

THE POWER OF SMALL

MSMEs as a Source of Innovation

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Micro, small and medium sized enterprises (MSMEs) are typically firms with 250 employees or less, whose assets, turnovers and other required indicators fall within a particular threshold based on the definitional criteria used. Presently, there is no globally accepted definition of an MSME and the indicators used in definitional criteria differ both nationally and internationally which complicates the comparability of data for this sector. Despite the definitional ambiguity, there is broad consensus that the term “MSME” connotes a sense of “smallness” in several aspects.² The collective economic contribution of MSMEs however cannot be considered small. 99.5% of all businesses in Latin America and the Caribbean (LAC) are MSMEs, accounting for 60% of employment and 25% of regional GDP (Herrera 2020). Consequently, as the cornerstone of regional economies MSMEs are a critical source of innovation both from supply and demand perspectives (Phan, Tu and Borgert 2020).

To highlight the relationship between MSMEs and innovation, this piece defines innovation, analyzes MSMEs’ demand for innovation, draws reference to MSME-led innovation supply and provides some concluding thoughts.

Defining Innovation

The Oslo Manual is commonly used by academics and policymakers as a guideline for defining and measuring innovation. In its fourth edition, the manual defines innovation as “a new or improved product or process (or combination thereof) that differs significantly from the unit’s previous products or processes and that has been made available to potential users (product) or brought into use by the unit (process)” (OECD and Eurostat 2018). Several studies provide empirical evidence of a positive relationship between innovation and economic growth in both developed and developing economies,

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² This can include the number of employees, annual sales, registered capital, total assets, total credit facilities, etc. (CDB 2016).

often citing innovation as a major source of increased productivity (Pece, Simona and Salisteanu 2015; Phan, Tu and Borgert 2020).

Understanding the Demand for Innovation from MSMEs

Conceptualizing demand for innovation from MSMEs first requires an understanding of the unique challenges that this sector faces. High levels of informality create a fragmented and disorganized MSME sector across the region “known for deficiencies in the quality, consistency and range of its products and services and for weaknesses in packaging, costing and pricing, technology usage, and management/worker know-how” (CDB 2016). Access to finance is particularly challenging for MSMEs, especially in a region where the financial sector is dominated by (foreign-owned) commercial banks who often deem these entities as high-risk, in turn imposing more onerous requirements (Beecher, Bissessar and Julien 2018 and CDB 2016). With limited access to financing, scaling up and exporting becomes much more difficult for MSMEs, while still facing barriers like logistic impediments, bureaucratic and other administrative constraints and market and business information asymmetries (Brathwaite, Nicholls and Remy 2020). Therefore, it is no surprise that although MSMEs constitute most businesses in the region, their access to international markets is limited (Cram-Martos 2018). For example, in the LAC region MSME participation in regional exports only reaches 6% (ECLAC 2019).

Rooted in a desire for economic survival and increased competitiveness, the MSME sector continues to demand innovative solutions for its various challenges. On the financial front, some FinTech companies have responded to the call for more innovative financial products for MSMEs. For example, ArawakX is a digital equity crowdfunding platform launched in the Bahamas to provide an alternative source of financing for MSMEs and WiPay Caribbean has formed strategic partnerships to facilitate cheaper international money transfers to over 160 countries for the 20,000 plus MSMEs on its platform (Eyewitness News 2020; WiPay 2021). Governments are also undertaking reforms to improve the ease of doing business with emphasis on increased digitalization. In 2019 the Economic Commission for Latin America and the Caribbean hosted a workshop exploring options for international cooperation to adapt trade single windows to the needs of MSMEs (ECLAC 2019). The COVID-19 pandemic also boosted the sector’s demand for innovative technologies to facilitate business continuity, including digital

payment and e-commerce solutions, videoconferencing platforms, etc. (Acevedo et al. 2021).

Evidently, from the demand side MSMEs are in constant need of novel technologies and innovative approaches to improve their competitiveness, not only to compete with larger, more global enterprises but also to navigate dynamic business climates (Phan, Tu and Borgert 2020). Subsequently, their demand for innovation exists across multiple parameters including business processes, technology, product/service development, handling external environment, etc. (PwC 2011). The numerical dominance of MSMEs across the region facing similar challenges also intensifies this type of demand.

Tracing MSME-led Innovation Supply

MSMEs also create innovation to supply the market. Economist Joseph Schumpeter, best known for the theory of creative destruction,³ formulated two hypotheses – one where small, entrepreneurial firms are likely to be the source of most innovations as they search creatively for new market opportunities, and the other where he proposed that due to high R&D costs small firms tend to imitate larger ones rather than innovate themselves (Blac, Wiczorek-Kosmala and Trzęsiok 2020). These hypotheses were tested across numerous studies focused on various sectors and economies, with overall mixed results (Freel 2007; Santarelli and Sterlacchini 1990; Van Dijk et al. 1997; Vaona and Pianta 2008). Some of the main determinants of innovation in MSMEs include sector belonging, nature/type of innovation, and firm characteristics. Hoffman et al. (1998) and Lerner (2009) observed that among MSMEs the smaller, younger firms are more likely to be innovative compared to the larger, older ones. Roper and Hewitt-Dundas (2017) found micro-enterprises to be sources of new-to-the-market innovation linking internal capabilities and collaboration as key drivers for a micro-firm's ability to develop such innovation and drive the creative destruction process. Empirical evidence also suggests a positive relationship between innovativeness and MSMEs performance, noting that the capability of MSMEs to innovate is a source of competitive advantage (Octasyilva et al. 2022; Phan, Tu and Borgert 2020).

³ Creative destruction was coined by economist Joseph Schumpeter to describe the incessant product and process innovation mechanism by which new production units replace outdated ones. Schumpeter considered creative destruction to be the essential fact about capitalism (Caballero 2010).

Although the MSME sector is highly heterogeneous, ranging from highly innovative firms to more traditional ones, the potential for these firms to create innovation exists. Perhaps the most visible examples exist in the tech sphere where MSMEs across the region are developing new services ranging from ridesharing and delivery platforms (WiFetch, Pink Cab, PickUp), FinTech solutions (WiPay, Squeeze Cash, Bitt), immersive experiences using AR/VR technologies (Bahama Myfi, I'm Local Grenada), some restaurants are even using QR codes instead of physical menus - just to give a few examples.

Concluding Thoughts

MSMEs are both a source of innovation supply and demand but tapping into this source requires a conducive environment where MSMEs can thrive. The Association of Caribbean States can play a leading advocacy role in this regard, advocating for:

- (1) Increased accessibility to technologies and other key inputs. Initial steps can include facilitating discussions around the reduction of tariff and non-tariff barriers and burdensome in-country taxation structures which render these inputs costly.
- (2) The prioritization of entrepreneurial education and digital skills, especially if the region's MSMEs are to be a source of innovation amidst the digital age.
- (3) Greater investment in R&D through affordable channels such as partnerships with regional universities and think tank hubs which can assist in bolstering the innovative capacity of MSMEs.

These are just a few suggestions for initial consideration but to fully unleash “the power of the small” it's time to prioritize the role of MSMEs as vital sources of innovation.

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