

In collaboration with the  
National University of Singapore



# Future Readiness of SMEs and Mid-Sized Companies: A Year On

INSIGHT REPORT  
NOVEMBER 2022



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# Preface

The business community is stepping up to tackle the biggest issues facing the world. SMEs and mid-sized companies are key enablers in this pursuit.



**Rashimah Binte Rajah**  
Lecturer, Department  
of Management and  
Organization, National  
University of Singapore  
Business School



**Olivier Woeffray**  
Practice Lead,  
Strategic Intelligence,  
World Economic Forum

The post-COVID-19 era is significantly more challenging than most people had initially hoped. Heightened geopolitical tensions, the energy crisis, supply chain disruptions, hyperinflation and extreme weather events are just a few of the difficulties that will make the next decade a demanding one.

Small- and medium-sized enterprises (SMEs) and mid-sized companies, perhaps more than any other companies, are at the frontline of these turbulences. Often eclipsed by their larger counterparts or by the latest high-tech start-ups, these hidden champions are often overlooked. Despite their challenging realities, there are important opportunities and

existing success stories of how smaller companies can step up to the challenges ahead.

This report sheds light on some key opportunity spaces for SMEs and mid-sized companies to pragmatically develop strategies and pathways towards increasing their future readiness. We also hope that this report helps change the perception many may have of these SMEs and mid-sized businesses. We aim to support leadership teams and the wider ecosystem in understanding how they can help increase the capacity for smaller companies to thrive and positively impact the economy and environment.

# Executive summary

SMEs and mid-sized companies have the potential to enable widespread growth, innovation and sustainability in global, regional and local economies.

Small- and medium-sized enterprises (SMEs) and mid-sized companies are the backbone of economies. They represent 90% of all companies and are responsible for close to 70% of jobs and GDP globally. Despite their tremendous collective impact, they are often challenged by economic shocks and turbulences in an environment that is not favourable for their survival and expansion. Indeed, many owners and executives of these smaller businesses must often choose to prioritize their immediate survival instead of being able to invest in business services and capabilities that can pay off in the longer term.

SMEs and mid-sized companies possess unique strengths that allow them to contribute greatly to the local and global economy. It is therefore crucial to examine how SMEs' ecosystems and growth capabilities can be improved to achieve success.

This report builds on the analysis of over 200 peer-reviewed articles and the quantitative and qualitative surveying of about 800 leaders and executives from SMEs and mid-sized companies as well as contributions from experts from the Forum's wider network. Here are some of the key learnings:

- Resilience and agility are two of the most important ingredients for these companies to thrive in a volatile and challenging environment. SMEs and mid-sized companies tend to be less resilient than their larger counterparts but display much higher levels of agility.
- Organizational changes, both big and small, require concerted efforts from leadership and members of the organization in a bid to achieve higher levels of future readiness. When the vision is well-understood, frameworks to initiate change can be executed faster in smaller companies than in larger firms.
- While SMEs and mid-sized companies can go a long way in building their future readiness in bridging the resilience gap, there is an urgent need for the wider policy environment, including policy-makers, investors and other stakeholders, to support their ability to thrive.

This report also aims to identify concrete areas of opportunities for SMEs and mid-sized companies to increase their future readiness. Below are some of the key recommendations that can be drawn from this research:

## **Boosting resilience:**

- Increased resilience can be achieved with a focus on successive stages of maturity, starting with the importance of authentic leadership, followed by the development of talent in the broader organization, and finally by focusing on the formalization of the business framework such as orientation, business model flexibility, networks, digital infrastructure and governance.

## **Framework recommendations to address top challenges of these companies include:**

- The development and implementation of a strategic approach to talent management.
- The successive rollout of digitization of processes, digitalization of products and services, and the digital transformation of business models.
- The implementation of specific sustainability measures depending on the company's level of maturity in this space.

## **System-level growth and digital trade:**

- Implementation of targeted measures aimed at harmonizing and driving interoperability of trade data across borders and supply chains can help smaller companies to trade internationally.

The World Economic Forum will be building on the insights generated in this report to further support SMEs and mid-sized companies in their future readiness journey. This will be achieved through the development and aggregation of additional resources, including the continuous development of the Forum's [self-assessment and benchmarking tool on future readiness](#), as well as the creation of a peer-to-peer community for smaller companies willing to learn and exchange best practices and connect with experts.

1

# Introduction

Stakes are high for SMEs and mid-sized companies, and how they perform will impact every sector of society.

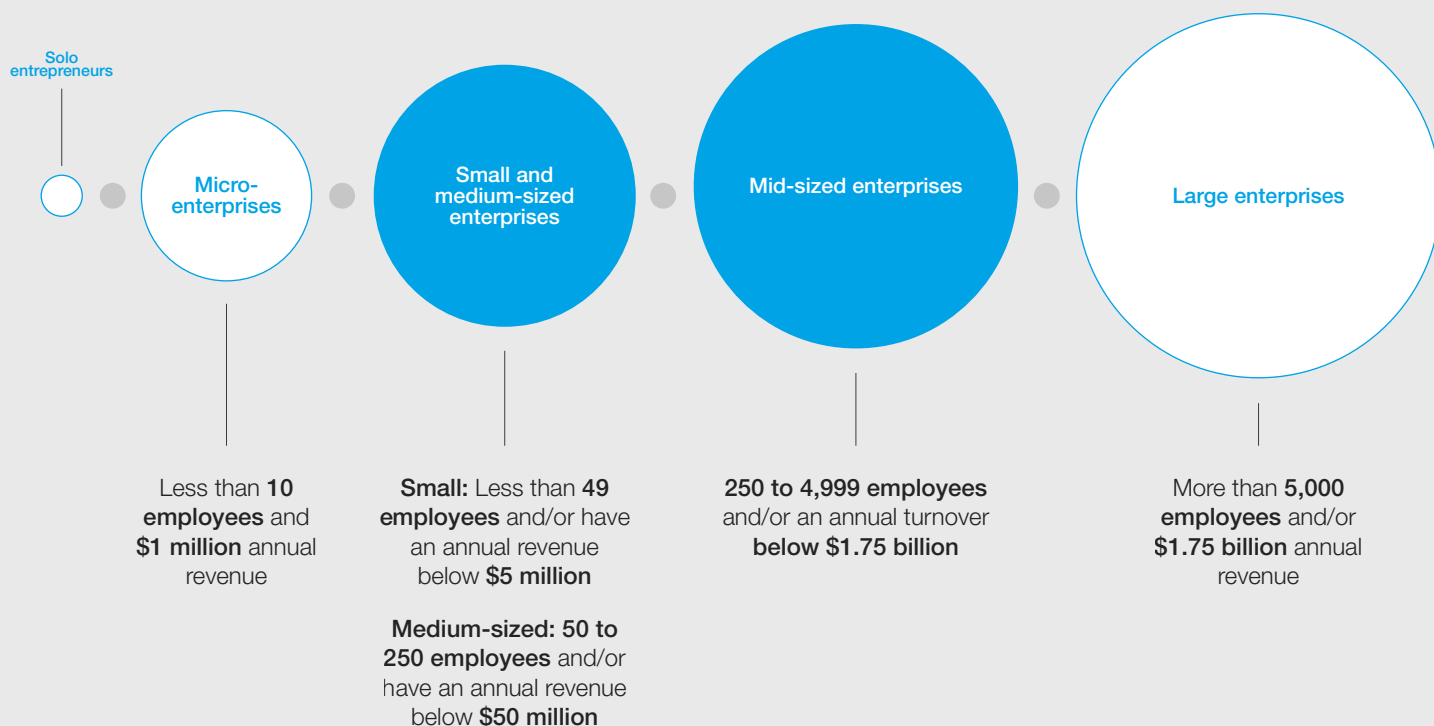


## 1.1 Why SMEs and mid-sized companies

Small- and medium-sized enterprises (SMEs) and mid-sized companies represent around 90% of all firms globally, provide roughly 70% of all employment and, by some estimates, contribute to up to 70% of

global GDP.<sup>1</sup> At an aggregate level, these businesses play a significant role in enabling, constraining and shaping the nature of growth, innovation and sustainability in global, regional and local economies.

FIGURE 1 Defining SMEs



Source: World Economic Forum

Given their collective weight, as well as their tremendous potential, ensuring SMEs and mid-sized companies are thriving and future-ready is fundamental. As defined in the first edition of the

*Future Readiness of SMEs* report,<sup>2</sup> future-ready SMEs should be able to generate long-lasting financial growth, positively impact society and the environment and achieve high levels of agility and resilience.

### What is future readiness?

Future readiness is defined as a set of capabilities and orientations that enable companies to thrive in the future. For SMEs and mid-sized businesses to be future-ready, they must be successful on the three pillars, which are at the forefront when considering challenges related to achieving high future readiness:



**Long-term growth:** Ability to generate lasting financial strength driven by innovative business models, products and/or services.



**Societal impact:** Ability to not only address both positive and negative potential externalities but most importantly, its business outcomes affect society positively in line with environmental, social and governance (ESG) goals.



**Adaptive capacity:** Ability to develop high levels of resilience and agility, enabling the company to bounce back in difficult times and to identify and seize opportunities as they emerge, and to create disruption in business models for the future.

## 1.2 On the front line of turbulences and shocks

Some estimates of small company closures as a result of COVID-19 go as high as a third closing down permanently from this shock.<sup>3</sup> Smaller companies also tend to be overrepresented in sectors that were most affected by COVID-19.

SMEs and mid-sized companies tend to be more financially fragile, have smaller cash buffers, weaker supply chain capabilities and lower uptake of digital tools and technologies.<sup>4</sup> This places them on the front line of various types of turbulence and shocks. While most observers initially talked about “a return to normal”, it is now increasingly clear that this sense of normality might be more of a reference to a distant past than a realistic expectation for the future. The “new normal” will mostly revolve around notions of volatility and uncertainty. Geopolitical tensions emerging from the Russian invasion of Ukraine, the subsequent energy crisis

and hyperinflation, coupled with the deeper and longer-term demand for sustainable innovation, climate change, rapid technological developments and social change, present new challenges. These challenges will linger for an unforeseen period and will continue to impact less resilient firms.

This volatile environment requires high levels of **adaptive capacity**. This includes the ability to bounce back in difficult times (i.e. resilience) and the ability to seize opportunities in line with an evolving market (i.e. agility). The capabilities of smaller firms in those two areas differ widely: smaller companies were less resilient but more agile than their larger counterparts.

SMEs and mid-sized companies have a significant opportunity to increase their levels of future readiness by focusing on increasing their resilience capabilities, while making the most of their existing high agility.



TABLE 1 | Adaptive capacity

| Resilience  | Agility   |
|---|---|
| In times of crisis, organizations require an excess of financial and social resources, termed slack resources. Compared to larger companies, smaller companies tend to have limited access to finances, skilled labour and infrastructure to help them stay afloat during crises. | Smaller companies tend to have fewer and more direct communication channels between departments and leaders. This allows them to react more effectively and quickly, pivoting to better cater to the current needs of the market. |

BOX 1 | Research sample

This year, an additional 441 companies participated in the survey, bringing the database to consist of about 800 SMEs and mid-sized companies' future readiness profiles.

The companies spanned different sizes:

- Small companies (less than 49 employees and/or have an annual revenue below \$5 million).
- Medium-sized enterprises (50 to 250 employees and/or have an annual revenue below \$50 million).

- Mid-sized companies (250 to 4,999 employees and/or an annual turnover below \$1.75 billion).

The companies came from major regions of the world and from across 21 different industries including but not limited to financial and professional services, education, agriculture, construction, commerce and public service.

2

## Top challenges

SMEs face major challenges. Some of them are already high on their agenda while others should be prioritized further.

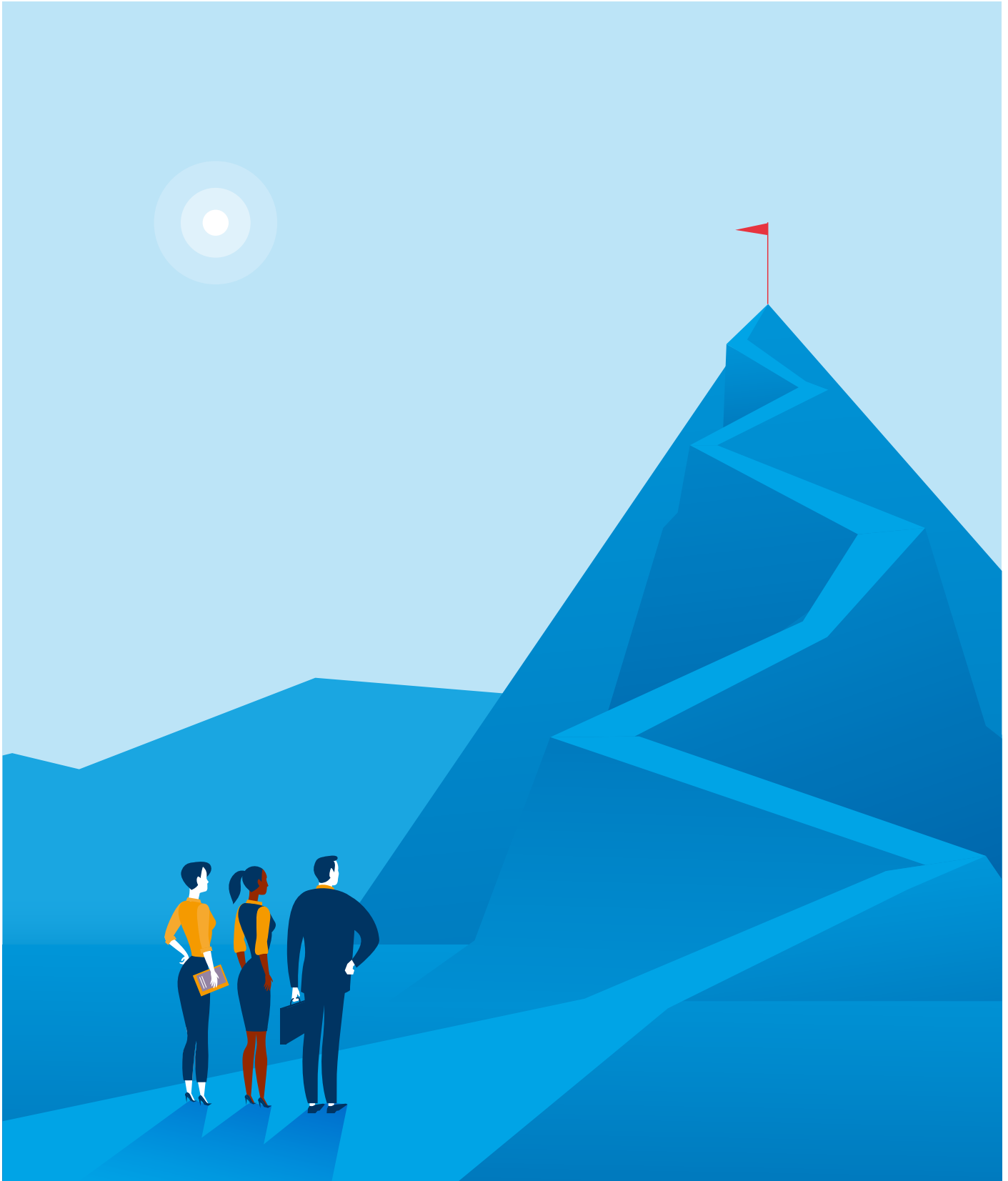
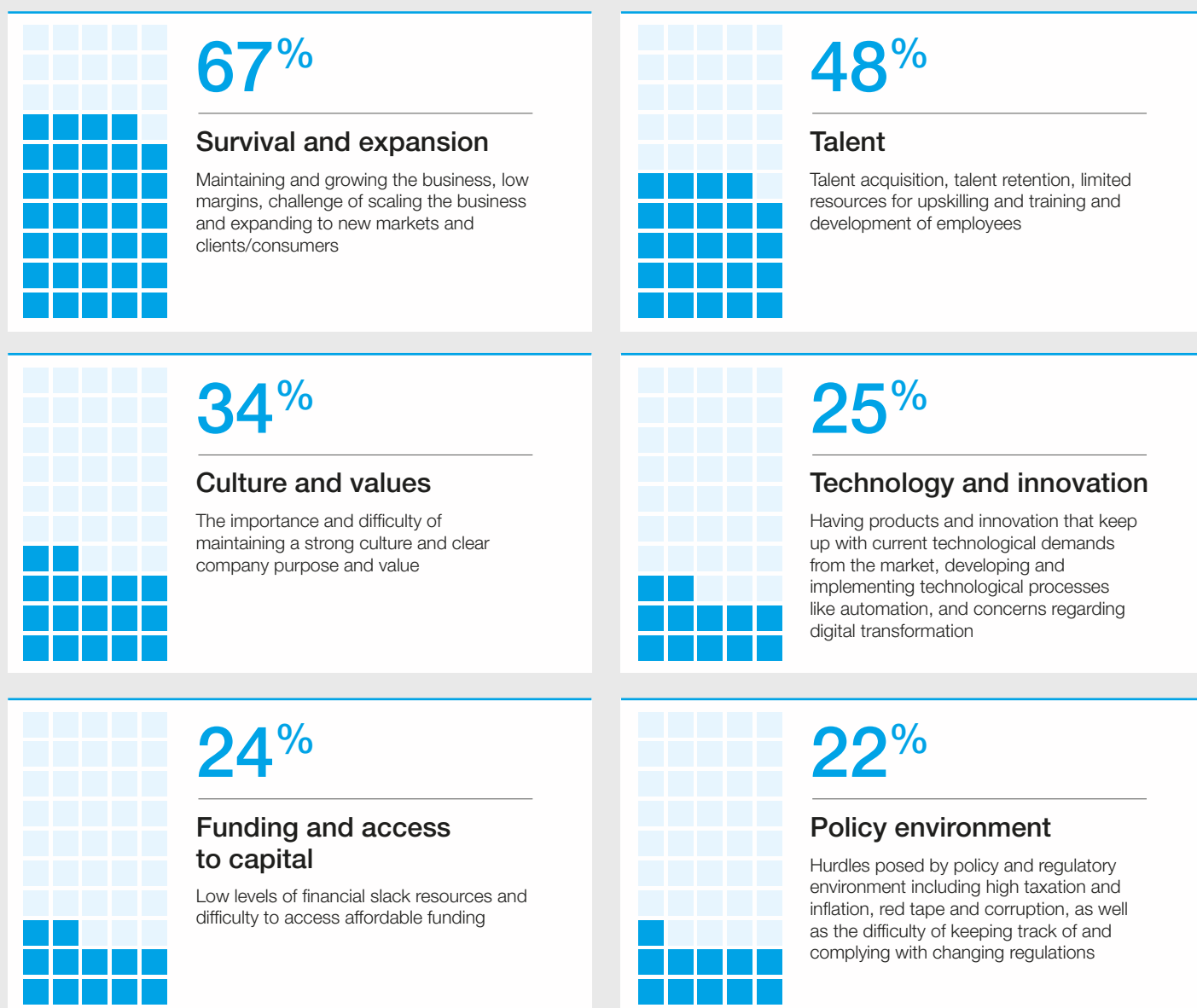




FIGURE 2 | Top challenges



Source: World Economic Forum

A recurring reality for SMEs and mid-sized companies is the overwhelming focus on the here and now. Decisions are often driven by existential challenges surrounding some of their core business fundamentals, such as survival, expansion, access

to capital and talent. While understandable, being on the front line often creates apparent tension and difficulty for leadership to place longer-term considerations on the agenda.

## 2.1 On the front line of turbulences and shocks

In 2022, survival and expansion (67%) and funding and access to capital (24%) remain top concerns. In 2021, barriers to entry, high operational costs, competition with larger corporations, informal economies and black markets were the key concerns curtailing growth and expansion. This year, there were additional concerns due to

new crises emerging in the world. Supply chain shortages and delays, retaining current clients, and keeping up and complying with new regulations were cited this year as challenges related to survival and expansion. Indeed, 22% of respondents identified less-than-favourable policy environments as a hindrance to reaching their goals.

While access to capital is fundamentally linked to survival and expansion, in 2021, networks were one of the key predictors of access to financial resources for smaller companies in particular. The diversity of these networks and the ability of the company to mobilize them at short notice strongly correlate with future readiness. SMEs and mid-sized companies that align their business purpose to the objectives of

investors and governments, often aimed at driving sustainability, can gain financial resources through investments and government grants.

However, access to finance is not only under the control of companies themselves. This requires broader alignment and a shift at the policy level, as explored in chapter 5 of this report.

## 2.2 Talent

“ While they have historically struggled to compete with larger corporations for talent, a shift of focus towards the subjective dimensions of work can make SMEs stand out.

In 2021, talent acquisition and retention topped the challenges among smaller companies' decision-makers, with 52.5% citing it as one of the three main challenges they have in their business. In 2022, at 48%, concerns about talent remain at a similar level of importance. Attracting the right kind of talent, and getting talent with the right skill set to stay in the company, still prove to be difficult. The trend of the Great Resignation is only making this more challenging.

According to a 2022 survey by Human Resources Online, more employees are resigning now compared to 12 months ago. Of the managers surveyed, 49% said that they were not finding it easy to deal with the Great Resignation. With the average training cost per employee to be the highest among small businesses,<sup>5</sup> motivating employees to stay in the organization is a top concern for SMEs

and mid-sized companies' business owners. With fewer financial resources, smaller companies are compelled to explore more subjective measures of job quality to attract talent, such as progression opportunities, well-being, work-life balance, purpose, flexibility and mentorship.

Important to note here is that SMEs have a specific competitive advantage they can make the most of to tackle this challenge. While they have historically struggled to compete with larger corporations for talent, a shift of focus towards the subjective dimensions of work can make them stand out. As further discussed in chapter 4.1 of this report, smaller companies tend to fare better than large corporations on the less tangible elements such as meaningful work, fulfilment, sense of purpose and closeness to decision-making.



## 2.3 Digital transformation and innovation

Digitalization and the adoption of digital infrastructure are crucial to the future readiness of companies. SMEs and mid-sized companies recognize that keeping up with technological and innovation demands is important, with 25% citing this as a top challenge. However, they might seem to be “playing catch-up” as they tend to lag on technology adoption and digitalization compared to larger peers.<sup>6</sup>

Results from 2022 also show that smaller companies tend to have less digital infrastructure, despite the ability to take advantage of this at relatively low cost. In analysing its impact on the three pillars of future readiness, digital infrastructure was found to be a significant driver for long-term financial growth and adaptive capacity but not for societal impact. This

could be because company initiatives that address environmental and social concerns do so traditionally without using technology (e.g. reducing their carbon footprint non-digitally, inclusive hiring, etc.). While a limited number of SMEs and mid-sized companies adopt technology to impact society positively, this has yet to become a widespread practice among smaller companies despite its huge potential and scalability.

There appears to be a lack of awareness of the potential of digital transformation for sustainable growth among the companies examined. Providing frameworks to increase digital transformation to simultaneously accomplish sustainability goals can be one way to “build in” future readiness, as addressed in chapter 4.2 of this report.



## 2.4 Sustainability

**Only 7%**

of decision-makers  
cite sustainability  
as a challenge

Sustainability was an overlooked topic, with only 7% of decision-makers surveyed citing sustainability as a challenge. Understandably, executives' top challenge revolves around traditional business fundamentals such as survival, expansion, access to funding and talent. However, this is in increasingly stark contrast to broader societal expectations. Stakeholders, from consumers, employees and investors, now hold businesses accountable for societal issues. According to the 2022 Edelman Trust Barometer, 59% of respondents believed businesses are not doing enough for climate change, and 49% said businesses are not doing enough for economic inequality. On the other hand, 58% would buy or advocate for brands based on their beliefs and values, 60% would choose a place to work based on their beliefs and values, and 88% of institutional investors would subject ESG to the same scrutiny as operational and financial considerations.

Despite the enormous societal impact that SMEs and mid-sized companies can collectively have, the Forum's research shows that they tend to rank lower on societal impact than other dimensions of future readiness. The major tension at play here lies between the limited resources and capabilities to undertake a deep sustainability pivot on the one hand and the advantageous position smaller companies have due to their high agility on the other. Engaging in digital transformation is one way SMEs and mid-sized companies can increase societal impact and sustainability efforts as explored in chapter 4.3 of this report. In addition, SMEs and mid-sized companies will need to understand their impact on the global supply chain and scope 3 emissions in the immediate future.

3

# Boosting organizational resilience

Strengthening organizational resilience can help smaller companies pave the way towards future readiness.



A core theme of this year's report revolves around resilience. As previously mentioned, this represents one of the major gaps or weaknesses of smaller companies in increasing their levels of future readiness. It is therefore vital that SMEs and mid-sized companies "build in" resilience and increase their chances of

survival in the short term while building their ability to respond to future shocks and disruptions.

This can be done by focusing on the "meta driver" of future readiness, people (leadership and talent), as well as on business frameworks.

“ While authentic leaders are necessary and strongly impact the future readiness of their companies, they are not sufficient.

## 3.1 People: leadership and talent as “meta drivers” of future readiness

### Leadership

Previous research has highlighted the importance of leaders who can develop and communicate strong and inspiring visions to drive a company's transformation. Further research on leadership highlights the specific attributes that this type of leader has, which resonate with authentic leadership. As conceptualized by organizational psychologists, authentic leadership refers to a leadership style that involves leading with a vision and values, self-awareness, self-regulation, positive modelling and encouraging authenticity from followers.<sup>7</sup> Authentic leaders empower employees, which subsequently motivates them to increase their efforts towards fulfilling the organizational mission.

The findings show that authentic leadership has a significant positive impact on all three pillars of future readiness. Authentic leadership is a strong predictor of long-term financial growth, societal impact and adaptive capacity.

However, while authentic leaders are necessary and strongly impact the future readiness of their companies, they are not sufficient. This is particularly true when taking the long view and considering what happens once the company leader hands over. This is also salient in the case of fast-growing companies with repeated changes in leadership. To ensure sustained growth of the company, the organization

needs to build in resilience by ensuring that the capabilities embodied by the leader are spread across the organization and become institutionalized through management, human resources (HR) practices and the broader company culture. This leads to the broader question of talent fit.

### Talent fit

Talent is to be understood as a major asset for smaller companies. In this context, the “right” people believe in the company's purpose, work collaboratively with others and have complementary qualities like resourcefulness and passion in fulfilling their roles. This is not to say that people are not viewed as an asset in larger companies, nor are skills completely unimportant in relation to talent fit; however, with the lack of financial resources to offer competitive salaries and incentives, it is even more crucial for smaller businesses to hire and train the right people. They must appeal to values and provide an environment aligned with these values.

Smaller companies also tend to be more open to hiring less-qualified people who demand a lower compensation package. This is driven by the belief that hard skills can be developed while cultural fit is more difficult to influence. The smaller the size of the organization, the more important are factors related to talent fit considered in recruitment.

FIGURE 3 The importance of talent fit by company size

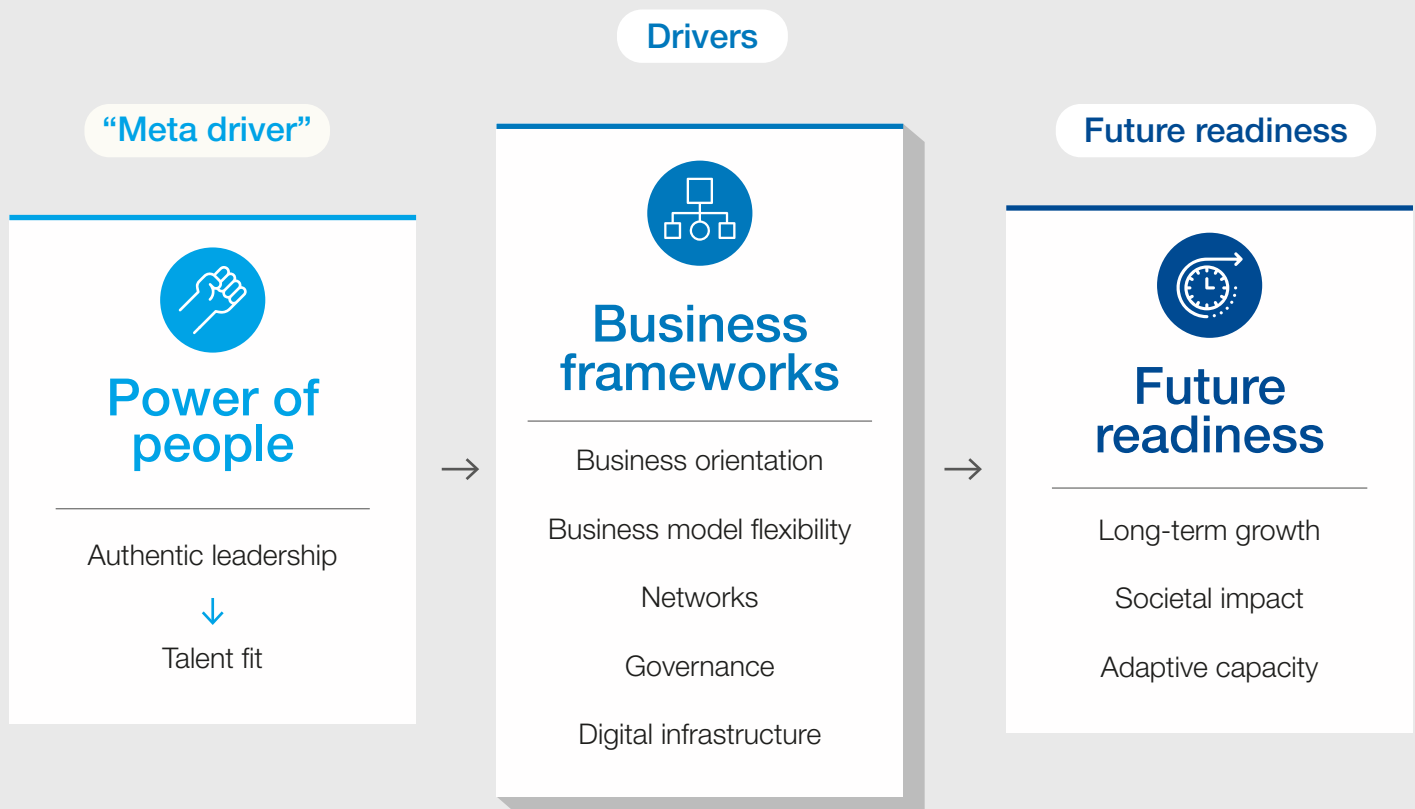
Scores out of five reflect the level of importance that talent fit has in different company sizes



Source: World Economic Forum

## 3.2 Business frameworks

FIGURE 4 Drivers of future readiness



Source: World Economic Forum

“ Respondents in the survey tended to face difficulty in responding to governance-related questions. The lack of clarity on this dimension likely indicates that governance is seldom discussed or consciously practised in the company.

While leaders and talent significantly impact the future readiness of smaller companies, their positive effects diminish when considering or developing business frameworks such as orientation, business model flexibility, networks, digital infrastructure and governance.

Building on work done by the Forum,<sup>8</sup> governance includes five dimensions:

1. Governing purpose and strategy
2. Quality of governing body
3. Stakeholder engagement
4. Ethical behaviour
5. Risk and opportunity oversight

These dimensions cover theoretical aspects of governance like strategy and analysis of risk and opportunities, as well as practical aspects like ethical behaviour, quality of the governing body and stakeholder engagement. Practical components include training on the company’s anti-corruption

policies and procedures, formal procedures to address results from stakeholder engagement, designated teams and/or individuals for appropriate follow-up, and executive compensation tied to the company’s social and/or environmental performance.

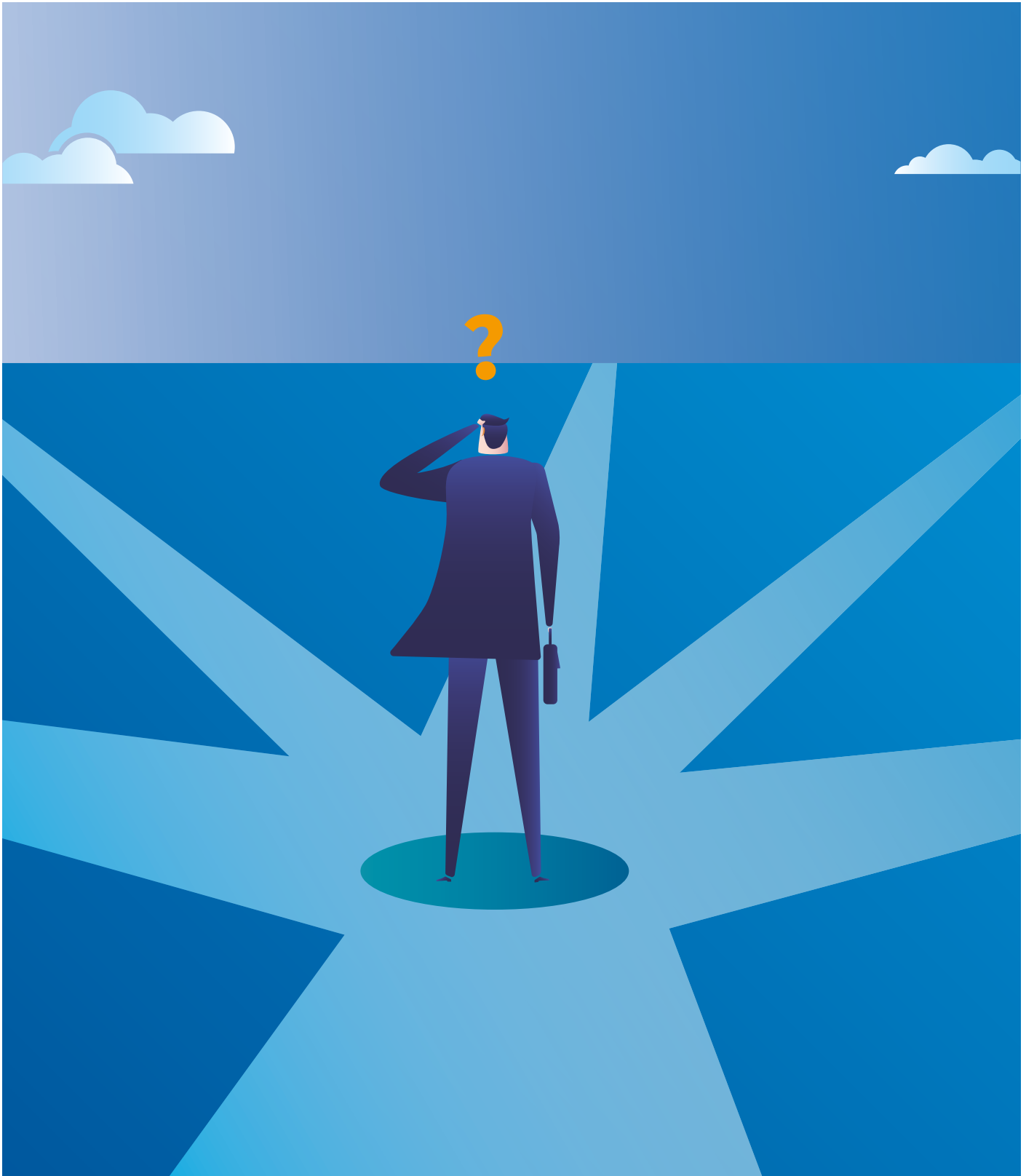
Respondents in the survey tended to face difficulty in responding to governance-related questions. The lack of clarity on this dimension likely indicates that governance is seldom discussed or consciously practised in the company. Governance might be an implicit part of management or a coincidental by-product of the company’s value-creation process. However, using governance as an explicit business strategy is generally new territory for SMEs and mid-sized companies.

This is important to address as governance is a significant driver of future readiness, especially for societal impact. Taking into account the collective impact that smaller companies can have on sustainability and the mounting pressure from consumers, investors and regulators alike, companies can benefit from clearer governance frameworks, among other business frameworks.

4

# Future readiness pathways

Overcoming major challenges using SMEs' competitive advantage.



What are some pragmatic and high-impact pathways for companies to boost their future readiness? This research highlights three core opportunity spaces to kick off this journey: talent management, digital transformation and

a sustainability pivot. This section explores how SMEs and mid-sized companies can get into those different spaces and move towards future readiness by using higher agility as a competitive advantage.



## 4.1 Attracting and cultivating talent

A talent deficit  
could result in  
**\$8 trillion**  
of unrealized annual  
revenue by 2030

Accessing and retaining talent is one of the most pressing challenges facing companies of all sizes. With the massive growth in industry and new innovative technologies requiring specialized knowledge, the demand for talent is quickly outpacing the availability of those with the right skills and experience. A report by Korn Ferry estimates a talent deficit of 85.2 million workers worldwide by 2030, which could result in over \$8 trillion in unrealized annual revenue.<sup>9</sup>

Companies are already feeling the heat from this “talent challenge”, and as they emerge from COVID-19, their ability to survive economic shocks relies on their agility and resilience. According to ManpowerGroup’s Global Talent Shortage study, 75% of companies worldwide reported challenges

accessing the talent they need in 2022 (up from 38% in 2015).<sup>10</sup> This gap is not only in hard skills but also soft skills; according to the study, self-discipline, adaptability and problem-solving are among the most in-demand soft skills globally.

While large and small companies are grappling with their talent management strategies, the stakes are often higher for SMEs and mid-sized companies as they rely heavily on a smaller number of employees to keep things moving and struggle to recover when key employees resign. Thankfully, alongside this growing challenge, new research and guidance have emerged that clarify the specific constraints facing SMEs and how these companies can make the most of their size, flexibility and informality to their advantage when competing with large firms.

### 4.1.1 Opportunities and strengths for SMEs and mid-sized companies for talent

Research on human resources and talent management approached the topic from the perspective of large firms. However, SMEs and mid-sized companies cannot be understood simply as smaller versions of large companies. Rather, they have unique demands of and relationships with their employees.<sup>11</sup>

Below are three ways in which SMEs’ talent needs and challenges differ from large corporations:

**1. SMEs and mid-sized companies require highly adaptable employees** who can play multiple roles within the organization and take on tasks not included in their job description.<sup>12</sup> SME employees are less tied to a specific job function and more to the fast-changing needs of the organization, particularly in growth-oriented firms that frequently adjust strategy. This is reflected in the way smaller companies recruit new talent:



a study in the United States corroborates the Forum's findings above in finding that SME leaders prioritized general competencies and person-organization fit over backgrounds and skillsets that perfectly meet a job description.<sup>13</sup>

2. **SMEs and mid-sized companies have less formalized human resources practices**, and, in the early stages, the company's approach to talent commonly reflects the culture of the organization and the philosophy/approach of the Chief Executive Officer (CEO) or founder.<sup>14</sup> This may play out in various ways; for example, SMEs may be less likely to track quantitative indicators of performance or offer formal performance reviews given the more consistent communication and closer proximity between supervisors and staff.
3. **SMEs and mid-sized companies are less visible in the labour market and struggle to compete in wages and benefits.** Information about job openings in large firms is easier to find for job

seekers, in part because large firms have dedicated personnel and financial resources for recruitment and branding efforts. Large firms are also able to partner with universities seeking placements for graduates. SMEs, on the other hand, can use their existing staff and trusted networks to access promising talent, reducing search costs (though this works best in firms seeking more general capabilities over technical or specialized skills).

For SMEs and mid-sized companies to maximize their ability to recruit, develop and retain high-functioning employees, they need to be pragmatic, recognizing what they can and cannot offer. Job quality comprises both objective dimensions, such as compensation and working hours, and subjective dimensions, such as employee satisfaction and fulfilment. SMEs typically score lower in objective measures of job quality.<sup>15</sup> However, employees of SMEs report higher-than-average job satisfaction, likely attributable to closer proximity to decision-makers and a greater sense of purpose in their work.<sup>16</sup>

TABLE 2 Objective and subjective measures of job quality

| Objective measures of job quality | Subjective measures of job quality                   |
|-----------------------------------|--|
| Wages                             | Employee fulfilment                                  |
| Job stability and security        | Professional development                             |
| Working hours                     | Employment-related relationships and work motivation |
| Social protection and insurance   | Employee satisfaction with wages/pay                 |
| Voice and representation          | Discrimination and equality                          |
| Occupational health and safety    |  |

Source: Hume, V. et al., *What We Know About: Job Quality within Small and Growing Businesses*, Aspen Network of Development Entrepreneurs, 2021.



## 4.1.2 Talent management recommendations

For decades, business managers and researchers have placed the burden of hiring, managing and retaining employees within the administrative function of HR. However, in more recent years companies of all sizes have begun embracing the concept of talent management (TM), which prioritizes those skilled employees best fit to contribute to a company's growth and competitive advantage.<sup>17</sup> TM pulls a company's approach to employment out of the realm of administration

and integrates it into the businesses' strategy highlighting the necessity of talent to achieve company milestones.

To improve their talent management, SMEs and mid-sized companies should focus on the areas in which they have a comparative advantage. The following highlights several research-backed takeaways smaller companies can use to improve their talent recruitment, development and retention.



### SMEs and mid-sized companies should align their strategic goals with the profiles of those they wish to hire and promote

As noted in Village Capital's talent playbook, "The #1 mistake we see CEOs make is hiring for the stage they are at, not the one they want to reach".<sup>18</sup> They also find that investors recognize the talent challenge and consider a company's talent strategy seriously when making investment decisions.

The talent playbook recommends that companies ask themselves seven questions when considering hiring new staff:<sup>19</sup>

- What are the five big things you need to accomplish in the next 18-24 months?
- Which skills are associated with each?
- Which skills exist internally? Which skills do you need to find? (New hire, adviser, investor)
- Approximately, when will you need these skills?
- What kind of background/experiences could provide the skills needed?
- What perspectives do you need on your team to achieve business milestones?
- What would success look like in this new position?

#### BOX 2 The COVID-19 effect

During the COVID-19 pandemic, companies were pushed to digitalize their work models and employment structures. Albeit challenging, this push away from in-person work has some major advantages. Employees have long been asking for more flexible work and remote work options, and systems are now largely in place to allow for this.

Digitalization has also opened new pathways to access talent, relieving constraints for SMEs in areas with limited access to employees with particular knowledge or skillsets.<sup>20</sup> Outsourcing also has cost advantages for resource-strapped companies by taking advantage of lower standard wages in locations of remote workers, where applicable.

## Play on strengths: The subjective aspects of job quality

### 1. Prioritize and communicate organizational culture and values

As previously discussed, the vision and leadership of the founder or CEO play a significant role in employee commitment and retention. When asked what sets companies apart in their ability to recruit high-quality talent, entrepreneurs and investors often point to the role of the CEO, with some firms even including an interview with the CEO as part of every hire.<sup>21</sup> Companies should also recognize the power of their “story” (incorporating the company’s mission, founding story and future direction) in recruiting potential candidates and motivating their teams.

Brazilian software company Omie exemplifies this lesson. In nine years, the company has grown from under 40 to over 1,000 employees and has kept culture at the centre of its growth strategy. The founder, in partnership with the executive team, identified six key values that guide the company in all areas, including its talent management. These include passion, trust, entrepreneurship, execution, perpetual learning and “the journey matters”. The values guide the company’s talent management from recruitment (where employees are assessed for cultural fit in their interview process) to development (staff are awarded for exemplifying values). The values are drawn on the walls of the office and shared in a monthly webinar in which the CEO recounts the founding story and company journey to date for all new recruits.

### 2. Use informality to your advantage

With often informal HR practices, smaller companies may feel they do not have the tools or resources for talent management. However, studies have found that prioritizing employee engagement and commitment over more traditional HR practices can increase a firm’s financial performance.<sup>22</sup> A meta-analysis of HR practices on SME performance similarly found that “HR practices that enhance employee autonomy, decision-making involvement and responsibility levels are generally more important in the SME context than directing employee behaviour through oftentimes costly incentives and rewards”.<sup>23</sup>

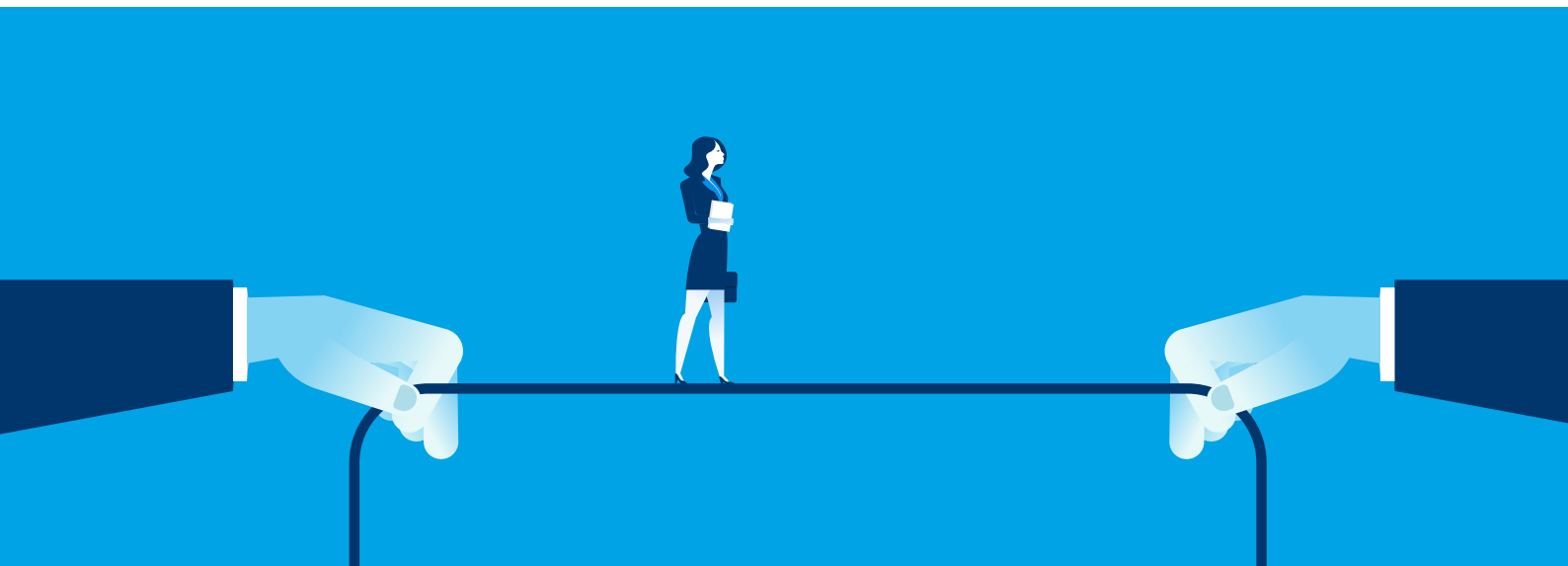
Kenyan sanitation company Sanivation, a roughly 60-employee company operating city-wide sanitation solutions for secondary cities in Africa, exemplifies how SMEs can use HR systems to enhance, rather than replace, the interpersonal engagement enjoyed by employees at smaller companies. Sanivation considers a company culture healthy when people feel free to speak up, bring ideas across the board and make mistakes. The founders and CEOs also maintain an open door policy so that anyone in the organization, no matter their level, has the ability to meet one-on-one with company leadership.

“ Companies should also recognize the power of their “story” (incorporating the company’s mission, founding story and future direction) in recruiting potential candidates and motivating their teams.

## BOX 3 Psychological safety

Psychological safety refers to an environment where it is safe for members of the organization to voice their ideas and opinions without judgement or consequences. In a psychologically safe environment, employees are allowed to take risks

while being able to admit mistakes and learn and progress together. The Forum’s results support that authentic leaders help create this environment of psychological safety, which has positive organizational impacts on future readiness.



“ Research has found that SMEs and mid-sized companies that seek the right employee-company fit have more hiring success than those focused on filling a job description perfectly.

**3. Prioritize employee-organization match as much (or more) as skills and experience**  
Research has found that SMEs and mid-sized companies that seek the right employee-company fit have more hiring success than those focused on filling a job description perfectly. Once hired, smaller companies should ensure that employees have avenues to take part in company decision-making and interact with leadership as an incentive to develop and grow with the company. Village Capital considers this part of a company's employee value proposition (EVP) which clarifies how the company's values translate to programmes and benefits for employees. Having a clear EVP not only helps with employee retention but also inspires current employees to act

as ambassadors of the company to external stakeholders and potential new hires.

To develop an EVP, Rippleworks recommends that companies:

- Understand what current employees see as value in the company
- Define core values and the promises made to employees
- Highlight what is currently offered (programmes, benefits, traditions) that build upon values
- Brainstorm new benefits and programmes that can be created upon those core values.

BOX 4 **A note on compensation and benefits**

While SMEs and mid-sized companies cannot realistically meet the wage offerings of large firms, smaller companies can still think creatively about how to adequately compensate their employees. In its infancy, Omie found that benefits such as healthcare were equally valued by employees and

could make up for lesser salary offerings. To be competitive in the market, Sanivation offers employees shares in the company, which serves as both a monetary incentive and a sense of sharing in the company's success.

**Prioritize upskilling and upward mobility**

A study from Deloitte found that the most common reason for an employee to consider leaving a company is the lack of career progression.<sup>24</sup> With internal promotion being the most time and resource-efficient way to fill positions and an average recruitment period for management positions of at least 3-6 months,<sup>25</sup> SMEs should start thinking early about how to prepare their staff for advancement. Talent Diagnostic, an online survey tool by management consulting and financial advisory firm Open Capital, outlines several practical approaches companies can take to clarify and

communicate career growth paths, emphasizing opportunities for both lateral and upward mobility.

There is an important role that business support providers can play in equipping SMEs and mid-sized companies to build quality training and development initiatives through financial and technical support. Smaller companies should also consider external trainers when peer-to-peer learning is insufficient, such as sales training for retail employees or hospital management for healthcare companies.

TABLE 3 **Attributes of a “growth-based” career path culture**

|                       | Practical approaches   |
|-----------------------|--|
| Adaptable paths       | <ul style="list-style-type: none"><li>– Provide several flexible career paths that offer engaging experiences to attract and retain talent, e.g. organizations need to create paths for individual contributors who do not aspire to become managers</li><li>– Embrace ongoing collaboration with employees to arrive at solutions that fit the business needs and individual employee aspirations</li></ul> |
| Employee advancement  | <ul style="list-style-type: none"><li>– Reward high performing employees with meaningful promotions</li><li>– Provide opportunities for employees to work in other countries</li><li>– Advancing career prospects is crucial in emerging markets where job titles and ranks carry significant cultural value</li></ul>   |
| Guidance and planning | <ul style="list-style-type: none"><li>– Create awareness about existing opportunities within the organization using mentorship programmes and job boards</li><li>– Guide employees in crafting their own career paths in the organization through flexible development paths e.g. generalists and specialists</li></ul>  |

Source: Talent Diagnostic, Open Capital.

## 4.2 Driving digital transformation

In combination, the implications of the rise of digital technology, the associated knowledge economy, world trade reorganization and the climate crisis have not only led to ever-shorter product and design life cycles, but also to faster technology and innovation cycles. New firms (i.e. start-ups) are often the driving force of such radical changes. Especially with technological innovations highlighted to shape the global sustainability agenda,<sup>26</sup> companies find themselves under historically severe innovative as well as competitive pressure.

Two types of smaller companies exist. On the one hand, incumbent SMEs suffer from their entrenched structures, rigid mental models and

path dependency. Such peculiarities can inhibit their ability to respond to new disruptive threats. On the other hand, non-incumbent SMEs may have the advantage that their structure and culture are still in development. However, they suffer from even more constrained resources and a lack of reputation and credibility as compared to their incumbent counterparts.

With the increasing speed and intensity of changes in the market environment, the “traditional” types of technological innovation are no longer sufficient to remain competitive. This is reinforced by the fact that technological innovation often requires a significant investment of resources and time.

### 4.2.1 Opportunities and strengths for SMEs and mid-sized companies for digital transformation

“ Smaller companies have specific advantages over large corporations in gathering, analysing and operationalizing necessary information and data for digital innovation and transformation.

Despite the undisputed importance of digital transformation, the phenomenon is still largely neglected in the practice of SMEs and mid-sized companies. To date, the growing interest from SMEs and mid-sized companies has focused mainly on applying digital technologies to enhance products and services, but the application of digital tools to enhance production and service delivery is often overlooked.<sup>27</sup> As highlighted earlier, there is also the potential to use digital technologies to pursue the sustainability agenda.

While large companies may have resources for research and development in innovations mentioned above, it is important to highlight here that smaller companies have specific advantages over large corporations in gathering, analysing and operationalizing necessary information and data for digital innovation and transformation. In SMEs, there tends to be a natural overlap of activities

and tasks from departments or business units compared to larger companies with various isolated departments and branches. Information exchange and knowledge transfer thus occur more organically in smaller companies, which is also essential for laying the ground for the digital innovation of processes, products/services or business models.

Nevertheless, it may be challenging for SMEs and mid-sized companies to either develop their established employees (e.g. AI-related skills and competencies) or find and recruit new digital talents. The latter may be a huge problem, especially for SMEs located in rural regions. SMEs and mid-sized firms can outsource this work, as highlighted earlier in the chapter on talent management. For this, management needs to first understand the framework for enacting digital transformation to analyse where they can make the most out of their currently available strengths and where they might need additional resources.

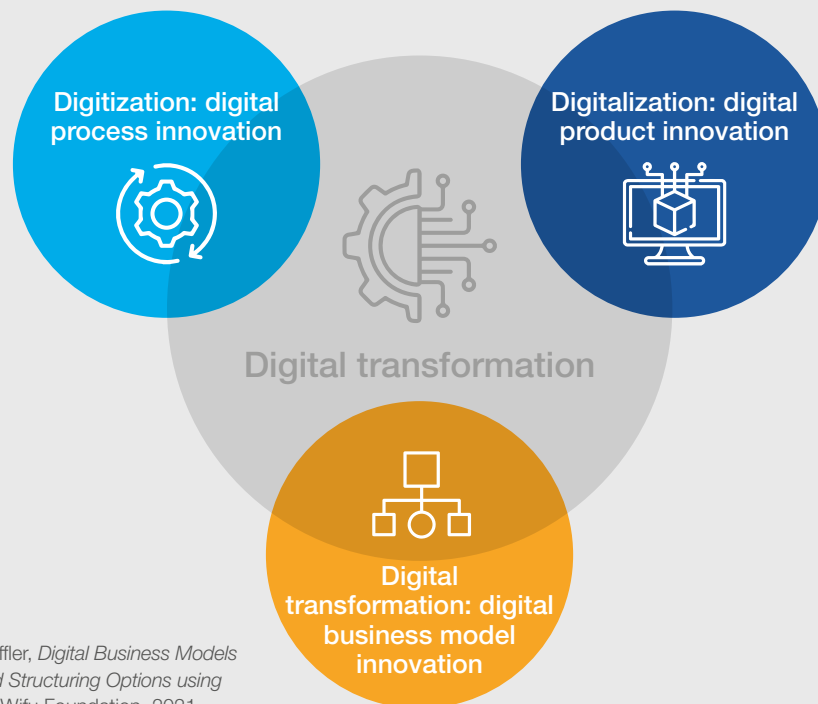


## 4.2.2 Digital transformation recommendations

As a starting point for smaller companies concerned with how to begin their digital transformation process, the following framework could serve as a guide. The framework also enables us to take a holistic view of digital transformation by breaking it down into its major elements:

1. Digital process innovation, i.e. digitization
2. Digital product/service innovation, i.e. digitalization
3. Digital business model innovation, i.e. digital transformation.

FIGURE 5 Digital transformation recommendations



**Source:** Clauß, T. and M. A. Scheffler, *Digital Business Models in Family Firms - Systemisation and Structuring Options using Case Studies from 4 Family Firms*, Wifu Foundation, 2021.

### Digital process innovation (digitization)

The first phase comprises all measures that are associated with the digitization of the existing infrastructure with the aim of saving costs. This phase is usually referred to as digitization. Digitization at this level predominantly refers to electrification, i.e. the conversion of analogue information into digital formats. At this level, the digitization of work processes occurs through information technology (e.g. digital inventory management).

This requires, first of all, full transparency of information and data on a company's value creation process. For example, much of the industry knowledge at Dorfner, a German industrial mid-sized company that transformed its business model by integrating data and AI, was stored either in their long-term employees' minds or spreadsheets. In a structured innovation process in collaboration with UnternehmerTUM, the Center for Innovation and Business Creation at the Technical University of Munich, it was proposed that data about chemical formulations could be gathered and organized in a database, and AI could be applied to that data

to help with reformulations. The results of these reformulations would serve as alternatives for the business to be more sustainable. Indeed, not only does digitization support sustainability goals through more efficiencies, but it also frees up more resources and capabilities for the company to engage in other sustainability and value-creating projects.

In this process, Dorfner initially thought that it would have to build its own AI software platform. However, it found a Silicon Valley company that had already built an AI platform for the materials and chemicals industry. By using existing resources and network connections, Dorfner uses AI to run simulations and can now offer a new formulation service to their clients around the globe.

Taking advantage of existing products was also observed in India, where FinoAllied, an AI-powered conversational banking platform that comes with built-in banking services and transactions, can be integrated with the various digital channels of small and mid-sized banks in India to be offered to customers.<sup>28</sup>



“ Although digital transformation serves as a way for smaller companies to cut costs, it can also play a huge role in sustainability efforts.

## Digital product/service innovation (digitalization)

The second stage, digitalization, is not about the digitization of existing processes, but rather a fundamental redesign or significant enrichment of these processes. The focal areas here are the intersections with customers, suppliers and distributors. This level also includes the digitalization of existing products and services as well as the development of digital product and service innovations.

At Dorfner, the new strategy is also expected to allow the company and its clients' products to become greener by digitalizing its own products and associated service offerings. For instance, it is starting to offer its clients AI-based recipes for functional fillers in paints that are cheaper and more sustainable.

## Digital business model innovation (digital transformation)

The third and final phase is that of the actual digital transformation through a holistic transformation of the company and the development of a digital business model. The measures taken here trigger fundamental, possibly disruptive changes to existing value creation approaches and, under certain circumstances, challenge the existing business logic of a company. This phase aims to generate long-term competitive advantages or respond to acute threats posed by digital business models of new competitors.

In the case of Dorfner, the first and most important thing for the CEO was to forge a digital strategy. The strategy is based on two pillars: sustaining innovations at the core business and introducing radical innovations outside current markets. While the ideation process is important, it is not sufficient. “Access to a network and talent is crucial to innovating outside the core business,” says CEO Mirko Mondan. “When you are from an old economy business you can't just transform the

whole organization and hire the right tech people,” he says. “You need to tap into a network”.

To realize the innovation and digital strategy, Dorfner did not just sign up a few key executives. It chose people from across its business whom management believed would become good change agents of the (digital) transformation and then instructed each of them to tell five people in the company what they had learnt along the journey.

To meet the planned growth path of the SME, new sources of value had to be developed to extend the existing business and tap new sources of revenue. This included the need to unlearn how things were done. The company's definition of innovation was rebuilt. Rather than just focusing on new products, the company started building entirely new business models or process innovations. Dorfner's journey is an example of how traditional, family-owned SMEs can successfully use digital technologies to remain relevant and competitive.



## Digital transformation hand in hand with sustainability

Although digital transformation serves as a way for smaller companies to cut costs, thereby allowing reinvestment of saved costs to other revenue-generating projects, digital transformation can also play a huge role in sustainability efforts. For example, in their bid to be more sustainable, some companies can use the digitization of processes to identify sources of waste and reduce them. As explored in chapter 4.3, one way that SMEs and mid-sized companies can make a sustainability pivot is to use technology in the context of a circular economy.

Digital products reduce negative impacts on the environment. For instance, paperless finance saves paper and reduces emissions from logistical arrangements to transport them. This is discussed more extensively in chapter 5. There is huge potential for smaller companies to take advantage of digital transformation for long-term growth and increased societal impact. To support this endeavour, the company and policy environment also need to provide the direction and infrastructure required for this journey to be successful.

### 4.2.3 Recommendations for business leaders

“ Smaller companies can take advantage of their quicker communication channels and close relationships to initiate and execute digital transformation at a faster rate than larger corporations.

Digital transformation is a holistic process that encompasses all three dimensions, which are strongly interdependent.

- Set up and run digital business models with a clear digital strategy.
- Appoint a spokesperson to mobilize every employee from the beginning, and invite everyone interested to join. Steps for digital business transformation need to be effectively communicated and understood by employees.
- Digitize information to create necessary data, which can in turn be used to improve process efficiency. This can lead to more available capacities to perform other tasks, e.g. create more value for customers, pursue sustainability goals, etc.

- Collect relevant data and ensure data transparency to drive product or service innovation. For example, installing sensors and analysing data from sensors can allow machines to operate more efficiently (e.g. by using data to reduce mistakes and to change algorithms to optimize processes).

While overcoming inertia and motivating employees for change can be difficult, this is also where smaller companies can take advantage of their quicker communication channels and close relationships to initiate and execute digital transformation at a faster rate than larger corporations. Employees in SMEs and mid-sized companies also tend to have deep institutional knowledge and might thus be aware of the areas of potential improvements through digital innovation and can implement new digital solutions faster.

### 4.2.4 Recommendations for policy-makers

Start-ups, SMEs and mid-sized companies should be able to assert themselves in the market independently, but they also need good framework conditions from policy-makers.

- Invest in digital infrastructure. This also includes having a cohesive national strategy to combat cybersecurity issues that can otherwise hamper digital transformation in companies.
- Policy-makers should address the energy crisis. The German Association of Small and Medium-Sized Businesses (BVMW) researched over 1,100 companies and found that SMEs and

mid-sized companies are struggling with rising gas and electricity costs.

- Smaller companies can also benefit from reduced bureaucracy. BVMW's study also found that 80% of SMEs are calling for a reduction in bureaucracy and deregulation to simplify procedures. Easing processes for the digital transformation of companies can aid them in offering digital solutions and using technology to increase efficiencies in the business model and supply chain, all in all contributing to the sustainability agenda.



## 4.3 Pivoting to sustainability

⚙️ **Manufacturing SMEs are reported to account for 64% of air pollution, whereas only 0.4% of these SMEs comply with an environmental management system.**

It is estimated that SMEs and mid-sized companies collectively contribute up to 70% of global pollution. Especially manufacturing SMEs are reported to account for 64% of air pollution, whereas only 0.4% of these SMEs comply with an environmental management system. SMEs are responsible for more than 50% of the industrial pollution in the Asia-Pacific region. As per the UK environmental agency report, eight out of ten pollution incidents are caused by smaller companies.

According to the reports launched after the COP26 UN Climate Change Conference, the target of every country to become carbon neutral by 2050 is not achievable unless SMEs and mid-sized companies become part of carbon reduction plans by larger corporations. While many large organizations have launched sustainability and low-carbon initiatives, these are still either uncommon or yet to mature in SMEs. The procurement and supply chain management processes of larger institutions increasingly consider SMEs and their carbon footprints as part of their net zero ambitions.

SMEs often struggle to achieve the right trade-off between economic, environmental and social performance, which can be attributed to:

1) environmentally friendly practices are capital intensive, 2) limited awareness of which practices to implement and how to implement them, 3) limited understanding about the impact of these practices on sustainable business performance, and 4) capital, workforce skills and resource constraints.

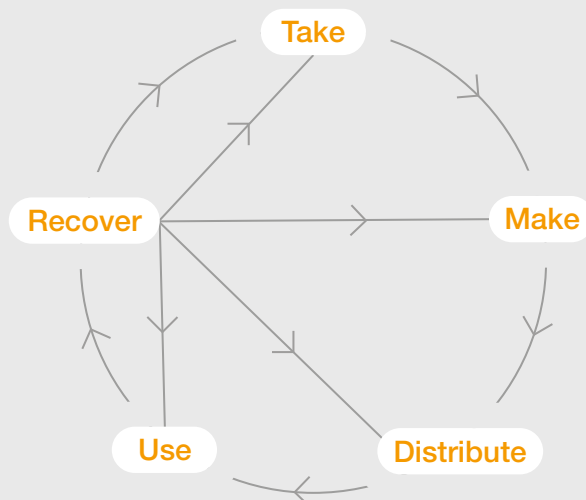
In this context, circular economy (CE) oriented business models have received immense attention in academic and practitioners' literature, due to their potential to reduce this perceived trade-off between economic performance and sustainability. More specifically, a circular economy is seen as a smart way to optimize energy usage and resource efficiency across supply chain processes, and effectively use recycling, remanufacturing and materials reuse, which will also lead to enhanced environmental performance, profitability and revenue generation opportunity. For instance, it is expected that CE adoption in the European Union could stimulate economic growth (an additional 0.5% of GDP) by creating jobs (700,000 in the EU by 2030), increasing virgin materials management and energy efficiency,<sup>29</sup> and helping reduce global greenhouse gas emissions by 39%.<sup>30</sup> This would fulfil the United Nations' Sustainable Development Goals (SDGs) 7, 8, 9, 12 and 13, and climate action plans.

FIGURE 6 Linear vs circular business models

### Linear business model



### Circular business model



Source: World Economic Forum

### BOX 5 Circular economy definition

A circular economy is an alternative to a traditional linear business model (make, use, dispose) to circular (take, make, distribute, use and recover) in which resources are kept in use for as long as

possible. Their maximum value is extracted while in use, after which products and materials are recovered and regenerated at the end of each service life.

### 4.3.1 Opportunities and strengths for SMEs and mid-sized companies for sustainability

Top barriers to sustainability practices, and CE in particular, include macro (contextual environment), meso (transactional environment) and micro (within the company) level considerations. At the macro level, stakeholders, including policy-makers, regulators and supplier chain partners, possess limited knowledge and lack clear guidelines for implementing sustainability practices. There is also a lack of CE know-how and proper quality green project standards management. At the meso level, a rapidly changing technology landscape means that smaller companies find it increasingly difficult to understand which technologies they should adopt for sustainability and how to adopt them.

At the micro level, organizations struggle with economic considerations as sustainability efforts are often linked with high investments in R&D, transition costs and added costs to production. A lack of experience in sustainability initiatives hinders management and employees from integrating sustainability into their daily business practices.

However, there are opportunities to be considered. At the macro level, policy-makers in developed and developing economies have introduced various

initiatives such as carbon pricing and taxing, ESG audits, financial access and credits to buy eco-friendly conversion technologies, and transnational partnerships for knowledge exchange (such as the EU-India circular economy partnership).

At the meso level, implementing low-carbon practices and strategies through CE adoption within SMEs will facilitate energy and resource efficiency. This will enhance their economic performance, creating jobs within the community and positively influencing the national economy.

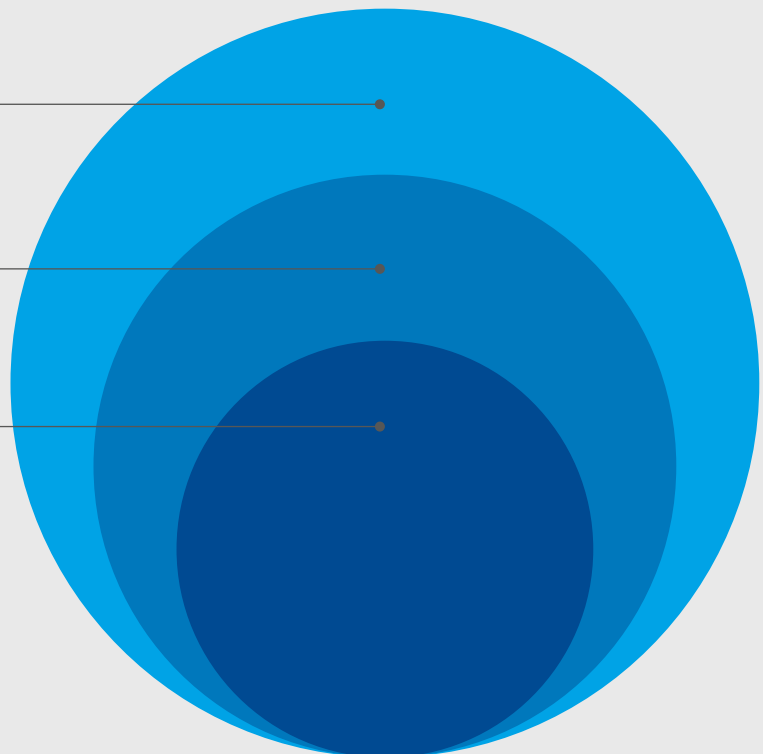
At the micro level, increased efforts at obtaining certifications like ISO 14000 and aligning with the UN's SDGs can benefit SMEs in building legitimacy. This increased reputation lends an advantage to these businesses as clients are more willing to transact with them for this recognition. Research has also shown that pivoting to sustainability can save costs in the long run. Cost savings from becoming energy efficient (low carbon footprint) and using waste as input (reducing consumption of virgin raw materials to achieve resource efficiency), for example, lead to new potential revenue streams to gain profit.

FIGURE 7 Different levels of environment

**Macro**  
(contextual environment)

**Meso**  
(transactional environment)

**Micro**  
(company level)





### 4.3.2 Sustainability pivot recommendations

The following recommendations are derived from surveys, interviews, case studies and focus groups conducted with around 1,000 SMEs.<sup>31</sup>

#### Business life cycle analysis

“ The key idea from a sustainability perspective is to understand and capture data corresponding to energy consumption across various processes and stages within the business life cycle.

Smaller companies can conduct a systematic and holistic business life cycle analysis, which quantifies the environmental impacts (e.g. energy and resource consumption, greenhouse gas emissions and waste generation) of products or services during their entire life cycle. The key idea from a sustainability perspective is to understand and capture data corresponding to energy consumption across various processes and stages within the business life cycle. The consumption value can then be used to calculate carbon footprint, process efficiency and relationship to throughput and productivity (financial performance). The measurement, management and recording of the use of natural capital will assist in environmental impact assessment and progression for smaller companies.

In this context, in a £1.7 million project funded by the European Regional Development Fund (ERDF) to reduce the carbon footprint of SMEs in the UK, researchers from Aston University used dataloggers

(electronic sensors that monitor and record parameters such as energy usage) to conduct energy audits across 140 process-intensive manufacturing and production SMEs in the West Midlands region of the UK. The energy audits for each organization identified business processes and machines that were not energy efficient, as well as their negative impact on throughput, resource efficiency and environmental and financial performance.<sup>32</sup>

Further analysis of the data and in-house processes carried out by the researchers in consultation with SMEs' managers showed how energy-efficient production equipment will positively impact their economic and environmental performance; in other words, the positive impact of energy-efficient processes on throughput and economic performance. This analysis made SMEs aware of how to reduce their energy costs and improve energy and resource efficiency, resulting in adopting low-carbon strategies and achieving economic productivity.

#### Data-driven green decision-making

Data-driven green decision-making entails analysing data generated from the various industrial processes (such as energy usage, water usage, throughputs, costs and quality) within the organization to identify energy and resource-intensive processes and then assisting organizations in strategizing and prioritizing their low-carbon initiatives. This is often called smart decision-making because managers use their subjective tacit domain expertise aligned to the

business priorities and mobilize objective insights from data analysis to make decisions.

This helps smaller companies keep track of and reflect on the impact of current green-oriented strategies and practices on sustainable business performance. In this context, data analysis resulting from a digital decision support system (having data analytics capabilities) will facilitate adoption, implementation, evolution and

“ Depending on their maturity level, SMEs can decide on strategies and actions for enhancing sustainability performances.

strategizing the sustainable-oriented innovation practices within the industry. Such systems can include many functionalities to: 1) assess the current state of practices in the organization and map the organization in the green maturity model, 2) compare existing practices with other organizations 3) visualize the strategic interventions and recommendations for the organization, and 4) visualize the pre-implementation and post-implementation (i.e. recommendations) impact on business sustainability, competitiveness, alignment between business priorities and key performance indicators. In other words, the data obtained from business life cycle analysis fed into a digital support system will help derive useful insights regarding sustainability interventions for the organization.<sup>33</sup>

Over the past three years, a leading manufacturer and supplier of medical consumables in India, with an annual growth rate of 7.3% (2020-21), has started making biodegradable products and carrying out internal waste recycling. It employs data analytics for energy, resource and process optimization. The decisions made by managers leveraging insights from a digital decision support system helped to:

- Map all wastes generated on-site and increase the proportion of waste being recycled.

- Effectively re-process and reuse their process co-polymer waste, ensuring the product's desired chemical and physical properties and reducing raw material consumption.
- Monitor energy usage across all the processes and machines periodically to develop strategic measures (e.g. repairing machines, getting rid of redundant processes) to reduce emissions.
- Set up a cross-functional team to implement ISO 14001 (an internationally agreed standard that sets out the requirements for an environmental management system), which was achieved in June 2021.
- Increase employee awareness of environmental issues by including an environmental section in the company newsletter and conducting workshops with academic institutions and policy-makers in the region: Federation of Small and Medium Industries.

While smaller companies lack digital infrastructure, advanced analytical tools, expert workforce on information analytics and capital investment to develop these capabilities, partnerships with academic institutions help develop their data-driven green decision-making capabilities.

## Sustainability strategies for different stages of SMEs and mid-sized companies

Depending on their maturity level, SMEs can decide on strategies and actions for enhancing sustainability performances.

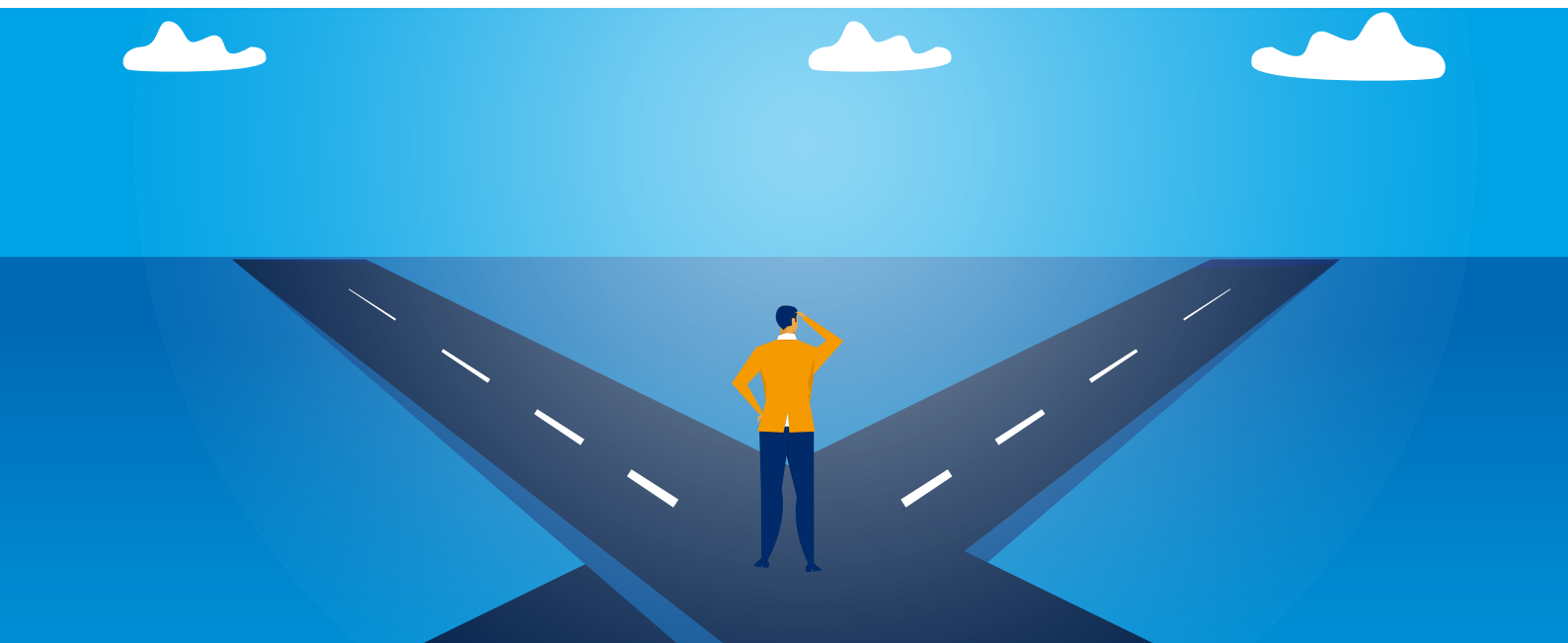
TABLE 4 Linking maturity level to actions for achieving sustainable business performance

| Maturity level | Phase   | Areas of focus   | Capital expenditure | Energy savings, reduction of operating cost | Payback period  | Company positioning  |
|----------------|---|--|---------------------|---|-----------------|--|
| Low            | Yet to embark on sustainability journey                             | Facility lighting, cooling, heating and alteration   | Low                 | Moderate                                    | Short           | N/A  |
| Low to medium  | Thinking about sustainability practices                             | Alteration in utilities within various processes   | Moderate            | Substantial                                 | Short           | N/A  |
| Medium         | Have implemented some sustainable practices, but need more guidance | Renewable energy sources   | Moderate            | Substantial                                 | Short           | Become an eco-investor within the ecosystem, which will enhance brand reputation |
| Medium to high | Becoming product innovator  | Energy efficient machineries   | High                | Substantial                                 | Moderate        | New economic channels open. Become an innovator in your sector                   |
| High           | Responsive focus  | Organizational transformation through technology, processes, structural and cultural changes | High                | Substantial                                 | Relatively long | Become a sustainability champion/green consultant SME                            |

### 4.3.3 Recommendations for business leaders

To systematically adopt low-carbon practices and evolve, smaller companies need skills, expertise and competencies within their workforce that will enhance organizational change capacity.<sup>34,35</sup>

- Create mechanisms that facilitate knowledge sharing, co-creation and exchange among employees, focusing on environmentally friendly practices, CE business models, business process reengineering and contexts of implementation within the business activities and existing workflows.
- Shift to an organizational culture that enables interdepartmental coordination, interdisciplinary collaboration, data-driven decision-making, risk proclivity, and an agile, experimental, and adaptable mindset.
- Plan for process standardization (e.g. using ISO 14000) while adopting low-carbon and sustainable practices.
- Build capacity at the community and regional levels through stakeholders (industry practitioners, academics, policy-makers and end customers).
- Employee well-being must be prioritized as economic and environmental performances depend on employees' ability to make SMEs dynamically capable of driving innovation and adopting change. Additionally, sustainability investments should focus on upskilling employees, and new job creations should be considered as measures for the social performance of SMEs.



### 4.3.4 Recommendations for policy-makers

Policy-makers must create level playing fields through policy regulations in green practices.<sup>36</sup>

- Governments should provide support in easing the processes of, and recognizing, relevant certifications for technological processes and sustainability initiatives.
- Policy-makers should recognize the legitimacy of these certificates in allowing businesses to trade domestically and internationally.
- Policy-makers should provide uniform standards upon which sustainability initiatives of companies are measured. For instance, measures related to environmental and societal impact tend to be on an ad-hoc basis and are currently developed by smaller groups of vested stakeholders.
- Provide clearer guidelines on how societal impact can be measured across the value chain, and dedicate resources to measure sustainability impacts concretely in various industries.
- Financial institutions have a role in recognizing sustainable SMEs through lower lending rates. Shareholders can also target sustainable SMEs with patient capital.

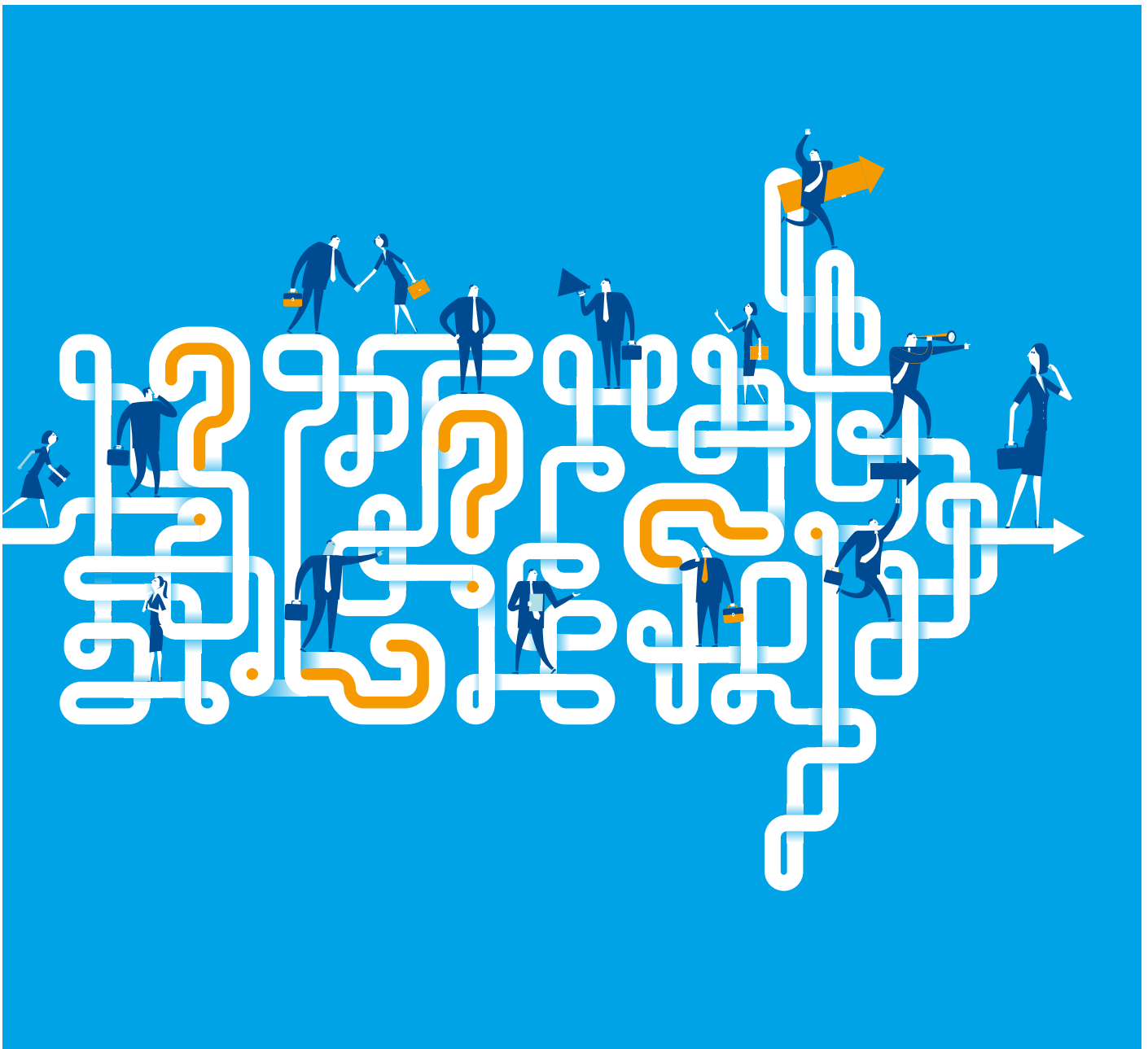
These recommendations allow for a national or possibly universal standard on what SMEs and mid-sized companies can do to increase the sustainability aspect of future readiness.

“ Governments should provide support in easing the processes of, and recognizing, relevant certifications for technological processes and sustainability initiatives.

5

## A system view: enabling an ecosystem to empower SMEs and mid-sized companies for growth

Digital trade can unlock new growth  
paths for smaller companies.





45%

of trade finance applications from SMEs are rejected by banks

Survival, growth and expansion remain serious challenges for SMEs and mid-sized companies. These companies tend to grow at a slower pace than the real economy and account for a smaller proportion of economic growth. They also export less and tend to be less globalized than larger firms.<sup>37</sup>

Internationalization and engagement in regional and global value chains are the keys to lifting smaller companies out of slow growth. However, small scales usually translate to weak bargaining power and difficulty in accessing and growing in new markets, which makes it very challenging for SMEs to break into the global value chains.

In addition, SMEs continue to face serious credit constraints, compounded by stringent know-your-customer (KYC) and anti-money-laundering compliance requirements that financial institutions must fulfil. On average, 45% of trade finance applications from SMEs are rejected by banks, compared to the 17% rejection rate of large and multinational firms (ADB).<sup>38</sup> The lack-of-financing cycle prevents growth, which becomes self-fulfilling as SMEs are kept where they are economically.

## 5.1 Digitalization: a key to SMEs and mid-sized companies' empowerment

Digitalization has already proven to be a critical success factor and a driver of growth on a micro level. Yet, despite the consensus on the necessity of digitalization, the uptake of digital transformation of SMEs is slow. The digital gap between SMEs and larger firms is also widening as technologies become more sophisticated.

For SMEs, digitalization in trade and finance could have a huge impact in terms of increased efficiency, lower costs, greater speed and transparency. With the help of data analysis, SMEs can adjust their production model and boost productivity. This is particularly important for SMEs, whose business growth is often impeded by their limited liquidity and human capital. Digital platforms can enable SMEs to access better and more specialized services while growing their businesses in new markets without adding significant administrative burdens.

Digitalization has the potential to cut costs and significantly increase the efficiency of trade finance. In a digital trade scenario, each time goods pass the border, the procedure would be real-time, automated and digital, based only on data rather than paper or other documents. The entire process would be transparent, based on established protocols accessible to all. SMEs would have

access to digital trade systems without being at an information-based disadvantage. The cost of compliance will also decrease for all parties, putting enterprises of different sizes on equal footing.

In such a scenario, the generation of supply chain and trading data could be ploughed back into operations for efficiency and new services such as traceability and supply chain mapping. Over time, the transaction data offers a new way to evidence an organization's robustness from a business perspective, making it easier for financial institutions to assess the creditworthiness of an SME. This subsequently opens up more lending pools and enables the participation of a wider diversity of lenders in the SME financing process. Digitalization will also allow lenders to significantly reduce the cost of onboarding, helping end lenders' discrimination against small loan sizes.

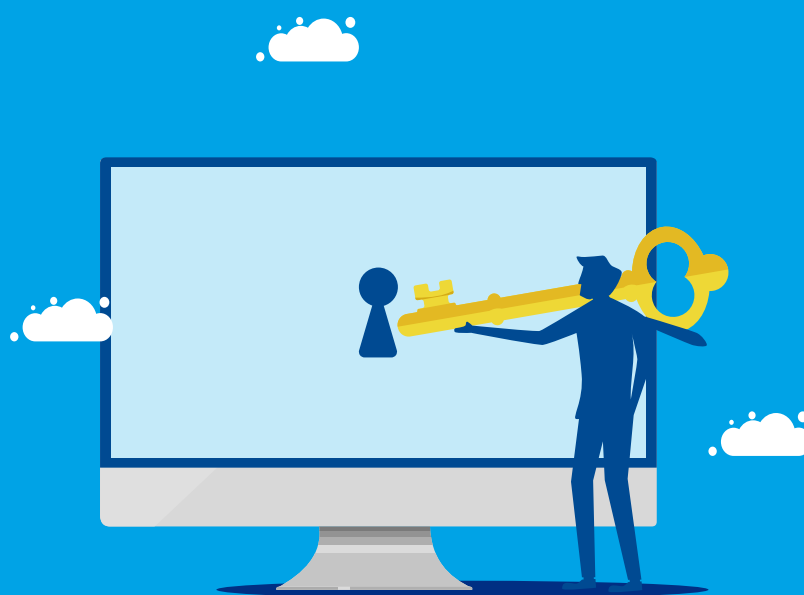
This scenario would be a drastic step away from how global value chains and trade finance currently operate; the technologies needed to make it happen are already available. Moves that target industry reform, connectivity and interoperability could advance the cause of digital trade in ways that could significantly empower SMEs and bring huge economic benefits.

### Regulatory reforms for trade digitalization at scale

The slow-paced digital adaptation in the public sector is an impediment to digitalization in all of the private sector, but it is especially discouraging to SMEs. A survey by the International Chamber of Commerce (ICC) shows that digitalization could reduce the cost of traditional trade finance by 35%.<sup>39</sup> The digitalization of trade is on the agendas of many international corporation frameworks, including the G7, G20, and the Asia-Pacific Economic Cooperation (APEC). What is needed now is that national governments accelerate

adoption domestically. Technical assistance programmes can help governments implement such regulations and should be supported and expanded. The broader adoption of common rules, such as the Model Law on Electronic Transferable Records (MLETR) and the Framework Agreement on Facilitation of Cross-border Paperless Trade in Asia and the Pacific (CPTA), is critical in carrying forward the digital transformation. As of September 2022, seven countries have ratified the MLETR though a number have committed to it in principle.

“ Digitalization could reduce the cost of traditional trade finance by 35%.



“ It is estimated that only 1% of global trade is digitalized, despite the widespread availability of technology to enable data sharing and approvals to be fast, secure and cheap.

## Standards harmonization and interoperability

The second major obstacle to trade digitalization is a lack of common standards and protocols across key trade and finance processes. Although there are common sets of documentation and processes across the supply chain, they differ across countries, sectors and networks, and there is a lack of set protocols to enable interoperability. Companies that operate in different networks may find it difficult to trade outside of a given network unless they can duplicate their administrative and compliance systems to fulfil an additional set.

It is estimated that only 1% of global trade is digitalized, despite the widespread availability of technology to enable data sharing and approvals to be fast, secure and cheap. The ICC Digital Standards Initiative is currently aligning and generating industry consensus on eight key trade documents which, if operationalized, would enable the digitalization of a significant portion of administration across global value chains. These are the certificate of origin, commercial invoice, warehouse receipts, packing lists, bills of lading, declaration forms, insurance certificates and customs bonds.<sup>40</sup>

To some degree, digitalization is already taking place within the finance sector. According to a survey conducted by ICC in 2020, over 60% of global banks and 30% of local banks said they have fully or partially digitalized their supply chain business – partly attributed to the sudden advent of the COVID-19 pandemic.<sup>41</sup> This has led, however, to

the creation of “digital islands”, where SMEs cannot validate their credentials across multiple networks.

One way to overcome SME credential issues is “digital ID”. In June 2021, the European Commission proposed the digital ID framework for individuals and businesses in the European Union. Digital IDs can significantly enhance connectivity within the trade landscape. If every SME had a recognized digital identity with their secured financial credentials, all international trade participants could easily assess their credibility. The loan process would also be less cumbersome as they move across financial institutions and networks. To encourage the universal adoption of digital ID, both public and private support are needed; the public sector can play a role in popularizing its use (e.g. in official compliance and regulatory processes), while the private sector, including finance, could also commit to accepting digital ID.

Beyond this, digital ID could democratize lending by providing a means for SMEs to evidence their credentials to a wider group of lenders, including those outside their own domains and nations. With the help of digital ID, the digitalization of finance introduces the possibility that lenders of all types could issue finance to SMEs without taking too many risks. To allow diversified sources of financing, regulators need to revisit and update finance regulations to allow more capital providers to participate in trade finance.



## 5.2 Moving forward

Digitalization can be used, or at least aligned, to enable or support priorities such as the fight against climate change, the alleviation of poverty, and inclusivity and closing of the income gap. The focus on smaller companies is a means to accomplish these objectives, given the roles that SMEs play in enabling inclusivity and addressing poverty at the base of the economy.

Digitalization – backed by interoperability and accessibility – is one simple and pragmatic means to enable SMEs to be a player in the “new world”, where data is the new currency, and tradability of data is a prerequisite to economic expansion. Today, the largest enterprises have achieved this somewhat through trade networks. However, these also limit the participation of different nation-states, which have their own protocols and customs procedures.

It has been estimated that digitalizing trade could add \$9 trillion to trade within the G7 economies alone, from 2019 through to 2026 while reducing trade costs by 84% within the same period.<sup>42</sup> The digitalization of trade would also address the pain points that drive the current \$1.7 trillion gap in trade finance, particularly in emerging markets where the absence of verifiable records represents a huge challenge.

Trade digitalization is not only pragmatic but is also implementable based on current globally agreed standards and technologies within a reasonable time frame. Digitalization should be a priority not only for SMEs but for other players and stakeholders involved in the global economy as the plight of SME inclusion across finance, supply chains and investment is solved.



# Conclusion

Considering the widespread impact that SMEs and mid-sized companies do have and the capabilities that they could further unlock to impact the economy, environment and society, it is imperative to develop their future readiness according to the three pillars of sustaining long-term innovative growth, developing high levels of adaptive capacity and delivering positive impact for the planet and people.

Key takeaways from this report include:

- SMEs and mid-sized companies' leadership should try to focus on bridging their resilience gap and exploiting their high level of agility, afforded by their smaller size, as a competitive advantage.
- Future readiness capability building should not be developed as ad-hoc initiatives but should be embedded into key corporate strategies and decision-making processes, ideally from the beginning, so that it becomes part of the fundamental building blocks of the company.
- Having practical and pragmatic ideas on how to kick off this process would be highly valuable as well as having a community of peers for more informal sharing of experiences, failures and best practices.

- While smaller companies can go a long way in building their future readiness, it is important to recognize the direct and important impact that their wider policy environment has on their ability to thrive. It is therefore crucial for policy-makers, investors and other stakeholders to do what is in their capabilities to contribute to building the future readiness of this segment of the economy.
- One of the high-impact areas of intervention at the system levels revolves around digital trade and includes implementing targeted measures to harmonize and drive trade data interoperability across borders and supply chains. This would greatly contribute to making it easier for smaller companies to trade internationally.

The World Economic Forum will use the insights generated in this report to further support SMEs and mid-sized companies in their future readiness journey. This will be done through the creation of additional resources, including the continuous development of the Forum's [self-assessment and benchmarking tool on future readiness](#), the creation of a platform for informal peer-to-peer learning between companies and meet ups with key experts.

# Contributors

## Lead authors

**Zishu Chen**

Engagement Specialist, World Economic Forum

**Soumyadeb Chowdhury**

Associate Professor, Information and Sustainability Management, TBS Education

**Abigayle Davidson**

Director, Research and Impact, Aspen Network of Development Entrepreneurs, The Aspen Institute

**Prasanta Kumar Dey**

Professor, Operations and Information Management, Aston Business School, Aston University

**Albert Michael Geiger**

Managing Director, Alphazirkel

**Shuyi Long**

Research Associate, Asia Global Institute

**Pamela Mar**

Managing Director, ICC Digital Standards Initiative, and Senior Fellow, Asia Global Institute

**Christian Mohr**

Managing Director, UnternehmerTUM

**Rashimah Binte Rajah**

Lecturer, Department of Management and Organization, National University of Singapore Business School

**Leopold von Schlenk-Barnsdorf**

Senior Consultant, UnternehmerTUM

**Olivier Woeffray**

Practice Lead, Strategic Intelligence, World Economic Forum

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Head, Strategic Intelligence; Member of the Executive Committee, World Economic Forum

**Olivier Schwab**

Managing Director, World Economic Forum

**Maryna Sviatenko**

Operations and Support Specialist, World Economic Forum

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World Economic Forum  
91–93 route de la Capite  
CH-1223 Cologny/Geneva  
Switzerland

Tel.: +41 (0) 22 869 1212  
Fax: +41 (0) 22 786 2744  
[contact@weforum.org](mailto:contact@weforum.org)  
[www.weforum.org](http://www.weforum.org)