A More Inclusive Recovery for SMEs and the Informal Sector

By Charles Odoom

Summary

The economic disruptions caused by COVID-19 are perhaps unprecedented in the history of globalization. The pandemic has frozen production, significantly scaled down consumption, heightened uncertainties in markets and hampered business confidence. While the impact is felt by the businesses that drive global trade, small and medium enterprises (SMEs) and businesses in the informal sector have suffered the most. Large-scale enterprises have resorted to cutting-edge technologies and digital products and platforms to accelerate innovation. However, SMEs are yet to catch up. While governments worldwide have provided various support packages to SMEs, policymakers could do more on social inclusion and innovation in ensuring business continuity.

Thematic context

The International Labor Organization (ILO) surveyed about 1,000 micro, small, and medium enterprises in eight countries across four continents[1] and found that approximately 70% have had to shut down their operations. The ILO also reports that 75% of SMEs had experienced a downturn in revenues because of plunging demand. In Africa, governments have implemented support systems for SMEs to cushion the economic setbacks. Strategies have focused on the provision of cash transfers to temporarily laid off staff, moratoriums on loan servicing, free or subsidized utility services, tax breaks and deferrals of other statutory payments, and guarantees to incentivize financial institutions to extend loans to SMEs. Central banks have also responded by easing their macroprudential policies to support the liquidity challenges of SMEs. In addition, some countries have extended loans directly through new and existing business support programs.

Although the responses are commendable, there are no clear guidelines on fund utilization and disbursement. So the funds do not incentivize innovation, nor do they promote inclusiveness. Support systems have primarily focused on cash transfers to owners of SMEs who may or may not apply the funds to innovative business activities. Therefore, the sustenance of the SMEs being supported is not guaranteed, losing the very essence for which the funds were created.

Innovation's role

SMEs are learning establishments that creatively internalize technology and market opportunities to extend their production frontiers. However, COVID-19 support packages have not sufficiently leveraged innovation for SMEs to help them navigate the changing work environment. A recent ACET paper on post-COVID-19 priorities for governments raised concerns about a disconnect between private sector policy and the needs of technology and innovation hubs, which can drive enterprise but need investment and support.[2]

Large firms that have responded well to the impact of COVID-19 have resorted to cutting-edge technologies and digital products and platforms to accelerate innovation. Innovation in SME development is a core element of inclusive growth strategies that must be supported even more in a COVID-19 era. SMEs that innovate are likely to employ more workers, pay higher wages, and are more productive than their counterparts who do not innovate. SME innovation can resolve social challenges efficiently, drive productivity and improve long-term growth. Innovative SMEs develop resilience and grow irrespective of what the environment is offering.

However, successful responses to the challenges of SMEs will be insufficient if policy responses do not prioritize inclusion. There is a disproportionate impact of COVID-19 on SMEs and businesses in the informal sector that are owned by vulnerable and marginalized entrepreneurs, a segment that is growing rapidly around the world. For example, women-owned entrepreneurs account for about 34% of SMEs globally,[3] and between 30% and 37% in emerging markets – which translates into approximately 8 to 10 million SMEs.[4] The blueprint for all responses must be inclusive; it must capture the nuances in needs of all vulnerable groups to ensure that no one is left behind in the recovery.

While there are significant long-term challenges—including the absence of technological infrastructure, digital literacy and skills—in the short term, COVID-19 interventions by governments need to include innovation promotion strategies for SMEs. Examples include a reduction in data and telecommunication charges, the provision of mobile internet connectivity technology, and training on digital marketing strategies, among others. Such interventions would address some of the immediate limitations to innovation that SMEs face—and possibly instill an innovation culture that could persist after the pandemic.

Recommendations

- For financial recovery packages to be impactful in driving SME innovation, funds need to be better matched to specific innovative activities. This will help clarify the theory of change for achieving targets and increase the prospect of successful outcomes.
- Governments should roll out more inclusive, targeted COVID-19 relief intervention programs for women and other marginalized SME entrepreneurs.
- The plethora of relief programs should be utilized to improve the diffusion of technology and innovation in the SME space.

Charles Odoom *is the head of the Private Sector Development (PSD) unit at the African Center for Economic Transformation (ACET), providing strategic policy advice to governments on PSD issues. Previously, he was a management consultant focused on supporting SMEs to deliver high performance.*

About the Series

Policy experts and researchers from the African Center for Economic Transformation **(ACET)** and the Development and Economic Growth Research Programme **(DEGRP)**, in partnership with ODI, explore the critical role of innovation in Africa's recovery from COVID-19. Essays identify areas in which innovation can contribute to effective responses and offer high-level policy recommendations.

Endnotes

1. ILO SCORE Global Covid-19 Enterprise Survey (International Labor Organization, 2020).
2. "COVID-19: Ten Policy Priorities for Africa's Recovery, Growth, and Transformation" (ACET, 2020).
3. *Women-owned SMEs: A Business Opportunity for Financial Institutions* (IFC, 2014).
4. Ruchira Kumar, *Targeted SME Financing and Employment Effects* (World Bank, 2017).

WORKING IN PARTNERSHIP WITH

Economic and Social Research Council

UKaid from the British people

Research jointly supported by the ESRC and FCDO

Growth Research Programme

ODI

ACET African Center for Economic Transformation