

EUROPEAN UNION FINANCING FOR SMES RETHOUGHT IN THE SCENARIO OF A LONG-TERM PANDEMIC

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Abstract

The European Union has been a vehicle for investing in business areas which are otherwise off-limits for traditional banks and investors. Indeed, the European Union, through its variety of financing programs has not only been a source of funding for otherwise risky business ventures but also for innovation, investing in ideas and business processes which are far from a state of going to market. In the context of the Covid-19 pandemic, many traditional businesses throughout the European Union, which relied on a physical operation for their profitability (such as shops, restaurants, local services), have had to close down or reduce their business. Meanwhile, businesses focusing on electronic commerce have been thriving, with rising consumer expenditure diverted to them as well as the possibility of more consumer time for prospecting. In the scenario that the business state of the pandemic lasts for another 2 to 5 years, a useful topic lies in addressing the way the European Union funds should be invested so that the European Commission can continue upholding its pledge of encouraging European businesses at local, international and global levels. Despite the fact that in the beginning of 2022, public attention has moved from the COVID-19 pandemic and towards other, more recent issues, such as the Russian-Ukrainian war, the health threat has not been completely eradicated. Since it continues in the background, worse for some countries than others, on a planning level, it is useful to consider what European Union financing can do for small and medium enterprises in such a scenario.

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1. Introduction

The European Union has been funding businesses in the last decades through a variety of channels and programs dedicated to diverse topics such as COSME, HORIZON and many others. These programs imply that financing is done either centrally, directly from the European Commission, or indirectly, at local level through financial intermediaries such as angel investors, investment funds or banks. Specifically, when addressing the financing realized through banks, these take the form of co-guarantees from the European Union or better conditions for financing such as better interest rates for SMEs. Banks are allocated funds and have a larger pool of investment available to small and medium enterprises which in absence, would have

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made banks very reluctant to lend at all to SMEs or to lend in worse condition of higher interest rates, faster payments or more pledged collateral¹. Banks are a crucial element of the discussion in the European Union, due to the attempts at consolidating the European Banking Union.²

The European Union has a long history of focus on businesses operating in the sector of agriculture but, in recent decades, has also started a significant focus on financing innovation, specifically innovation related to Internet Technology and communications, smart technologies, smart applications, digital or big data businesses³. Somewhere between the lines of the traditional, proven competitive advantages of agriculture and the emerging technologies, which employ a handful of very skilled professionals, lie the bulk of the jobs and businesses. These are the businesses which, despite not realizing great profits, are the majority of the small businesses in the European Union, and the largest employer.⁴ It is precisely these businesses which have been mostly affected by the COVID pandemic, the business as usual for them having been disrupted.

While no amount of financing can remedy shifting market trends, and the disruption created now by the COVID-19 pandemic has meant that some businesses have been permanently closed, the European Union now faces a different challenge of what businesses to fund. On the one hand, it has a great expertise on funding physical, productive or customer facing enterprises; on the other, the new, uncharted territory of digital business seems to have grown in importance with the rise of working from home, more e-commerce and the growth of the relevance of the service sector in the overall economy. This area also presents a different kind of challenge. Whereas before, the small and medium enterprise sector financing for the European Union consisted in picking winners from a cohort in attempting to find small businesses that can be sustainable starting from the ground up, with a new idea, or activating in an untapped niche, the reality of digital businesses means that SMEs have to compete with larger, more established firms, usually compete for services with multinational companies.

2. Possibilities for European Union Financing

A solution for the new model of picking winners among emerging SMEs for European Union financing could be in complementarity. Indeed, despite the fact that large, multinational corporations seem to dominate the area of digitalization and Internet commerce, due to their unified leadership and objectives, these companies are usually very good at doing a core of activities, but very slow in changing direction, or changing direction within departments and the making of teams more autonomous.

¹ European Commission, *Banking and finance*, online source: https://ec.europa.eu/info/business-economy-euro/banking-and-finance_en, latest access May 2022.

² European Commission, *What is the banking union*, online source: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/banking-union/what-banking-union_en, latest access May 2022.

³ European Commission, *Annual report on European SMEs, European Union Support Programmes for SMEs*, online source: <https://eufunds.gov.mt/en/EU%20Funds%20Programmes/Other%20Programmes/Documents/SME%20guide.pdf>, latest access May 2022, pages 2-22.

⁴ *Annual Report on European SMEs 2018/2019, Background document*, published November 2019, online source: <https://op.europa.eu/en/publication-detail/-/publication/cadb8188-35b4-11ea-ba6e-01aa75ed71a1/language-en>, pages 9-58.

In this respect, small and medium enterprises have an advantage because they can consist of much smaller teams which are not committed to long term objectives (between 2 and 5 years). The role of flexibility in small and medium enterprises has been examined at lengths in papers such as that of Marek Matejun (2014).⁵

For example, due to the numerous creation of websites, more mobile applications, more computer programs, more online commerce as well as an increasing palette of services provided fully or partially on-line, the demand for customer support, customer care and technical support is increasing and will continue to increase. As such, a whole emerging industry has developed in the last decade, for different levels and types of customer support, technical support or a blend of these areas and sales, with multi-skilled agents, capable of promoting the business, solving customer issues, selling new products and providing professional rapport and interaction with the customers.

This provides a niche which SMEs can tap very well, either independently or in collaboration with larger enterprises because the teams needed in customer support, customer care and technical support are usually small, versatile and adaptive. These kinds of teams can be concentrated in individual agents working individually from home, their only point of dependence further up with the firm being points of difficult case escalation. Or, in other cases, they consist of small, collaborative, fast communicating teams of under 10 employees.

The advantage of this kind of set-up is two fold: the SMEs can maintain independence in organization while the large companies can tap into areas which would otherwise be much more inefficient to manage. Such areas are difficult for large companies to direct through a unified change of management and unified vision specific to large companies and are not very relevant for these kinds of teams and activities, customer-facing teams usually having a direct, hands-on activity, which is separate from the rest of department activities in large enterprises. This scenario can represent a win-win for large companies, SMEs and the labor market as a whole. The relationship between small and business collaboration to eradicate poverty has also been examined in articles such as that of Richard Moreton (2019)⁶. Moreover, the relationship between small and large enterprises collaborating for innovation has also been explored in articles such as that of Adi Gaskell (2016)⁷.

A second route that the European Union financing can take is the funding of SMEs which are attempting to innovate in niche areas which are unprofitable to large companies. Due to the large scale of companies, high operating costs, and the direction of activity usually through unified hierarchies, large companies tend to compete with other large companies over bigger markets segments, usually trying to bring to market

⁵ Marek Matejun, *The Role of Flexibility in Building the Competitiveness of Small and medium Enterprises*, published in Management 18(4), May 2014, online source: https://www.researchgate.net/publication/283153159_The_Role_of_Flexibility_in_Building_the_Competitiveness_of_Small_and_Medium_Enterprises, latest access in May 2022.

⁶ Richard Moreton, *Why Large and Small Businesses Need to Collaborate to Compete in Complex Markets*, published in 2019, in Business Fights Poverty, online source: <https://businessfightspoverty.org/why-large-and-small-businesses-need-to-collaborate-to-compete-in-complex-markets/>, latest access May 2022.

⁷ Adi Gaskell, *How Big and Small Companies can Innovate Together*, Forbes, 10th of February 2016, online source: <https://www.forbes.com/sites/adigaskell/2016/02/10/how-big-and-small-companies-can-innovate-together/> latest access on May 2022.

game changing technologies that would assure them large revenues for periods of several years, against their competition. Such products include computer hardware, more advanced smartphones, applications or business computer software. The target market for large companies is usually the United States first, or if not, other developed economies, with the majority of their products being geared towards either the business sector or large scale consumer appliances. Such is the case with large businesses competing to sell business software or hardware to other large or small businesses or the sale of mass produced smartphones, watches, computers, hardware parts, applications or accessories to end customers.

As such due to costs associated with trying to develop large-scale manufacturing, large scale customer loyalty to a service or cultivate customer loyalty to a set of upgradeable, replacing products, large companies do not usually tap into smaller, local opportunities. This represents an opportunity for SME. For example, in the growing field of software, SMEs can deliver locally adapted mobile applications or computer software. The competitive advantage in this area lies in adapting to differences in cities, cultures, countries which the large companies are not interested in, due to their attempt to standardize, create and serve a generic customer base. The relationship between differences in small and medium business has been explored at length in by John A. Welsh and Jerry F. White in an article in 1981.⁸

There is a plethora of untapped local services which SMEs can tap into, not only for their own direct benefit but also with the possibility of revitalizing local trade and competitiveness. Here advantages can include the geographically specific branding of services for local customers, specifically tailored services to local customers. Specifically, in the area of household consumer services, there is much fertile ground for local SMEs to access. The area of serving local businesses can be more difficult to access, specifically in local businesses which attempt to compete internationally and need to rely on globally standardized networks of communication or work, or standardized software such as Microsoft suites. However, SMEs can attempt to innovate, bringing locally successful and locally flavored technologies to compete on a larger scale. But mostly, they can service local small businesses.

A third way in which European SMEs can integrate into the growing multinational landscape and for which they have a pan-European cooperation advantage is through the creation and improvement of existing networks for small and medium enterprise knowledge sharing across the European Union. Since many of them activate in different countries, focusing on local markets, they are not and will probably not be direct competitors for their foreseeable business life. As such, there are many avenues for knowledge, process, technique, practice and technology diffusion among them for a better integration of ideas into products and services for different markets. For example, SMEs activating in historical tourist activities can have a much better service delivery if they can integrate the stories that they are presenting into a wider European context of stories together on loose, indirect collaboration and knowledge sharing with similarly placed, non-competing SME's in other parts of the European Union.

⁸ John A. Welsh and Jerry F. White, *A Small Business Is Not a Little Big Business*, Harvard Business Review, July 1981, online source available at: <https://hbr.org/1981/07/a-small-business-is-not-a-little-big-business> latest access in May 2022.

The advantage brought about by Internet learning can now also be applied to more traditional manufacturing or service industries which would have otherwise been geographically locked and could have diffused knowledge only through physical transportation on site, or through regional trade fairs. Such is the case for companies that provide local manufacturing services, some of them with a long history or connected to a country's culture, history or other unique traits. Example here include pottery, woodworking, painting, sewing and many other local crafts. It is also the case for local service providers, even among more established services such as locksmithing, plumbing and many others.

3. Challenges for European Union financing

The challenges for European Union financing in the scenario of a long term-pandemic are different because now it means that they need to assess the possible profitability of SMEs in a different manner, possibly based on their ability to do e-commerce or otherwise handle demands, and contracts on-line and deliver over longer distances, as the in-person-shopping can reduce. Also, since many European Union programs are not focused on eliminating firms based on productivity, but, based on their potential for innovation, the process of the evaluation of the innovation must necessarily be different. Not only would many of the assessments have to be done over the Internet, replacing in person visits by evaluators, but also, the trustworthiness of the endeavor would require much more information. Additionally, the long-term profitability factor is very different and the reality of doing business presents more unknowns and faster changes in business due to faster changes in consumer demands and preferences as shelf life and life of product are decreasing.

The digitalization of processes brings a greater speed and efficiency to some processes, but frequently, the volume of information created overrides the capacity to absorb the information. Such can be the case for the application for business grants from the European Union during these times if strong entrepreneurship resurges. However, the handling of these requests by increasing staff volume would be very unlikely due to the strict but stable structure of European Union clerical employment. In this regards, a possible solution is the introduction of pre-screening processes which should not be too rigid to disqualify genuine entrepreneurial endeavors. However, no screening process can guarantee the success of entrepreneurship, the process being in its nature a very original and different activity in any case, the evaluation of which can only reside with experienced professionals in business evaluation and experienced entrepreneurs.

4. Conclusion

There is a great difference between the valuation process that large, established firms go through and the evaluation of projects for small and medium enterprises in which officials for government or intergovernmental organizations fulfill. First of all, in valuating businesses which are stable and have been operating for several years, there are many proven economic indicators which can provide a degree of reliance in analysis. These include accounting indicators such as debt ratios, profit and loss statements, ratios for different resource use such as return on equity; or financial indicators such as capital asset pricing, value at risk and many others. In evaluating a

new business, none of these indicators can be used and indeed there are very little financial indicators that can be reliable, instead the focus is more upon entrepreneurial spirit, ideas, adaptation to the times, past work experiences in the field, initiative or former entrepreneurial endeavors if available. These issues have an added level of complexity with the added informational unknowns created by the context of the pandemic. There are also untapped advantages, but the quantification of these by evaluators is very unlikely.

Secondly, in the process of evaluating small and medium businesses which are trying to innovate, there can be no reliable process in standardized evaluation which can quantify the future results of businesses operating in completely different, many times emerging fields, with unproven processes, technologies or organizational structures. The European Union is in a safe position as an investor and should probably take additional risks to what private lenders take in the process of financing new, risky businesses.

Thirdly, I believe that the current times can represent turning points for some industries and sectors in the sense that some, even which are small at present and emerging, might in time be over-represented in the overall economies while some other sectors, might disappear, become obsolete and need to reorganize, or reduce in income and importance. As such, additional care needs to be done when evaluating and funding small and medium enterprise projects on a case by case basis. While some areas might be strong in geographical avenues based on local competitive advantages, such as tourism; others are still based on locally made, traditional products such as foods or crafts; there are areas and sectors in which modernity has advanced more and innovation and risk taking can take on much bigger roles. This is the case with the emerging Silicon Valleys of Europe (some examples are in Finland and Romania) but not limited to this. There are currently many areas of new technologies including Internet and Technology, Telecommunications, Medicine, Gardening and many others in which small and medium enterprises can activate.

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