



**BUSINESS**atOECD

**Policy recommendations for SME recovery  
and long-term resilience**

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## **I. Introduction**

Small and medium-sized enterprises (SMEs) and entrepreneurs have been at the front line of the Covid-19 crisis. OECD data shows that SMEs have been particularly hard hit by the economic shock as they are overrepresented in the sectors most affected (e.g. tourism, retail and professional services, and construction and transportation). While SMEs and entrepreneurs provide almost two-thirds of jobs and half the GDP in the OECD area, they account for three-quarters of all jobs in those sectors most affected by the crisis.<sup>1</sup>

The crisis is likely to leave long-lasting scars on our society and economies, including the SME sector where issues of high indebtedness are particularly salient. The crisis impact could also lead to strongly negative spill-overs into financial markets, reduce confidence and constrain credit, hampering the recovery.

Besides recovering from the economic shock induced by Covid-19, SMEs must deal with long-term structural challenges and transformation towards digital and green. With regards to digital, the Covid-19 crisis has shown that many SMEs were ill-prepared and struggle to adapt, which risks widening the digital gap both within the SME sector and compared to large companies. At the same time, such transformations also yield great opportunities towards more digital and sustainable SME business models, which should be encouraged by adequate policy action.

The post-Covid world will not be a return to business as usual and policies need to adapt to the new reality facing our economies and societies. Against this background, this policy paper sets out eight overarching policy priority areas for SME recovery and long-term resilience.

## **II. Policy priorities for SME recovery and long-term resilience**

### **1. Ensuring access to finance at adequate terms**

Context:

SMEs tend to find it more difficult to obtain external financing compared to their larger peers, which helps to explain why they are typically more vulnerable in economic downturn. Notably, SMEs have traditionally relied heavily on bank lending, which in context of a crisis can become increasingly expensive and hard to access. They also have fewer possibilities to use equity or bond markets and are usually less informed about alternative financial sources.

This is a concern as a lack of sufficient finance at adequate terms threatens to subdue the growth of smaller firms and thereby undermines job creation and economic development. Financing constraints weigh on private investment, business and innovation capacity, and negatively impact on SMEs productivity. They may also amplify economic downturns such as the current Covid-19

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<sup>1</sup> Kamal-Chaoui, L. (2020). “Rescuing SMEs from the COVID storm: What’s next?”, OECD Forum.

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crisis. The pandemic will likely create debt overhang issues in particular for smaller companies. Debt overhang would further constrain lending and has been shown to reduce investment and growth.<sup>2</sup>

With the Covid-19 crisis, there is a risk of backsliding on recent progress in diversification of financing instruments for SMEs.<sup>3</sup> At the same time, the Covid-19 crisis has provided an incentive to develop alternative sources of finance for SMEs, with particularly Fintech becoming increasingly important in offering more convenient and accessible services, more effective credit risk assessment and lower transaction costs, helping thereby to drive innovation also amongst traditional finance providers. This fast-moving area of SME finance grew significantly in recent years. In 2018, online alternative finance grew by median rate of 54%.<sup>4</sup> FinTech and distributed ledger technologies have the potential to alleviate some of the financing constraints faced by SMEs and provide more inclusive financing mechanisms for start-ups and small businesses.

*Policy recommendations:*

- Foster SME access to diversified sources of funding, in line with the G20/OECD High-Level Principles on SME Financing,<sup>5</sup> including through capital markets. In particular, equity and quasi-equity financing plays an important role to prevent insolvencies of viable SMEs and should be enhanced. Public-private risk sharing will also be important.
- Widely promote and communicate the new funding opportunities and financial aid schemes, which were implemented by governments in context of Covid-19, in order to reach even small business owners.
- Provide monitoring and evaluating exercises for the impact of new financial support mechanisms, allowing policy makers to better target financial support to SMEs in critical need of such support.
- Explore policies that support solvency and the recovery and resilience of SMEs and entrepreneurs also aiming to avoid SME over-indebtedness and an SME solvency crisis and ease SME liquidity constraints.
- Explore policies to restructure existing SME debt such as through extending maturities on loans and grace periods on principle repayment, lower instalment, extension of the loan repayment period and other.
- Create an enabling environment for FinTech development and deployment in efforts to bridge the widening credit gap entrepreneurs are facing in the wake of the Covid-19 pandemic. This may as well include retail-orientated solutions, such as crowdfunding.
- Work towards the development of a market place for improved cross-border access to finance for SMEs.

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<sup>2</sup> Myers, S. C. (1977). "Determinants of Corporate Borrowing". *Journal of Financial Economics*, 5, 147–175.

<sup>3</sup> OECD (2020), "The impact of COVID-19 on SME financing: A special edition of the OECD Financing SMEs and Entrepreneurs Scoreboard", OECD SME and Entrepreneurship Papers, No. 22, OECD Publishing, Paris, <https://doi.org/10.1787/ecd81a65-en>.

<sup>4</sup> OECD (2020), "Financing SMEs and Entrepreneurs 2020: An OECD Scoreboard".

<sup>5</sup> "G20/OECD High-Level Principles on SME Financing", <https://www.oecd.org/finance/G20-OECD-High-Level-Principles-on-SME-Financing.pdf>.

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- Provide tax incentives to support SME capital investment, SME credit availability, as well as to promote private equity investment in small non-listed SME.
  - Assess existing tax regulations regarding loss carry back in order to enhance liquidity.
  - Address the issue of late payment, such as through recognizing and promoting voluntary codes of practice in this area.
  - Enhance financial literacy among owners and employees of small firms.

## **2. Promoting the adoption of digital technology and greener business practices**

### *Context:*

Digital tools and technologies have played an important role in helping businesses across all sizes to mitigate the negative impact of the Covid-19 crisis on their activity. 70% of SMEs have implemented new digital solutions in 2020 in order to be able to survive the Covid-19 crisis.<sup>6</sup>

The accelerated digital transformation offers a great potential to boost the small business economy and support inclusive and green growth both during the recovery and post-crisis period. For example, digitalization may bring efficiency and productivity gains by helping to expand the scale and scope of operations. Such technologies help access new clients and markets and can also reduce barriers to access to finance, thus fostering entrepreneurship and job creation.

However, SMEs lag in the digital transition for a variety of reasons such as insufficient skills and knowledge, a lack of information and awareness, and inadequate financial resources. The SME digital gap slows productivity growth and widens inequalities among people, firms and locations. In addition, SMEs often face greater difficulties than larger firms in adapting to changing regulatory frameworks, addressing cyber security issues and accessing high-quality digital infrastructure.

SMEs can also play an important role in the green transition. SMEs, on aggregate, have a high environmental footprint, with literature estimating that SMEs contribute to 60-70% of industrial pollution in Europe.<sup>7</sup> At the same time, SMEs can play a pivotal role in the green transition by supplying or developing green goods and services and thus driving green business practices, but they often lack the means to adopt new technologies and thus drive innovations, which could trigger a boost to the green transition.

### *Policy recommendations:*

- Employ targeted programs and incentives to further accelerate SME digital uptake, which started during the Covid-19 pandemic.
- Help owners and employees of small firms to develop their digital skills. For instance, strengthen the technological competence of SMEs through specialized training and access

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<sup>6</sup> OECD (2021). “The Digital Transformation of SMEs”. Studies on SMEs and Entrepreneurship.

<sup>7</sup> OECD (2018), “Environmental Policy Toolkit for SME Greening in EU Eastern Partnership Countries”, OECD Green Growth Studies, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264293199-en>

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to advice, public data, and global information. Tax incentives for in house and external training can be one effective way for governments to support digital skills development as well as targeted voucher schemes and loans, conditional on SMEs' adoption of digital and/or green practices.

- Provide targeted financial support and technical assistance in conducting technology and problem-solving diagnosis, or in the process of implementing new e-commerce solutions.
- Build new and robust regulatory frameworks (e.g. related to data protection and cyber-security) and adjust existing regulatory frameworks and legislation in order to create room for new working arrangements and business models to be deployed.
- Use digital technology to itself help reduce and simplify red tape for instance in terms of submitting tax forms, public tender applications, etc.
- Enhance digital connectivity and high speed networks, for example through greater investment in ICT and infrastructure in rural and remote areas.
- Promote understanding about distributed ledger technology and ensure clear regulation in this area, both to support current applications and innovation and new technology models.
- Encourage efforts of governments and private actors to promote green behavior of SME by providing financial, sector-specific technical assistance to companies introducing green practices, and other support.

### **3. Fostering inclusive entrepreneurship**

*Context:*

While the Covid-19 pandemic and its economic and social impacts have disrupted life for all groups in society, people of different ages are not uniformly affected. In particular, for young people the crisis brings considerable risks in the areas of education, employment, mental health and disposable income. This risks widening inter-generational inequalities.<sup>8</sup> Fostering youth entrepreneurship can be one important way to address high youth unemployment and skill mismatches between educational systems and private sector needs, which are likely to increase as a result of the crisis and transformational changes in our society.

Many countries also face challenges regarding SME transition, where younger generations can play a vital role to keep up the performance of the SME sector by taking over existing companies from elderly owners.

At the same time, population ageing and higher dependency ratios across many developed economies also underline the importance of keeping older workers employed, including through the promotion of business start-ups and self-employment as a late-career alternative. Similarly, fostering 'immigrant' and foreign born entrepreneurship can help address the effects of population ageing on the economy and public finances, not least because foreign born

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<sup>8</sup> OECD Policy Responses to Coronavirus (COVID-19). (2020). "Youth and COVID-19: Response, recovery and resilience".

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entrepreneurs can be crucial in employing other foreign born and hence increasing the employment rate.

Similarly, the Covid-19 pandemic disproportionately affected minority and women entrepreneurs, whose businesses tend to be smaller and younger compared to male-owned enterprises. Women also face more challenges in access to external finance while possessing lower levels of financial skills compared to men. Women entrepreneurs retain fewer professional contacts, including advisory boards or professional advisors to share advice about managing risks through the pandemic.<sup>9</sup>

*Policy recommendations:*

- Ensure generation based entrepreneurial education, including youth entrepreneurship development schemes, which address the special needs of the millennial generation as well as strengthen youth-oriented and youth-friendly business development services.
- In order to foster senior entrepreneurship, increase older people's awareness of entrepreneurship as a late-career option, promote a positive image of older people as entrepreneurs, introduce targeted skills-oriented measures, and review relevant regulations to make sure that they do not set disincentives to enterprising activity.
- Put in place targeted programs for foreign born entrepreneurs.
- Recognize the heterogeneity of SMEs and the diversity of business models, including highly innovative start-ups, those with social objectives and more traditional, newly founded, small businesses. Make sure aspiring entrepreneurs are aware of these different business models and financial logic behind them in order to be able to plan better their venture and activities and capitalize more effectively on existing support schemes.
- Encourage business networks between aspiring entrepreneurs and business mentors, such as through start-up ecosystems.
- Recognize the challenge of business transfer by encouraging SME owners to develop succession strategies and identify ways to successfully transfer companies within or outside of the family.
- Promote inclusive support measures that reach vulnerable segments of the SME community, including women and minority entrepreneurs.

#### **4. Supporting self-employment**

*Context:*

Self-employment cannot only be an important remedy to keep more vulnerable groups such as for example the younger and more senior generation employed, but has a particularly important role during a crisis to mitigate negative scarring effects of long-term unemployment and ensuing skills losses.

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<sup>9</sup> OECD (2020), "Women enterprise policy and COVID-19: Towards a gender-sensitive response" - OECD webinar.

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Notably in countries with a large informal sector, gaps in social protection coverage and lower savings and assets for the self-employed add to their financial vulnerability in case of forced interruption of activity as a result of the crisis.

Finally, a growing gig economy will likely increase the importance of self-employed in the future.

*Policy recommendations:*

- Encourage self-employment by designing policy frameworks that foster entrepreneurial spirit, for example through policies that facilitate access to flexible business opportunities and lessen administrative burdens and red tape for the self-employed. In addition, expanding education and training for entrepreneurs and providing targeted support at key phases for the development of businesses are also crucial.
- Ensure that tax financed social security systems also support new entrepreneurs and the self-employed, such as by providing easier access to family support and by promoting access to a number of public facilities (starting with schools or hospitals). Unemployment and other social benefit schemes must be accessible for entrepreneurs if they fail, and not as currently being almost solely aimed at the employed.
- Promote the formalization of informal businesses especially in economies with large informal sectors, accompanied by structural support to increase their competitiveness and avoid recent formalized SMEs to fall back to informality. This will help enhance resilience, allow actors in small firms and the self-employed to benefit from wage and employment protection, and expand the tax base in the longer-term. The latter is critical in light of the high debt burden resulting from the Covid-19 crisis.
- Encourage public policies in support of SMEs to further reduce barriers to their formalization and improve their competences and productive capacities in efforts to enhance their access to international as well as strengthen their performance in national markets.
- Recognize diverse forms of employment and ensure an equal access to social safety nets to accommodate various employment paths and transitions in the world of work, besides fostering framework conditions for SME digitalization (please refer to policy priority 2 for more details).

## **5. Calibrate the burden of regulation and encourage good governance**

*Context:*

Regulation aims to guarantee the operation of markets, promote business development, and permit a level playing field, including throughout the participation in public procurement tenders.

At the same time, businesses of all sizes need to comply with an ever increasing number of domestic and international regulations that carry significant operational costs.

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In light of Covid-19, it is ever more important to ensure that regulatory burdens do not carry disproportionate costs to SMEs, for example related to record keeping, employment, and tax regulations. Should compliance costs be so high that they discourage entrepreneurs from starting-up a business or drive SMEs out of business, they will significantly hamper the economic recovery.

*Policy recommendations:*

- Reduce administrative burdens and red tape where possible to facilitate access to support programs and help small companies throughout the recovery phase.
- Minimize the burden of tax compliance for smaller firms and entrepreneurs by seeking to simplify tax systems wherever possible.
- Prioritize greater coordination between global financial regulators and government bodies; ensuring financial regulation does not hinder SME growth.
- Ensure labor market regulation does not create bracket effects that may disincentives SME growth.
- Ensure that new regulatory proposals are tested with thorough Regulatory Impact Assessments, ensuring their direct cost and impact on SME competitiveness is taken into account.
- Set fixed dates for the implementation of new regulations and clear dates for ex-post reviews. Regular reviews of existing regulatory frameworks are key to ensuring they are fit for purpose.

## **6. Promoting SME internationalization and GVCs**

*Context:*

The globalization of business has enhanced the role of SMEs as important contributors to global value chains through the goods and services they exchange within supply chains. By engaging in trade, SMEs can deliver value to customers worldwide and unlock growth potential on a much larger scale.

However, barriers to international trade and investment hinder SMEs' ability to develop and sustain business operations both in large and niche markets. A particular challenge exposed by the Covid-19 crisis relates to the fact that trade remains strongly reliant on paper-based processes. During the pandemic, companies experienced great difficulties in the physical exchange and review of paper-based trade documents, which created significant obstacles to global trade. In addition, delays in processing of associated financial documents impaired companies' cash flows and put a particular burden on SMEs. Digitalization has the potential to increase SME access to trade finance by improving process efficiency and quality, enhancing the portfolio of trade finance instruments, and expanding the field of dedicated trade finance and Supply Chain Finance suppliers.<sup>10</sup>

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<sup>10</sup> Bartz-Zuccala, W. and Boschmans, K. (forthcoming), "Trade finance for SMEs in the digital era", OECD SME and Entrepreneurship Papers, No. 23, OECD Publishing, Paris.



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*Policy recommendations:*

- Simplify customs control mechanisms and regulations on export control, and support movement across borders for entrepreneurs.
- Promote the development and adoption of international standards, technological, commercial and legal.
- Encourage international regulatory cooperation and a minimum level of comparability of SME financial information to facilitate supplier / customer due diligence across borders and foster SME exports.
- Create frameworks for SMEs to better integrate into local supply chains in their countries or regions and help SMEs capitalize on the trend that many large enterprises are looking for suppliers from closer distance due to supply chain disruptions caused by Covid-19.
- Enable paperless trade by legally recognizing digital documents besides only hard copies in order to fostering trade financing for SMEs underpinning global trade.

## **7. Foster skills and education**

*Context:*

Businesses, particularly smaller ones, understandably have a greater need for advice and support during the crisis. Especially during the immediate phase of the crisis we have seen that SMEs are busy with crisis management and often do not have the capacity and knowledge to identify the sources of funding and support available to them and to navigate often complex applications processes.

More generally, adequate skills are key assets for companies to do business, adopt new technologies and innovative techniques and to manage organizational changes required in view of the digital and green transitions. Compared to their larger peers, SMEs tend to have greater difficulties in attracting and retaining skilled employees and have fewer opportunities to provide for skills development.

*Policy recommendations:*

- Increase the quality of education systems for individuals of all ages, including through updating curricula, improving teaching practices, fostering work-based learning opportunities, and expanding vocational education and training (VET). This is particularly relevant in light of digitalization and greening of the economy.
- Create well-designed qualifications frameworks, foster formal recognition of skills acquired in non-formal learning and high-quality entrepreneurship education, and promote cooperation between SMEs and the education system at all levels. In this context, explore greater investment and incentive programs for employers taking-up apprenticeship or internship programs as well as training programs in SMEs.
- Expand active labor market support and general access to employment services to ensure

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job readiness and quality job transition especially for youth. This includes addressing information asymmetries and advising young people on job and career prospects as well as skills needed, with pathways to continued education.

- Enhance SMEs' access to Covid-19 support funding via professional advice, which can help SMEs to build their knowledge base and expertise (for instance on how to access public support programs). Make sure the support systems are adapted to SME's needs.
- Ensure that SMEs are included and informed about various public support programs, including on business and entrepreneurship education.

## 8. Culture of innovation and entrepreneurship

### *Context:*

SMEs are primary sources of innovation and play a key role in shifting innovation models by adapting supply to different contexts or user needs and responding to new or niche demand. The Covid-19 crisis has demonstrated the value of entrepreneurial activity and innovativeness of many SMEs and the benefits of the ecosystems in which SMEs operate to the wider society.

Wealth creation and employment greatly depend on the speed by which scientific and technological breakthroughs are converted into innovative products and services for consumers. This requires both a culture of innovation and entrepreneurship to function successfully. However, early OECD evidence shows that the crisis negatively impacted start-ups and entrepreneurship, with a decline in the number of new business registrations in many countries.<sup>11</sup>

There is also a stigma on failed entrepreneurs in many countries and “fear of failure” holding back talented people to start their own company. Covid-19 will likely result in a large number of bankruptcies related to wider economic conditions and not the mismanagement of business owners. It is therefore vital to encourage such business owners to restart their activities and business ventures and re-create value and employment with their entrepreneurial activities.

### *Policy recommendations:*

- Equip people with entrepreneurial skills through a comprehensive policy response and closer cooperation between the education system and employers and foster more personalized classroom experience, in efforts to shift away from traditional content on traditional schedules to building job skills in a flexible manner and through collaboration with the private sector, including community centers and experts, using project-based learning and problem-solving skills.
- Have a clear focus on innovation and research. Notably, the transition towards digitalization and climate neutrality should be facilitated through research and innovation

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<sup>11</sup> OECD (2021), “One year of SME and entrepreneurship policy responses to COVID-19: Lessons learned to ‘build back better’”, Tackling Coronavirus Series, OECD, Paris.

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funding and digital innovation hubs for local and regional ecosystems that foster entrepreneurship.

- Create “win-win” collaboration ecosystems that deliver for business – including industry clusters, university collaboration and innovation – so as to improve SMEs’ access to cutting-edge technology and product testing capabilities.
- Increase public investment in science and R&D policies – especially through precompetitive R&D platforms, ensuring these include SMEs.
- Set a supportive tone from the top of government, celebrating entrepreneurial success.
- Promote “second chance” entrepreneurship, reducing the stigma of failure and creating re-starting opportunities and options to learn from failure.

### **III. Concluding remarks**

The crisis again underlines that SMEs are especially vulnerable compared to their larger counterparts. SMEs not only had smaller financial buffers going into the crisis, but are also overrepresented in the sectors most affected by the crisis. In addition, small firms have more limited means to address liquidity constraints and often lack the expertise and scale to adapt their business operations to the new circumstances, which is of particular relevance in light of the digital and green transitions.

Policy-making which aims at being inclusive and leaving no one behind must therefore address the particular challenges SMEs and entrepreneurs are facing. A prolonged period of uncertainty could negatively influence general attitudes towards entrepreneurship, thereby depressing start-up rates over the longer term, and must thus be avoided.

A post-Covid world will not be a return to business as usual as SMEs, hoping for a return to the old normal are not likely to survive. Small business owners need to be active agents in crafting their own future success by exploiting the opportunities created in building back better. While the Covid-19 crisis brought about huge challenges, it also accelerated positive trends such as the digitalization and greening of the SME sector. Policy action should capitalize on this window of opportunity to support SMEs in becoming more productive and international through the use of new tools and business models. It should also increase local markets’ purchasing power and complimentary technology capacity and access to support for SMEs in their communities.

As Winston Churchill once famously said: “never let a good crisis go to waste”. Indeed, many see a real opportunity in the current crisis for building back better by adopting policies and laws that, amongst other, foster digitalization, secure a green economy, increase resilience and address inequalities. However, to use another famous saying: “the devil is in the details”. The OECD will have a critical role to play in both assessing the most effective policies and promoting these at a global level, including through the delivery of the OECD Strategy on SMEs. *Business at OECD* stands ready in supporting the OECD in these efforts through its extensive business network and expertise.



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