

# POLICY BRIEF #4

## European SME Innovation



### EXECUTIVE SUMMARY

The Covid-19 outbreak is transforming the way that Governments, businesses and civil society communicate. Underpinning these changes has been an emphasis on the need to render European small and medium-sized enterprises (SMEs) more resilient and responsive to the unpredictable global environment by innovating their business model and operating systems. Innovation is vital to SMEs within a competitive global economy and the rise of global value chains (GVCs) (Business Europe, 2020). Digital innovation and technologies offer new opportunities for SMEs to effectively innovate their business and grow in a way that ensures that they retain their competitive advantage. Although digital technologies are key to SME innovation and internationalisation, they present

a challenge to some SMEs who may not have the capacity to manage the innovation processes effectively or who struggle to adopt the necessary strategy, business process or skills. The Horizon 2020 EU Research and Innovative programme (2014-2020) has significantly contributed to developing an SME innovation eco-system through a series of capacity building, network and other support actions (European Commission, 2020b). Increasing SME internationalisation as part of the innovative process is important especially in light of the current EU-Australia Free Trade (FTA) negotiations. The participation of SMEs in global markets creates opportunities to scale up, innovate, broaden and deepen their skills sets, and thus enhance their productivity (Business Europe, 2020).

## EU SMES AND INNOVATION

In the European Union (EU), an estimated 23 million SMEs account for nearly 70% of EU jobs, and their flexibility is understood as a major engine of future innovation and job creation (European Commission, 2019a). Over the past 5 years, SMEs have created approximately 85% of new jobs and provided two-thirds of the total private sector employment in the EU. SMEs are vital in supporting for EU growth, as they comprise the majority of exporting firms and represent one-third of the total export value. The European Commission considers SMEs and entrepreneurship as central to ensuring economic growth, innovation, job creation and social integration in the EU (Cernet et al., 2014).

Several major barriers for innovation in SMES have all been identified, including the lack of access to up-to-date skills, knowledge, and the incapacity to manage innovation processes effectively. The Horizon 2020 pilot action 'European SMES Innovation Associate' is an innovation capacity building initiative that aims to address these issues (European Commission, 2020b). Various action programmes have been adopted to support SMEs including, the Small Business Act, Horizon 2020 and the COSME programme (European Commission, 2019) Despite European initiatives targeted at enhancing SMEs' innovation performance, Europe continues to suffer from poor productivity (Timmer et al., 2010). The European Commission

(2011) reported that over the past years, innovation performance in SMEs has declined in comparison to other geographical regions such as the United States and parts of Asia. SMEs 'often suffer from scarce financial resources [especially at] the time between the stage of developing a new technology, process, product or service and the stage of exploiting it commercially' (Hånell & Nordman 2019, p.254).

In June 2008, the European Commission created a comprehensive and encompassing SME initiative in the form of communication on the Small Business Act (SBA). Its primary objective is to provide an SME policy framework to improve competitiveness and promote entrepreneurship as well as improve market conditions for SMEs and boost the economy (European Parliament, 2019; EurActiv, 2011). The Competitiveness and Innovation Framework Programme (CIP) (2007-2013) and the EU COSME programme for the competitiveness of SMEs (2014 -2020) were designed to encourage the competitiveness of European enterprises with a focus on SMEs. Innovation activities were developed to assist businesses to better access finances and deliver business support services in the regions. The CIP was divided into three operational programmes each of which had specific objectives:

- Better access to finance for SMEs through venture capital investment and loan guarantee instruments;

- Business and innovation support services delivered through a network of regional centres: The Enterprise Europe Network;
- Promotion of entrepreneurship and innovation;
- Support or eco-innovation;
- Support or policy-making that encourages entrepreneurship and innovation (European Commission, 2014).

The Horizon 2020 specific objective 'Innovation in SMEs' aims to boost the innovation capacity of SMEs, including through the Eurostar Joint Programme, which promotes transnational collaboration on R & D performing SMEs (European Commission, 2019b). The aim of Innovation in SMEs is to optimise the Research, Development and Innovation environment of SMEs, including through the establishment and facilitation of a range of support services, with the aim of strengthening the innovation capacity of SMEs and creating value on the market and/or into society, thus underpinning the Europe 2020 strategy for smart, inclusive and sustainable growth (Ibid, 2019b).

## **SME DIGITALISATION**

Today, European SMEs are essential drivers of economic growth and are key players in cross-regional and cross-sectorial value chains. The unprecedented acceleration of digital transformations is having notable ramifications

on how SMEs do business and the way the public sector interacts with companies (Business Europe, 2020). While EU innovation initiatives are encouraging enterprises to innovate, only 1 in 5 companies across the EU are highly digitalised. Notably approximately 90% of SMEs lag in digital innovation. The main impediment to such developments has been the difficulty for businesses to know which technologies to invest in and how to secure financing for their digital transformation.

In the EU, SME spending on digitalisation (part of the total spending for ICT) was estimated to be €57 billion in 2018 and is expected to reach €65 billion by 2022. The growth however is imbalanced among industries and countries. Results from a joint survey of SMEs in France, Germany, Poland, Spain and the United Kingdom reveals that SMEs' spending on ICT and digitalisation depends on two main factors: firstly, the geographical location of the SME; and secondly, the industry vertical in which the SME is active. The study explains that in terms of geographical location, Northern European countries such as Denmark and Sweden are leading the global rankings for digital transformations. In 2018, approximately 95% of the total SME spending on digitalisation and ICT was concentrated in Western Europe. However, only 5% of spending was in Eastern and South-Eastern Europe (European Commission, 2019c).

At the industry level, the study highlights clear sectoral gaps, which exist amongst SMEs. For example, it is estimated that almost 60% of the total ICT spending comes from the financial services, Information Communication Technology (ICT), and advanced manufacturing sectors (such as automotive, electronics); whereas, traditional sectors such as education, healthcare, transportation and construction account for less than 12% (European Commission, 2019c). Moreover, a mere 1.7% of EU enterprises take full profit of the digital opportunities. Those companies that stay ahead of mainstream IT adoption, and employ new technology advances (big data, cloud computing, mobile and social solutions) show a significant improvement in efficiency and in their ability to easily connect with new customers and markets, as well as compete with larger multinational corporations (MNC) (European Commission, 2020).

In response to this disparity and to further encourage European SMEs to innovate by embracing the digitalisation process, the EU has invested in 'Digital Innovation Hubs (DIHs) which provide innovation services, such as financing advice, training and skills development that are essential for successful digital transformation in SMEs. There are currently 386 digital innovation hubs in the EU member states (European Commission, 2019c). These digital innovation hubs play a crucial role in the ecosystem and its

development. They are key enablers fostering the digitalisation of SMEs.

The services available through digital innovation hubs have been categorised into three pillars: 1) innovation activities: concerned with identifying opportunities for digitalisation and developing and validating innovative solutions based on cutting-edge technologies; 2) Business development: concerned with helping companies apply their solutions, assess the business implications, and manage changes to the business models; and 3) Skill creation: concerned with building innovation capacity through enriching human capital (European Commission, 2019c).

The European Commission recently proposed the initiation of the first-ever Digital Europe Programme which will invest €9.2 billion to align the next long-term EU budget 2021-2027 with increasing digital challenges (European Commission, 2020c). This initiative is intended to facilitate SME accessibility, reliability and affordability to top-performing digital infrastructure critical to the SME digitalisation process (Business Europe, 2020).

## **IMPLICATIONS AND RECOMMENDATIONS**

The covid-19 outbreak has prompted European SMEs to rethink and transform their businesses and organisational models. An emphasis is given

on the need to render European SMEs more resilient and responsive to the unpredictable interconnected global environment (European Commission, 2020b). SME innovation and internationalisation are essential within an increasingly competitive global economy and with the rise of GVCs. Underpinning these developments is the importance of digital innovation and technologies which allow SMEs to better innovate their businesses and grow in ways that ensures they retain their competitive advantage.

The EU has reiterated its firm support for digital business innovation with the initiation of several programmes; including the Horizon 2020 EU Research and Innovative programme (2014-2020), which is contributing to developing and enhancing SME innovation performance by encouraging capacity-building and network. Similarly, the Competitiveness and Innovation Framework Programme (CIP) (2007- 2013) as well as the EU COSME programme for the competitiveness of SMEs (2014 -2020) encouraged the competitiveness of European enterprises with a focus on SMEs.

While these EU level initiatives are critical for SME innovation and internationalisation, ensuring that European SMEs maintain a long-term commitment to digital transformation and innovation, IT security & digital infrastructure,

and issues of finance need to be addressed and managed.

Digital technologies offer SMEs new possibilities to communicate, organise workflows and production processes, as well as innovative ways to interact with customers and suppliers. The future competitiveness of the European economy will increasingly depend on how successfully companies can take advantage of these new technologies. It is the effective digitalisation of European SMEs that will determine the future of the European economy. SMEs provide a high number of jobs, and generate the largest portion of economic value in European countries (European SME Survey, 2019).

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