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Policy Brief

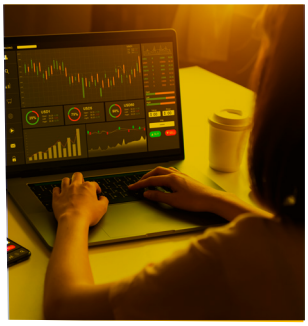
Improving the Competitiveness of Micro, Small and Medium Enterprises by Introducing Digital Transformation













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Summary

The digital transformation of the enterprises is important in today's business environment and operation and can have a positive impact on the development of the companies in the direction of increasing their productivity, efficiency and competitiveness. In addition to these positive changes, the digital transformation can contribute to the increase of the customers' satisfaction, it can strengthen the cooperation and improve the communication with the customers, suppliers and other parties in the business operations, increase agility, reduce the human risk factor, provide information and data that will help create new corporate strategies, as well as facilitate the internal processes of operation and management of the enterprise.

Having in mind that the micro, small and medium-sized enterprises (MSME) in the Republic of North Macedonia are an important and dominant factor in the economy, and few of them are ready to work on innovation and improvement of their business processes in the direction of digital transformation, it is necessary, in addition to the other forms of support, to also provide more help for their strengthening aimed at digitalization of their processes by introducing digital technologies and channels, as well as their digital transformation by innovating the systems and cultivating and applying digital technologies and digital mindset of the employees.

This Policy Brief has been developed based on the findings of the research conducted within the "Business Support Organizations – Champions" Activity implemented by Strategic Development Consulting with the financial support of the United States Agency for International Development (USAID). In addition to the data collected during the research, this document also includes an analysis of secondary data sources (researches, policy briefs, the legal framework. etc.) that define the "digital" operation in the country. The recommendations for the measures and activities presented in this document are intended for the policy makers and they should contribute to the improvement of the competitiveness of the micro, small and medium-sized enterprises by introducing digitalization and digital transformation of the operations.



Introduction

When it comes to the digital transformation of the enterprises, one of the key challenges is the lack of a qualified workforce that has "digital" knowledge and skills, which, in combination with the resistance of the managers to introduce digital transformation, constitute limiting factors that negatively affect the capacity and capability of the MSMEs to take advantage of the development potential enabled by the digital technologies. In addition, the conservative corporate culture prevailing among the enterprises in the Republic of North Macedonia also contributes to the low level of digital transformation.

In addition to these challenges, there are also a number of opportunities for introducing digital transformation in the Macedonian enterprises. The possibilities offered by the digital technologies and the online tools are numerous – from using digital marketing for promotion, placement and sale of products or services to online sales etc.

In that regard, when it comes to the digital transformation, it should be observed through the prism of the external and internal factors, i.e., the capacities of the very MSMEs.

The external environment plays an important role when it comes to the digital transformation of the MSMEs. The key factors that affect the ability of the enterprises to effectively start the digital transformation process and to take advantage of the opportunities offered by the digital technologies are: the business environment, the business climate, the legal, i.e. regulatory framework, as well as the created policies. However, in order to take advantage of these opportunities, the policies should be designed in a manner that they create opportunities that can be used by the MSMEs, rather than restrict their access to support.

On the other hand, the internal factors play a key role in determining the success and effectiveness of the digital transformation of the MSMEs. The level of readiness for adoption of digital operations varies among different enterprises, with some managing to fully embrace and apply the digital technologies, others being in the early stages of development, while still others not even thinking in that direction at all. This situation is partly contingent on the sector/industry in which the enterprises operate, depending on the need to use digital and innovative solutions and tools, while partly it is the result of the awareness of the management of the enterprises about the benefits of the digital transformation, i.e. the need to allocate appropriate financial resources for the purchase of software, hardware and other programs and tools that enable the digitalization of the work processes and to invest in the development of their employees' digital skills. The internal factors can be limiting or supporting the extent of application of the digital tools and practices in the operations of the enterprise.

The situation in the Republic of North Macedonia

The Republic of North Macedonia has made a significant progress in the development of the regulatory framework for digital transformation, through the adoption of the legal framework that regulates this issue.

However, despite the progress made by the Republic of North Macedonia, there are still challenges that need to be overcome in order to ensure effective implementation of the regulatory framework for digital transformation. To that end, better coordination and cooperation between the regulatory bodies is needed, as well as greater public awareness and education about the digital rights and responsibilities. In addition, there is a need to strengthen the capacity of the regulatory bodies so that they will be able to monitor the implementation of the relevant regulations in practice.

Another challenge in the regulatory framework for digital transformation in North Macedonia is the lack of compliance with the EU regulations. Although the country has made progress in aligning its laws and regulations with the EU standards, there are still gaps and inconsistencies that need to be addressed. These differences[1], which are also noted in the Republic of North Macedonia's 2022 Progress Report, can create confusion for the businesses and consumers, and can also limit the country's ability to fully participate in the EU's digital single market. Solving these challenges requires continuous efforts for harmonization of the regulations and standards with those of the EU, as well as increased cooperation and dialogue between the Republic of North Macedonia and the EU regulatory bodies.

The strategic policy documents that were adopted in the past period also defined the support for the digital transformation on various grounds – from institutional, through regulatory to providing direct support to those who need it the most. The Republic of North Macedonia has taken a proactive stance towards digital innovations and transformations, as defined in the objectives of various strategic policy documents adopted in recent years which pertain to the MSME sector and cover issues related to the digital transformation.

Although the strategic framework for the digital transformation policies in North Macedonia defines the goals that are to be achieved and provides a roadmap for accelerating the economic growth and

[1] Finalize and adopt the long-term information and communication technology strategy; align national legislation with the European Electronic Communications Code and the EU Broadband Cost Reduction Directive; and continue efforts to align national legislation with the EU Directive on Security of Network and Information Systems (NIS Directive)/ and the 5G toolbox

improving the country's competitiveness, there are still challenges that the state must tackle in order to fully utilize the benefits from the measures and activities outlined in these strategic documents.

External factors

According to the findings of the research of the International Labor Organization[2] (at the time of the preparation of this document, the research report is not publicly available), 43% consider the digital ecosystem as a serious challenge, almost one third (32%) perceive it as an environment that enables rapid development of the MSMEs, while 13% of them consider it as a fragmented and isolated system. This points to the diverse nature of the digital ecosystem and highlights the need for tailor-made strategies for addressing the specific challenges and opportunities faced by the different industries.

Encouraging the adoption of e-commerce and facilitating the access to online markets and platforms is vital to enable the MSMEs to reach the wider public and to effectively compete in the market.

The results of the same research show that the majority of enterprises (92%) rely on their own funds when it comes to the digital transformation, which indicates the limited supply and opportunities when it comes to external sources of funding. However, the entrepreneurs believe that the Government should provide tax incentives for digitalization investments and encourage the development of the digital skills. Such support can further encourage the MSMEs to invest in modern digital technologies and strengthen their internal capacities, thereby accelerating the digital transformation process.

The access to business development services is essential for the enterprises looking to improve their digital capabilities. The consulting companies and business support organizations are important factors in this process, considering that they are the most frequently used service providers for the enterprises (60% – 74%)[3]. Although the non-governmental organizations and international projects also play an important role, their involvement in providing direct support is relatively lower.

Internal factors

The internal factors (within the enterprises themselves) contribute to the development or stagnation of the enterprises when it comes to digital transformation to an extent similar to the one of the external factors.

In that direction, according to the research of the International Labor Organization, the level of readiness for digital transformation varies in different enterprises, with some fully adopting the digital technologies (only 3% of enterprises), while others are still in the early stages of development. However, a significant percentage (32%) has yet to allocate a budget for this purpose, which indicates the need for greater awareness and prioritization of the digital initiatives.

[2] An enabling environment for the digital transformation of Macedonian enterprises: opportunities, constraints and the way forward, Draft report, International Labor Organization, 2023

[3] An enabling environment for the digital transformation of Macedonian enterprises: opportunities, constraints and the way forward, Draft report , International Labor Organization , 2023

Employees' digital skills are a critical internal factor. Approximately one third of the companies (31%) believe that the digital skills of their employees are adequate, 51% believe that there is room for improvement, and 18% of them believe that the digital skills of their employees are inadequate. Bridging the digital skills gap requires proactivity aimed at providing trainings for improvement of the digital skills and competencies and the digital literacy of the enterprises' employees. Investing in human capital and nurturing a digitally skilled workforce is essential for harnessing the full potential of the digital technologies.

Another fact that goes in that direction is the fact that half of the companies (50%) do not send their employees to digital skills trainings, while the rest organize some kinds of trainings. Of them (of the remaining 50%), 32% send their employees to attend external trainings, while 30% of them train their employees in the company itself, while 22% provide on-the-job training. The remaining companies use other types of training methods, such as mentoring programs, online courses for the employees, etc.

On the other hand, the corporate culture and flexible management[4] are key pillars in the process of implementation of the digital transformation. More than half of the MSMEs (58%) face challenges in fostering an innovative culture and adapting to the new digital technologies. In order to succeed in such environment, the enterprises need to embrace a culture of innovation, encouraging experimentation and risk-taking to drive continuous improvement and adaptability.

Furthermore, addressing and introducing innovation is a vital internal factor influencing the digital transformation process. While a significant portion of the companies (30%) see digitalization as a key driver of growth and success, there is also a notable portion (14%) of them that consider it a risk to their business. The rest of the companies consider that digitalization can contribute to business development, but it is not a key factor in their businesses. The promotion of a positive outlook towards innovation is crucial when it comes to fostering a mindset of continuous improvement and creation of resilience to adverse impacts.

If the enterprises are characterized by digital readiness, develop and nurture digital skills, apply an innovative corporate culture and encourage the introduction of innovations and the application of innovative processes and practices, they can very easily and quickly implement the digital transformation in their operations. It is imperative for businesses to be able to recognize the value of the digital technologies and to adopt a proactive approach to leveraging these tools for driving growth, efficiency and competitiveness.

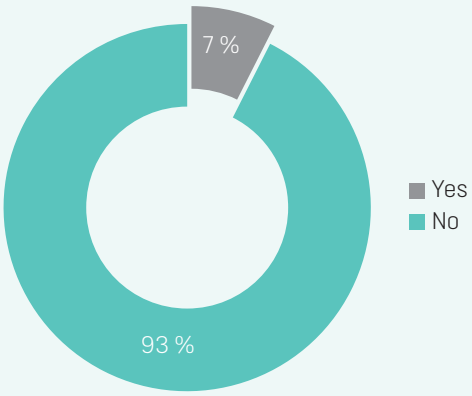
[4] The managerial decisions/plans should be appropriately adapted to the changes occurring in the environment

Analysis of the research results

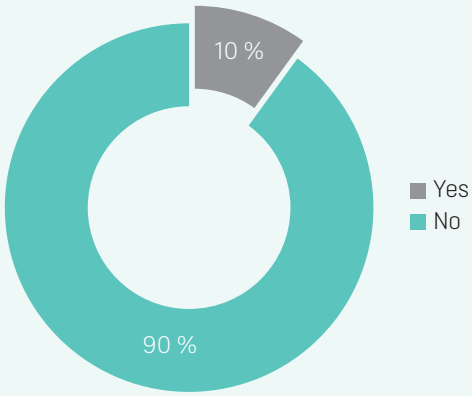
Within the framework of the research that was carried out in the period March - June 2023 for the needs of the USAID "Business Support Organizations – Champions" Activity, using qualitative and quantitative methods, the aim was to analyze the challenges and needs of MSMEs from eight sectors of the economy (manufacturing industry; retail and wholesale trade; accommodation and food service facilities; transportation and storage; agriculture; arts, entertainment and recreation; information and communication; supply of electricity, gas, steam and air conditioning; craftsmanship) to which the government support was focused in the last three years (during the health and energy-economic crisis), as well as to perceive the attitudes and thoughts of the representatives of the key state institutions and the representatives of the business sector (chambers, business support organizations, business associations of women) in relation to the development of the MSMEs in order to develop recommendations for effective policies and measures that will contribute to more competitive and adaptable enterprises.

Innovations and digitalization turned out to be one of the main segments of the research. The goal was to define the extent to which the enterprises are ready to introduce innovations in their work processes, and thus to digitize and digitally transform themselves, and to accordingly give policy recommendations for the further development of the MSMEs. The basic conclusion regarding digitalization is that there is a low level of knowledge among the MSMEs about what it represents and a low level of implementation of innovative solutions in any segment of the operation. The finding is consistent, because the information about the low readiness of the MSMEs to introduce innovative processes/products in their operations is also confirmed by the business support organizations and the state institutions, which also consider that there is a low interest among the MSMEs to implement innovative solutions. An additional conclusion is that the companies understand the digitalization at an elementary level (launching a website, using social media, etc.). Considering that the digitalization and innovation contribute to the accelerated growth of the companies, increasing the awareness of the importance of digitalization and innovation is imperative.

Has the company developed new (innovative) business processes or innovative products in the last three years?



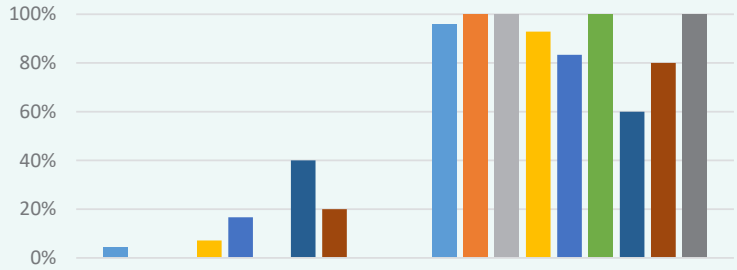
Does the company have a plan for developing new (innovative) business processes or innovative products for the next 3 to 5 years?



Based on the research data, 7% of the surveyed enterprises have introduced new processes and/or products in their operations in the last three years, while 10% plan to introduce innovations in the form of processes or products in the next few years. Considering that in the last 3 years, the process of digitalization of the businesses has been accelerated as a result of the challenges faced by the MSMEs during the health crisis of COVID-19, the participation is significantly low. It can be concluded that the MSMEs in North Macedonia are significantly lagging behind when it comes to the processes of digitalization and digital transformation.

Has the company developed new (innovative) business processes or innovative products in the last three years?

General overview of answers



	Yes	No
Manufacturing industry	4%	96%
Retail and wholesale trade	0%	100%
Accommodation and food service facilities	0%	100%
Transportation and storage	7%	93%
Agriculture	17%	83%
Arts, entertainment and recreation	0%	100%
Information and communication (IT companies)	40%	60%
Supply of electricity, gas, steam and air conditioning	20%	80%
Crafts	0%	100%

Also, if we analyze the industries in which the enterprises that have developed new (innovative) processes or innovative products in the last three years operate, it may be concluded that the majority are companies from the IT sector, followed by those working in the sector for supply of electricity, gas, steam and air conditioning, as well as those working in the agriculture sector. The enterprises that have developed certain innovative processes or innovative products in their operations, for the most part belong to the group of micro-enterprises. Based on the answers, it can be concluded that the MSMEs are characterized by a low degree of innovation.

Apart from the enterprises, both the business support organizations and the public institutions need to increase their level of digitalization. The organizations understand the meaning and need of digitalization to a higher degree and consider that a reform is needed in their internal processes. The digitalization will enable their greater management effectiveness, which also brings about an increased satisfaction of their members. In order to encompass the entire ecosystem of digital functioning, digitalization of the processes in the state institutions is necessary, especially integration of the systems in a single solution where the MSMEs and the organizations will have quick and simple access to the necessary information.

The main conclusion of the research, including from the consultations with the business community and the government institutions, is that there is agreement when it comes to the need for educating the MSMEs on the importance of innovation and digitalization. In order for the domestic companies to compete successfully, both on the local and the international market, activities are needed that will contribute to the advancement of that knowledge even in the short term. The digitalization of the business support organizations and the institutions will help in increasing the quality of the services they deliver to the companies, and thus, in a way, they will increase the level of acceptance of the innovations and digitalization in the enterprises themselves.



Recommendations for measures/activities

Based on the findings of the research conducted within the USAID "Business Support Organizations - Champions" Activity, the following recommendations were defined as priority areas in the field of innovations and digital transformation of the enterprises:

- Education of the MSMEs about the importance of the innovations for the business development and ways of introducing innovative processes/products in their operations.
- Introducing benefits for the companies that invest in staff development and innovation.
- Improving the communication about the opportunities for financing and supporting innovation between the MSMEs, business support organizations and institutions.
- Digitalization of services aimed at simplifying the application procedures for the measures/ support for the MSMEs, as well as improving the efficiency of the procedures for obtaining documentation and permits.
- Creation of a one-stop system/platform for programs, measures and projects and for all financing opportunities for the MSMEs (access to all information and application documents).
- Creating and providing support services to the MSMEs for applying to EU projects for innovation, research and development by the business associations.
- Digitalization of the work and internal processes of the business associations.
- A platform for effective dialogue between the business sector and the government on the measures that reflect the needs of the MSMEs.
- Digitalization of services, including the processes and procedures to support the MSMEs.

Based on the above findings and priorities which speak about the state of the MSME sector in terms of their readiness for digitalization and digital transformation, presented here are the measures and activities that should be taken into account and implemented within the framework of the support provided by the state in the segment of promotion, introduction and application of the digital transformation among the MSMEs. Raising the awareness about the digital skills and knowledge, as well as about the technical sciences, are two of the eight key competences for lifelong learning, and

therefore they should be part of the formal education from an early age, as well as of the non-formal, lifelong education, for the purpose of raising the awareness of the importance of these competencies.

The measures are divided into several areas according to the type of activities to be implemented. Some of them are preparatory, such as conducting a needs analysis, while some refer to providing direct support to the enterprises for education, awareness raising and co-financing of the purchase of equipment for digital technologies.

Table 1. Proposed activities that should be part of the policies/annual programs of the institutions that provide support to the MSMEs

Activities	Estimated time required for implementation	Institution/organization responsible for the implementation
Organizing a campaign/caravan for digital education and raising awareness about the benefits of the introduction of the digital transformation among the MSMEs	6 months	Ministry of Economy, Chambers of commerce, Chamber of Commerce for Information and Communication Technologies and other business support organizations
Making an analysis of the supply of ICT training and mapping the training providers (for non-formal adult education) at the national level	3 months	Adult Education Center
Organizing trainings for people from the vulnerable groups (including people with disabilities) and the elderly aimed at acquiring ICT skills	6 months	Employment Service Agency
Organizing events for peer-to-peer knowledge transfer between companies that have experienced the benefits of the introduction of digital transformation in their operations and companies that have not taken significant actions in that regard	12 months	Ministry of Economy, Chambers of Commerce and other Business Support Organizations
Providing subsidies up to 50% of the investment for the introduction of digital transformation in the micro-enterprises that have existed for more than 3 years, where the amount of the subsidy should not exceed EUR 10,000	6 months	Ministry of Economy
Co-financing projects in the field of ICT, based on an established partnership between the MSME and academic/scientific organizations (10 projects)	12 months	Ministry of Economy
Digitalization of the process of registration of the companies in the MoE	4 months	Ministry of Economy
Monitoring of the companies that received subsidies for the introduction of digital transformation in relation to the achievement of the key indicators, i.e. evaluation of the results and effects of the support	36 months	Ministry of Economy and Agency for Entrepreneurship Support

The proposed activities presented in the table above should be integrated into the following programs/ plans of the respective institutions:

- Program for supporting entrepreneurship, competitiveness and innovation of the SMEs - Agency for Entrepreneurship Support
- Program for supporting the competitiveness of the manufacturing industry and the social responsibility and Program for the development of entrepreneurship and competitiveness of the SMEs - Ministry of Economy
- Operational plan for active programs and measures for employment and services on the labor market and Annual Work Program – Employment Service Agency
- Work Program of the Public Institution Adult Education Center - Adult Education Center.

For each of the proposed activities, key indicators should be defined based on which the success of the activity's implementation will be monitored. The budget for the proposed activities is calculated based on the comparative analysis made on similar activities and measures for support of the digital transformation of the MSMEs that are implemented in the countries of the region.

The majority of the funds for the implementation of the planned activities defined in the table have already been provided within the existing budgets that the institutions have for the implementation of their programs (by canceling the activities that have little impact on the target group for which they are intended, or by allocating a part of the funds that are not utilized in full and their repurposing for new activities), and the rest should be provided by the state budget.



Conclusion

The introduction of digital transformation among the MSMEs is a challenge not only for the enterprises but also for the other stakeholders who are (in)directly connected with the digitalization process, starting from the state institutions responsible for creating the strategic and legal framework, all through to the business support organizations which should be supporters of the process itself by providing services and support for an easier transition to digital transformation.

In terms of the legal and strategic framework, it can be stated that in the past years many activities were carried out in that direction, which contributed to the preparation and adoption of several legal solutions and documents (strategies, plans, etc.) that rounded off the framework that should be respected when it comes to the digitalization process, not only for the private sector but also for the institutions and organizations from the public sector.

However, in order to achieve the goals and expectations defined in this framework, additional activities are needed which would accelerate the process of digitalization and digital transformation, especially of the MSMEs.

For that purpose, this document proposes a set of activities that should provide initial help in the process of digital transformation of the MSMEs, but also a long-term help in achieving the goals foreseen in the strategic policy briefs.

The implementation of the proposed measures and activities should be part of the action plans that will be an integral part of the development strategies and the policy briefs that are to be implemented on an annual level. Furthermore, they will be included in the annual programs that are implemented through the ministries, i.e., the agencies and other state institutions.

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