1934, the WIR Bank is a complementary currency system in Switzerland that serves mainly hospitality, construction, manufacturing, retail, and professional services SMEs. Its original goal was to stimulate trade within its representative community (which now includes more than 50,000 businesses, almost 20 percent of all enterprises in Switzerland); more than 1 percent of the Swiss GDP is exchanged in WIR francs.

Research by economist James Stodder shows that the WIR creates a countercyclical tendency in the economy: during financial crisis, when the availability of legal tender contracts, trade in the WIR network increases and

hence enables SMEs to avoid a severe downturn in profits and annual turnover. Despite the small absolute volume of the WIR franc in comparison to the national Swiss franc economy, this effect proved statistically significant.

The unit of account of the WIR franc is the Swiss franc: one always equals the value of the other. What's more, no physical WIR francs are printed or minted—WIR credit is purely electronic. And WIR francs enter into circulation when being lent by the bank to an account holder, as with any other legal tender.

All participants sign up for a membership and start with a balance of zero, and all

participants can buy from one another. The banks' software keeps score of everyone's balance, and the WIR website works as a marketplace for people and companies that want to buy and sell in WIR francs. However, not all suppliers accept 100 percent payment in WIR; combined payments—in which goods and services are paid for in part by cash and partly in complementary currency—are more common. Members agree to accept at least 30 percent of the payment in WIR francs.¹

The organization levies a fee of about 0.1 percent on every transaction and charges interest on overdraft facilities and loans, typically below 2 percent.²

¹ Those who accept receiving more than 30 percent in WIR francs are known as "official members," though there are many who accept up to 50 percent. Those who cannot guarantee the acceptance of at least 30 percent are considered "unofficial members"; since it is not necessary to publish this data, there are a number of "undercover" members.

² "The WIR 'schafft es', already more than 80 years," *European Business Review*, September 10, 2018, europeanbusinessreview.eu; Institute of Social Currency, "The WIR, the supplementary Swiss currency since 1934," in *Bitcoin, The Economy Journal*, accessed March 3, 2020, theeconomyjournal.eu; Thomas H. Greco, Jr. and Theo Megalli, "An Annotated Précis, Review, and Critique of WIR and the Swiss National Economy," accessed March 3, 2020, reinventingmoney.files.wordpress.com.

credit scoring, which happens before an SME or individual is allowed in the network. The plan charges a one-time fee or small interest on negative balances. Most of these currencies have a proven record of a statistically significant expansion of credit and sales volumes, even though they tend to remain small-scale.¹⁷ Governments at all levels could consider complementary currencies as an inexpensive vehicle to stimulate demand and credit for local businesses, helping them increase their sales, investments, and ultimately, productivity and profits.

Formalizing informal businesses

Government intervention can abate the three main barriers to business formalization: high cost

of becoming formal, high cost of compliance, and insufficient perceived (or actual) benefits. Many governments have mobilized in this direction along several touchpoints:

- **Business registration.** Facilitating registration process and lowering associated cost could improve not only formalization levels but also the overall business environment. For instance, Thailand has reduced the time it takes to start a business from 27.5 days to 4.5 days via simplifications such as removing unnecessary requirements and reducing fees.¹⁸ And Estonia's e-Residency policy allows any entrepreneur around the world to register their business in Estonia—thus gaining access to local banking,

¹⁷ Sara Calvo and Andres Morales, *Exploring complementary currencies in Europe: A comparative study of local initiatives in Spain and the United Kingdom*, Living in Minca, September 2014, livinginminca.org.

¹⁸ "Ease of Doing Business rankings 2018," *Doing Business*, World Bank Group, accessed March 3, 2020, doingbusiness.org.

payment platforms, and the entire EU market—without having to physically enter or visit Estonia. Since the launch of the policy, more than 60,000 e-residents have created more than 10,000 companies and generated more than €25 million in taxes.

- **Tax registration and structure.** Simplifying tax structure, tax registration, and returns filing has helped formalize SMEs. Again, Estonia introduced a flat tax rate and a platform for e-registration and filing returns; nearly all tax amounts are calculated online by the application. The result was that 98 percent of all taxes (personal, corporate, and value-added) are now filed electronically—among the highest compliance rates in the world.
- **Examination and audit.** With a growing digital footprint and availability of innovative data analytics, governments are using data to identify informal businesses. Turkey has created an extensive e-invoice, e-archive, and e-audit system that resulted in thousands of new taxpayers across sectors.¹⁹
- **Support to registered businesses.** Some governments offer incentives or rewards for formalization. As a part of the Colombia se formaliza program in Colombia, the Fondo Nacional de Garantías facilitates access to formal credit by offering loan guarantees. And Sweden encourages formalization among some categories of self-employed people, such as those who lack a formal contract but are paid by an organization—a common arrangement for services like food delivery, driving, or software development. They do so by requiring a parent company to employ these workers and pay for social-security contributions.
- **Awareness and education.** Among the biggest challenges in the informal sector is ensuring that

SMEs have correct and complete information regarding the process, benefits, and penalties. In 2013, The Colombia se formaliza program reached 80,000 entrepreneurs a year, raising awareness and offering personal assistance to formalize their business operations, with 40 percent accepting to formalize.²⁰

Credit-guarantee schemes

On average, 40 percent of SMEs in the world are unserved or underserved when it comes to banking credit.²¹ Some subsegments are too risky for banks' appetites while other subsegments have access to loans that have higher interest rates than their true risk profile. In reality, SME loans are often more profitable than large firms for lenders.

A widely used program to resolve this is a credit-guarantee scheme (CGS), which aims to reduce the cost of potential defaults by guaranteeing part of the repayment of SME loans. CGSs have significantly increased SME credit access, with existing and running public and private credit-guarantee schemes in nearly 100 countries. The Korea Credit Guarantee Fund, one of the largest CGSs in the world, guaranteed a portfolio of loans of approximately \$44 billion in 2018.²² As of 2015 and since its incorporation, the program has issued 205,361 guarantees—about 12 percent of SME loans in Korean banks. Furthermore, Korean CGSs have indirectly supported the increase of SME lending from 35.7 percent (when the agency was established) to 76.7 percent in 2015.²³

SME digital platforms

Several SME-development agencies have created a platform—usually a website—as a one-stop shop to not only access any government service, program, and data but also fulfill government

¹⁹ "Product tracking system," Informatics and Information Security Research Center, accessed March 3, 2020, bigem.tubitak.gov.tr.

²⁰ *Policies for the formalization of micro and small enterprises in Colombia*, International Labour Organization, 2014, ilo.org.

²¹ *MSME finance gap: Assessment of the shortfalls and opportunities in financing micro, small and medium enterprises in emerging markets*, joint report by World Bank Group and International Finance Corporation, 2017, ifc.org.

²² "About KODIT," KODIT, accessed March 3, 2020, kodit.co.kr.

²³ "Korean experience in credit guarantee scheme to enhance financial accessibility of MSMEs," KODIT, May 12, 2017, unescap.org.

requirements, such as paying taxes. Some websites have additional functionality, including marketplaces for business opportunities, access to data, and links to financial institutions, advisers, and legal services.

For example, UK charity Be the Business has developed an online self-assessment platform that is open to all SMEs and aimed at helping them improve their performance. On the platform, business owners and managers can undergo a comprehensive evaluation to understand their businesses' current level of productivity relative to peers and receive systematic and immediately actionable advice and guidance. The platform also points business leaders toward other resources, including training programs and networking events, that can inspire improvements and build SMEs' confidence in their growth.

The most advanced governments have started to provide services through apps with an

SME login that gives users customized insights on government offerings and markets as well as tailored recommendations.

As many of these examples show, governments can help SMEs capitalize on growth and productivity-improvement opportunities. But unlocking SME growth is no easy task. Although we presented many success stories, some ventures have proven less successful and signal a need for caution. Careful assessment of benefits, costs, and risks can help identify the initiatives with the highest potential. Most importantly, the potential of SMEs' growth and increased productivity is great enough that all governments should be paying attention.

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