



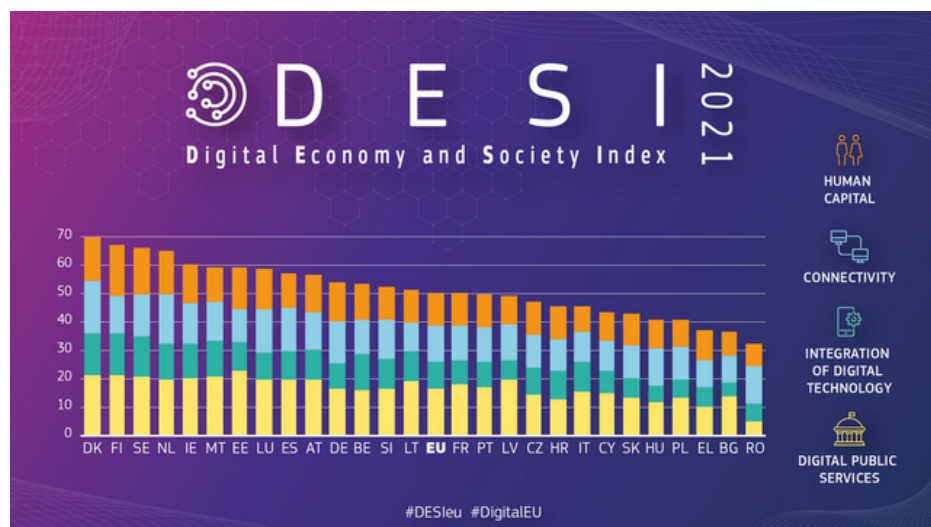
The digitization of SMEs in the CEE

Introduction

SMEs are the backbone of the European economy. According to the European Commission's data, they represent 99% of all businesses in the EU.¹ They provide 2 out of 3 jobs in the EU and generate 50% of Europe's GDP.² Importantly, SMEs undertake about half of all innovation activities within the EU.³ Nevertheless, SMEs are in a disadvantaged position when it comes to digitization. Suffering from a lack of resources – both human and financial – they cannot afford to invest in digitization. Only 17% of SMEs have successfully integrated digital technologies, compared to 54% of large companies.⁴ This is particularly concerning since digital technologies are changing our world at an unprecedented pace.

Without adequate support, European SMEs will not be able to digitize and, with time, risk lagging behind large enterprises, while their role in the EU economy becomes marginalized. It will have tangible effects on the lives of Europeans who depend on the jobs provided by these companies. Given the changing geopolitical situation and looming global economic crisis, one should not see the digitization of SMEs as merely an aspirational goal, but rather as a necessity to build a resilient European economy.

SMEs in the CEE merit specific attention. As it can be seen in Graph 1 below, the vast majority of CEE countries remain below the EU average. Only Estonia is among the ten Member States with the highest indicators in the European Commission classification. However, the countries of the Visegrad group lag behind the index leaders.



GRAPH 1. DIGITAL ECONOMY AND SOCIETY INDEX⁵

The Digital Economy and Society Index (or DESI in short) is a set of indicators created by the European Commission to measure the progress toward attaining Europe's digital targets. As DESI shows, Bulgaria, Romania and Poland are the least digitally advanced economies. They are closely followed by Hungary, and Slovakia. The Czech Republic, Latvia and Lithuania oscillate around the EU average.

DESI also shows that the digitization progress in the CEE is slower compared to the rest of the EU. The first DESI ranking was published in 2016, when the EU average was equal to 35.3%. By 2021, it increased by 15.4 percentage points (pp).

¹ https://ec.europa.eu/growth/smes_en.

² https://ec.europa.eu/commission/presscorner/api/files/attachment/863069/EU_SMEs_strategy_en.pdf.pdf

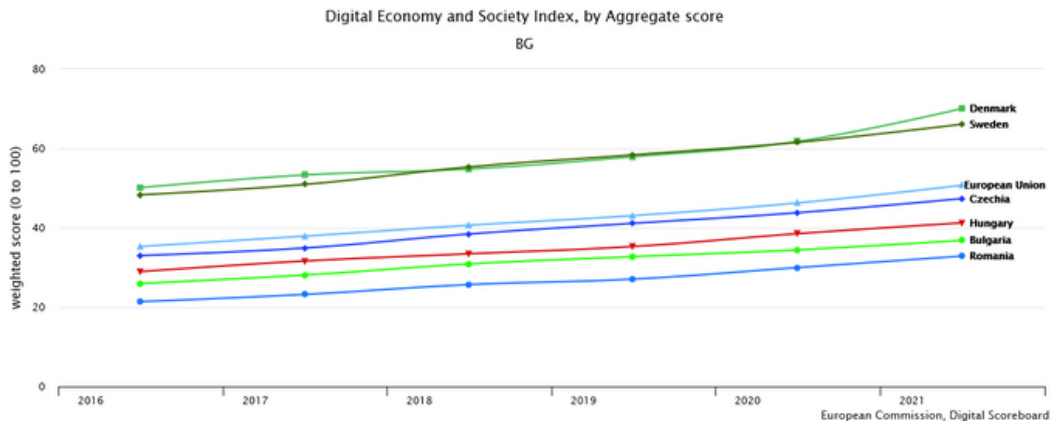
³ Ibid

⁴ Ibid

⁵ <https://digital-strategy.ec.europa.eu/en/policies/desi>

During the same period, no CEE country has made progress higher or equal to the EU average. Poland and Hungary made the largest progress (with the same score of 14.8 pp), closely followed by the Czech Republic (14.4 pp), and Lithuania (14.2 pp). The progress of Slovakia, Romania, Latvia and Bulgaria was significantly slower than the EU average with 12.6, 11.5, 11 and 10.8 pp respectively.

At the same time, Sweden has progressed by 17.8 percentage points and Denmark by 20.



GRAPH 2. DESI PROGRESS COMPARISON⁶

Therefore, the data clearly shows that not only are the CEE Member States at a disadvantaged starting position, but also that the pace of their digitization process is slower than that of the rest of the EU. Hence, if nothing changes, there is a real risk that the Central and Eastern EU will not catch up with the rest of the Member States. This will have negative effects for the cohesion within the EU as well as the block's position globally.

The EU lags behind not just in terms of the creation of digital technologies, but also in the adoption of existing digital solutions.⁷ By 2020, 37% of all European companies had not adopted any advanced digital technologies. The rate of adoption of digital technologies is dependent on the company size. While European medium and large companies tend to do better when it comes to digitization, micro and small companies continue to lag behind considerably.⁸

It's time to close the gap and make real progress in terms of the digitization of SMEs in the CEE to the benefit of the entire EU. That is why the League for Digital Boost has created this report, which consists of two major parts: first, the blueprint – a practical guide for CEE countries to boost the digitization of SMEs, and second, the roadmap – main areas of interest for SMEs. We hope that this will be a useful tool for both policymakers, informing their choices, and entrepreneurs wishing to invest into digitization.

Blueprint – a practical guide for CEE countries to boost digitization of SMEs

The topic of SMEs digitization is often viewed as overly complex, granular and time-consuming. This does not have to be the case. We have put together a concise to-do list to boost digitization.



1. Increase awareness

The European Commission, through the Recovery and Resilience Facility (RRF), put a great deal of attention to digitization. The Member States were obliged to allocate a minimum of 20% of RRF funds towards achieving digital transition. Out of 25 National Recovery and Resilience Plans (NRRP) accepted so far, about 26% of funds have been allocated to digital transformation, hence exceeding the target required by the Commission.⁹

Among the CEE countries whose NRRP has been accepted so far, Lithuania has allocated the most funds towards digitization (31.5%), followed by Bulgaria (25.8%) and the rest of the region: the Czech Republic (22%), Latvia (21%), Slovakia (21%) and Poland (20.85%). In comparison, Finland has allocated the most funds towards digitization among the European digital frontrunners (27%). Estonia and Sweden have allocated respectively 21.5% and 21% of funds available within the RRF for digitization. Given the digital divide between the CEE and the frontrunners, CEE countries should have allocated more funds to close the gap.

⁶ <https://bit.ly/3l4uvQd>

⁷ <https://www.eib.org/en/essays/european-digitalisation-study>

⁸ <https://www.eib.org/en/essays/european-digitalisation-study>

⁹ https://ec.europa.eu/info/business-economy-euro/recovery-coronavirus/recovery-and-resilience-facility_en#national-recovery-and-resilience-plans

Increasing awareness among government officials

RRF is a unique opportunity for the EU to speed up the digitization process. In order to unlock the full potential, the EU must, however, focus on SMEs. As it was pointed out before, large companies in the EU are in a better position than SMEs. While everyone seems to be accepting this as an obvious truth, we might be underestimating the consequences of such an approach. In the EU there are more than 21.5 million companies employing 125.3 million people.¹⁰ It means that on average a European company employs only 6 workers. We should bear in mind this fact while creating policies for the digital economy. At the same time, in order to unlock the true potential of the European economy, governments need to prioritize investment into digitization in SMEs.



21.5 million



125.3 million

The role of DIHs and EDIHs

Reaching SMEs can be a challenging task. Understaffed, small enterprises often do not have the resources and the possibility to look into external financing options. That is why increasing awareness is crucial for the success of digitization efforts.

The European Commission provided € 500 million EU funding for the Digital Innovation Hubs (DIHs) between 2016-2020.¹¹ They are spread throughout the EU and inform about available opportunities. In partnership with more than 200 DIHs, the fund has supported over 2000 Start-ups, SMEs and mid-caps to assess digital innovations. The program fulfilled its purpose, but the scale of the action taken is insufficient concerning the amount of European enterprises that need guidance.

As part of the Digital Europe programme, the European Digital Innovation Hubs (EDIHs) will be established in fall 2022. Some of them will be created by transforming DIHs. Their goal is to support the digital transformation of SMEs. However, other funding methods and organization schemas have been adopted for these units. Their scope of tasks will be extended from support to capacity building. Moreover, they will be partially financed by the Member States. The European EDIHs network will be to ensure that they are "within working distance" for all businesses in the EU. Digital administration and environmental aspects will also be their target. From our perspective, proactive actions of EDIHs and government entities are crucial here. To maximize the effects of the awareness raising campaign, we would recommend for EDIHs officials to visit SMEs in person and explore the regions, rather than focus on the capitals.

2. Facilitate access to financing

Insufficient staffing is only a part of the problem. The lack of or an inadequate access to financing is stopping SMEs from investment and growing their businesses. According to the European Commission's data, only 10% of European SMEs' external financing is from capital markets. Only 11% of businesses in Europe consider equity as a viable financing option while only 1% have used it. Not to mention the fact that venture capital investments in Europe are notably smaller than in the US. At the same time, SMEs struggle to get paid on time. Not even a half of small businesses in the EU are receiving their payments on time. This is the cause of 1/4 of SMEs bankruptcies.¹²

Innovation vouchers are an increasingly popular tool, which greatly facilitates access to financing in comparison with traditional ways of acquiring European funds. By handing out innovation vouchers, governments provide SMEs with a specific product or service without burdening them with a lengthy application process, and extensive book-keeping obligations. Even though the amounts of funds allocated in this way may be smaller than those available in projects, from our experience, the innovation vouchers are the most SMEs-friendly tool.

In order to further facilitate access to SMEs financing, Member States should stimulate the development of private-public-partnerships (PPPs). Funds available under the RRF allow governments to establish programs, whereby large companies have economic incentives to transfer technologies to SMEs. Benefiting SMEs would increase their capital to become stronger market players. Even though the idea of PPPs sounds rather obvious, it remains a largely underutilized tool. Red tape, lack of trust and corruption fears are key constraints in this respect.

At the same time, NRRPs should not allow the governments to choose business winners and losers. For this purpose, governments can opt for a combination of grants and low-interest loans, which would provide companies with cheap capital to increase their efficiency and sustain the growth of enterprises. This is due to limited access to financial tools resulting from the rise of interest rates. A loan application process run by a commercial bank should filter out ineffective companies.

3. Provide in-person training

The European Commission's 2019 study has indicated that the greatest barrier to SMEs digitization is a lack of time. Next in the line were constraints such as the availability of training programs, their cost, inflexible timetables and distance.¹³ Against this background it can be seen that in order to enable effective digitization, SMEs should be provided with in-person trainings in their premises. This approach has three major advantages. First, it puts SMEs in the center of the process and saves their time. Second, it allows to reach entrepreneurs without basic digital skills, who cannot participate. Third, it allows micro-companies, that cannot spare an employee to attend a training, to invest in digital skills, too.



¹⁰ https://www.eib.org/attachments/efs/digitalisation_in_europe_2020_2021_en.pdf

¹¹ https://www.secdigital.gov.gr/wp-content/uploads/2020/08/2020-07_EDIH_Greece.pdf

¹² https://ec.europa.eu/commission/presscorner/api/files/attachment/863069/EU_SMEs_strategy_en.pdf.pdf

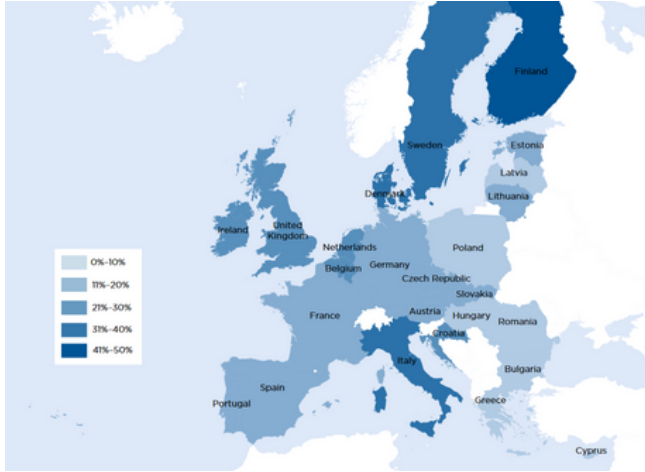
¹³ <https://www.digitalsme.eu/digital-skills-for-smes-challenges-and-opportunities/>

Roadmap – main areas of interests for SMEs

Having discussed key guiding principles for the policymakers, below we present a roadmap prioritizing areas of interests for SMEs. We hope that this set of recommendations will be a useful tool for small businesses in their digitization process.

1. Cloud

Only 19% of all companies in the EU have adopted cloud technology. In comparison, 37% of small American companies have already implemented the technology.¹⁴ As we can see in the map below, the CEE has the lowest rate of cloud adoption. Cloud technology is traditionally associated with high costs and sophisticated technical demands, which can be a particularly deterrent factor for small businesses in the CEE. Despite this stereotype, there is strong economic evidence in favor of the introduction of cloud technology.



MAP 1. ADOPTION OF CLOUD TECHNOLOGY IN THE CEE IS SMALLER COMPARED TO THE REST OF THE EU.¹⁵

Instead of investing into creating and maintaining their own IT infrastructure, companies can use Infrastructure as a Service (IaaS) solutions, which are charged on the basis of actual usage. More importantly, using cloud technology can free up valuable human resources. Of course, cloud computing does not come without any risks. In order to successfully implement and use cloud, one needs to undertake a risk assessment focusing on security and privacy of data, service management and business continuity issues.

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2. Cybersecurity

During the covid pandemic, European Union Agency for Cybersecurity (ENISA) interviewed SMEs to assess their ability to cope with cybersecurity risks. 90% of the interviewed entrepreneurs stated that cybersecurity issues would have a strong negative impact on their business, while 57% of them stated they might even go bankrupt.¹⁶ The most commonly identified risks included: ransomware attacks, phishing attacks, CEO fraud and stolen laptops.¹⁷ In its analysis, ENISA has concluded that the lack of digital skills and low budget for cybersecurity may seriously decrease SMEs competitiveness and compromise their role in the value-chain.¹⁸ Hence, SMEs should remember that expanding their business online has to go hand-in-hand with increasing levels of cybersecurity.

¹⁴ https://espas.secure.europarl.europa.eu/orbis/sites/default/files/generated/document/en/Into_the_Clouds_web_1011.pdf

¹⁵ https://espas.secure.europarl.europa.eu/orbis/sites/default/files/generated/document/en/Into_the_Clouds_web_1011.pdf

¹⁶ <https://www.enisa.europa.eu/publications/enisa-report-cybersecurity-for-smes>

¹⁷ <https://www.enisa.europa.eu/publications/enisa-report-cybersecurity-for-smes>

¹⁸ Ibid.

¹⁹ <https://op.europa.eu/sk/publication-detail/-/publication/849659ce-dadf-11eb-895a-01aa75ed71a1>

²⁰ Ibid.

²¹ https://ec.europa.eu/growth/smes_en

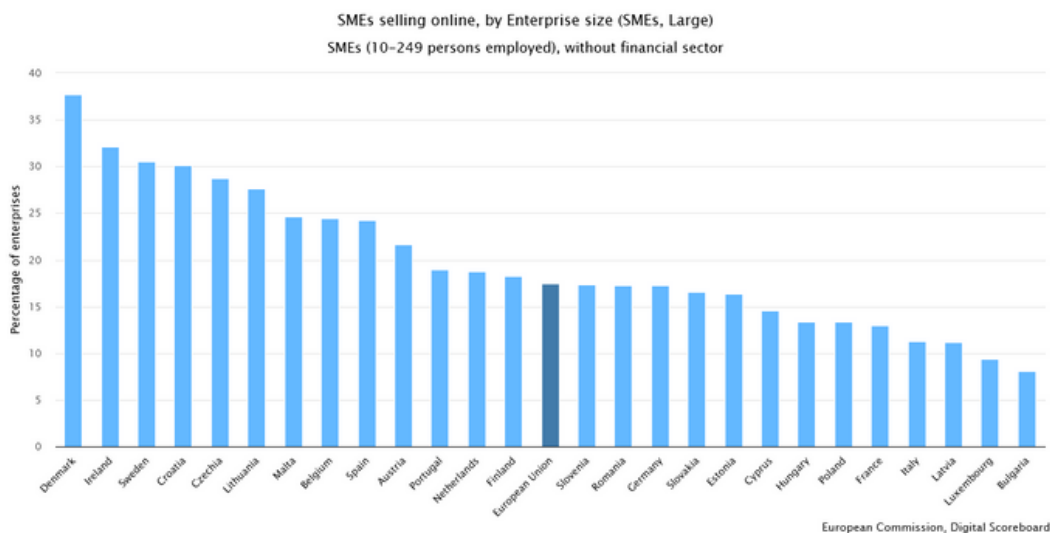
3. E-commerce

In recent years, the e-commerce sector has grown exceptionally. Progressive digitalization of economic processes has created new channels and sales opportunities. Before the pandemic, around 20% of businesses were selling online.¹⁹ The coronavirus has only accelerated these changes. As lockdowns forced the economic activity to move to the internet, e-commerce has enabled enterprises to survive the lockdown. E-commerce offers a unique benefit of unlocking markets, which were traditionally too distant to approach, and offers at least an illusion of an unlimited customer base.

Before the confinement, close to 15% of companies selling in Europe used online marketplaces through their own website or apps. On the other hand, 7% of companies used the e-commerce marketplace to sell their products. According to the data from the European Commission, the vast majority of companies sell products to customers in their country.²⁰ Only a tiny part sells them to consumers in other EU countries. At the same time, as many as 67% of enterprises selling their goods to other EU countries indicated that they did not experience any difficulties in this regard. On the contrary, 27% of entities stated the high cost of delivering goods, and 11% were linguistic and legal problems. Moreover, only 600,000 out of 25 million SMEs export goods outside the EU.²¹



The above data show how far unused are the possibilities of European companies to sell cross-border and outside the EU. The unleashed potential would stimulate the growth of these companies and increase trade turnover. In order to enable these entrepreneurs to develop, it is necessary to ensure accessible and affordable access to the Internet. In addition, there is a need to increase legal certainty and predictability. Consistent provisions would ease and standardize obligations towards sellers throughout the European Union. Another facilitation could be simplifying the shipping of goods, such as clear tax regulations.



What is interesting, e-commerce is likely to be the only category where two CEE countries Lithuania and the Czech Republic outperform other Member States, including digital frontrunners such as Finland and Estonia. Despite this success, a lot of work remains to be done in the region.

4. Fintech

Adoption of consumer-centered financial technologies (FinTech) goes hand in hand with development of e-commerce channels. Innovative financial products such as Buy-Now-Pay-Later (BNPL) are liked by the consumers and can stimulate a company's growth. Furthermore, FinTech can also play an important role in diversifying SMEs sources of financing. SMEs remain largely dependent on bank financing. Financial technologies can not only decrease their dependence on traditional banks but also protect SMEs against credit supply shocks.

A research conducted by a group of economists²³ suggests that FinTech allows well-performing SMEs to finance their growth and diversify lending relationships. On the other hand, small businesses without lending history in the traditional banking system do not seem to use FinTech. It shows that while providing additional sources of financing, FinTech does not increase financial inclusion of small business nor does it lead to risky lending practices.²⁴

¹⁹ <https://op.europa.eu/sk/publication-detail/-/publication/849659ce-dadf-11eb-895a-01aa75ed71a1>

²⁰ Ibid.

²¹ https://ec.europa.eu/growth/smes_en

²² <https://bit.ly/3On03Tq>

²³ Afonso Eça, Miguel Ferreira, Melissa Prado and Emanuele Rizzo

²⁴ <https://voxeu.org/article/effects-fintech-lending-small-and-medium-sized-enterprises>



5. Data analytics

In the EU, 33% of large companies, 19% of medium-size businesses and 10% of small firms have adopted data analysis.²⁵ No CEE country has performed above the EU average, with Lithuania achieving the highest score (10%), followed by the Czech Republic, Latvia and Poland (8%), Hungary (7%), Bulgaria (6%), as well as Romania and Slovakia (5%).

A common mistake committed by SMEs is assuming that they do not generate enough data to conduct useful data analysis. This is a misconception that leads to the loss of potential competitive gains by SMEs. Even small sets of relevant data can help companies optimize their processes and increase efficiency.

Annex

The League for Digital Boost, a brainchild of the Slovak Alliance for Innovation Economy (SAPIE) is emerging in Central and Eastern Europe with an ambition to create a broad coalition of actors in the field of digital economy to support the digitization of SMEs.

The digitization of SMEs entails processes that involve a large number of changes. The adjustments include the preparation of a new business model, process automation, data processing, modification of payment systems, sales platforms and marketing channels. In order to undergo such transition, companies need financial support, counseling, favorable policies and low bureaucratic barriers. This is where the public sector can help to maximize the benefits of this trend. Connecting business and the public sector is one of the goals of the League for Digital Boost.

The League for Digital Boost aims to tailor policymaking to business needs via organizing discussions, building networks of experts and organizations, and launching media campaigns to make the topic resonate. The activities are spread over several countries in the region with involvement of key unions, associations and individuals active in the space of digitalization or SMEs.

²⁵ https://nangs.org/analytics/download/4161_532d6df670508fcbc5517e0d5039ea7e

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The vision of the League is to create a broad coalition of the key actors in the field of digital economy and to launch and drive a sustainable format of a long-term cooperation in the implementation of digital transformation in SMEs.



Lucia Colníková
The League for Digital Boost Lead

Next steps:

The ambition is to launch and drive a sustainable format of a long-term cooperation in the implementation of digital transformation of SMEs and to focus on several pillars:



Addressing specific policy recommendations to governments



Preparation of a digital handbook for SMEs



Connecting key stakeholders - governments, businesses, NGOs



Raising awareness through different set of activities

Under the Auspices of: Founded & Led by: Partners:

