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UNLEASHING THE POWER OF INNOVATION: THE TRANSFORMATIVE ROLE OF SMES IN EU

ABSTRACT

This article explores the significant efforts made by the European Union (EU) to support small and medium-sized enterprises (SMEs) through a range of initiatives, policies, and programs, such as Horizon 2020 and COSME. These endeavors have provided dedicated funding and resources to facilitate research, development, and innovation within SMEs. Recognizing the significant role played by SMEs and innovation in driving economic growth, job creation, and competitiveness, the EU has prioritized targeted support and the establishment of an enabling business environment to unlock the full potential of SMEs as engines of innovation. Furthermore, the EU actively assesses SME innovation levels to identify areas of strength, weakness, and improvement. These concerted efforts demonstrate the EU's commitment to cultivating a culture of innovation and providing comprehensive support to SMEs in their entrepreneurial pursuits. Ultimately, these initiatives contribute to the overall innovation landscape in Europe, fostering sustainable growth and prosperity.

KEYWORDS: innovation, SMEs, initiatives, startups, business-friendly environment

JEL: O31, L26, L53

INTRODUCTION

Innovation has long been recognised as the driving force behind economic growth, technological advancement, and societal progress. In an era of rapid change and disruption, the role of small and medium-sized enterprises (SMEs) in fostering innovation has attracted increasing attention and significance. As engines of entrepreneurialism and creativity, SMEs have a unique capacity to shape industries, stimulate job creation, and stimulate regional development.

The connection between innovation and SMEs is not merely a matter of survival or adaptation; it represents a compelling opportunity to redefine the boundaries of success and prosperity. Although large corporations often dominate the headlines, SMEs are those who demonstrate remarkable resilience and an inherent ability to embrace uncertainty, challenge the status quo, and disrupt established norms.

Innovation in the context of SMEs goes far beyond the development of groundbreaking technologies or revolutionary products. It encompasses a wider spectrum, including process improvements, service innovations, organisational transformations, and collaborative networks. SMEs have the freedom to be agile, experiment with new ideas, and quickly respond to customer needs, allowing them to build niches in saturated markets and challenge established players.

Furthermore, innovation in SMEs is not limited to individual efforts; it thrives within vibrant ecosystems that foster knowledge exchange, cooperation, and collaboration. SMEs are

increasingly engaging in partnerships with research institutions, universities, large corporations, and government agencies, allowing them to have access to diverse resources, expertise, and funding opportunities. These collaborative efforts strengthen their innovation capabilities, allowing them to leverage external knowledge and remain at the forefront of emerging trends.

Despite the undeniable potential, SMEs face a myriad of challenges while pursuing innovation. Limited financial resources, lack of skilled talent, regulatory complexities, and risk aversion pose significant obstacles. Addressing these challenges requires a holistic approach that combines supportive policies, targeted investments, and customised support mechanisms specifically designed to nurture and harness the innovation potential of SMEs.

The aim of the article is to explore the European Union's efforts in supporting innovation within small and medium-sized enterprises (SMEs) and to analyse the innovative landscape in EU member states by highlighting the relationship between innovation and SMEs and examining the challenges and opportunities in creating an enabling environment for SMEs to thrive as drivers of innovation.

1. EU activities in support of innovation in SMEs

The European Union (EU) has long recognised the crucial role of SMEs and innovation as drivers of economic growth, job creation, and competitiveness. Throughout the years, various initiatives, policies, and funding programmes have been designed and implemented to support SMEs and foster innovation in member states.

The Horizon 2020 programme was a flagship EU initiative designed to promote research and innovation. With a budget of approximately €80 billion that spans seven years (2014-2020), it aimed to advance a broad range of research and innovation projects. One of its key objectives was to increase the participation of small and medium enterprises in these initiatives. To achieve this, Horizon 2020 offered dedicated funding schemes. In 2018, the European Commission (EC) announced its support for 283 innovative projects through the European Innovation Council (EIC) pilot, with a particular focus on SMEs. In the latest round of the SME Instrument, 278 SMEs from 27 countries have been selected for funding, receiving a total of €129 million in Phase 2 and €10 million in Phase 1 of Horizon 2020. Through the Fast Track to Innovation scheme 15 projects from 16 countries received €34.4 million. They encompass a range of cutting-edge technologies, such as blockchain, quantum photodetectors, and biocompostable packaging. Phase 2 recipients expected funding between €0.5 million and €2.5 million for activities such as testing and scaling up, while Phase 1 provided €50,000 for business plan development. Successful Spanish and Israeli SMEs lead the funding recipients, followed by companies from Norway, France, Denmark, and Germany. The EIC pilot, which supported breakthrough innovations, aimed to provide €2.7 billion for market-creating innovations between 2018 and 2020 through Horizon 2020's SME Instrument and Fast Track to Innovation programs (European Commission, 2018). The succeeding programme Horizon Europe for the period 2021-2027 continues to support SMEs in their innovation endeavours with a dedicated overall budget of EUR 3,5 billion (Efmcc, 2021).

Another dedicated EU programme for SMEs was COSME, active for the 2014-2020 funding period with a total budget of EUR 2,3 billion, specially designed to support SMEs in their growth and competitiveness (European Commission a, n.d). This initiative, initiated by the EC, aimed to provide SMEs with the tools, resources, and opportunities to thrive in the European market. COSME focused on areas such as improving access to finance, facilitating market access and internationalisation, fostering entrepreneurship, promoting business-friendly

regulatory frameworks, and improving the competitiveness of SMEs in Europe. Additionally, it helped SMEs benefit from the Single Market by establishing business links and expanding their export activities beyond Europe. The programme also aims to reduce administrative burdens, promote smart and SME-friendly regulations, and strengthen the coordination of industrial policies between member states. COSME played a vital role in the empowerment of SMEs by fostering an enabling environment and supporting competitiveness in strategic sectors such as tourism.

Figure 1. EU SMEs data



Source: European Commission (10 March 2020)

In March 2020, the EU launched the EU SME Strategy (European Commission, 11 March 2020). According to EC data, SMEs constitute more than 99% of all businesses in the EU and employ approximately 100 million people (European Commission b, n.d.). To facilitate their success, the EU has implemented various initiatives and allocated significant resources. It aims to create a favourable business environment by reducing regulatory burdens and improving access to information and support services. The strategy focusses on promoting innovation and digitalisation, facilitating access to finance, expanding market access through internationalisation and trade support, and fostering entrepreneurship and skills development. With the goal of driving economic growth, job creation, and innovation, the EU SME Strategy provides a roadmap to enhance the competitiveness and sustainability of SMEs in the EU.

These initiatives represent notable examples of the EU's commitment to fostering innovation within SMEs and supporting their growth and competitiveness. Through targeted funding, access to resources, and policy support, the EU aims to create an enabling environment in which SMEs can thrive and contribute to the overall innovation landscape in Europe. Furthermore, the member states could further design and implement specific local policies that add up to regional incentives and further support SMEs and their entrepreneurship.

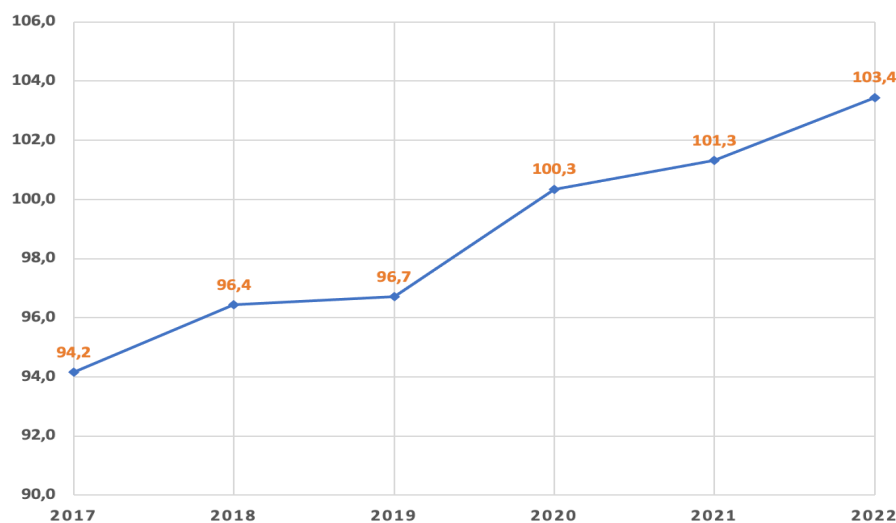
2. How innovative are the SMEs in the EU member states?

Measuring the link between innovation and SMEs could be challenging, but there are existing indexes and databases that can help provide insights. At present, there are two renowned indexes dedicated to measuring innovation levels at the global and regional level. The Global Innovation Index (GII) and the European Innovation Scoreboard (EIS) (Ligonenko, 2015). Since the research is focused on EU member states, the necessary data will be sourced from the second. Like the GII, the EIS represents a complex index composed of 32 indicators grouped under 12 dimensions (European Commission c, n.d) as few of them directly concern SMEs and will be part of the analysis.

Developed by the EC, the EIS provides comprehensive data for various dimensions of innovation, enabling policymakers, businesses, and researchers to gain insights into the innovation landscape across Europe. The index measures key indicators, such as research and development investments, intellectual property rights, innovation networks, and the integration of digital technologies. This assessment plays a critical role in monitoring and benchmarking innovation performance, helping countries identify their strengths, weaknesses, and areas for improvement. By examining the latest findings from the European Innovation Scoreboard, a deeper understanding of Europe's innovation ecosystem and the factors contributing to its success and their impact on SMEs could be obtained.

EIS, calculated average for five years, reveals an overall positive trend, with the most significant increase occurring between 2019 and 2020 (Fig. 2). Even during the Covid-19 crisis, there was no decline in the index, but a 1% punt increase. This could be at least partially attributed to the EU's sustainable commitment to supporting innovation activities. The commitment of the EU to innovation underscores its recognition of the decisive role of innovation in driving competitiveness and resilience effectively resisting the challenges of the pandemic. It shows the effectiveness of EU policies and initiatives in creating an environment that is friendly to innovation and in encouraging companies, including SMEs, to invest in research, development, and technological progress. The positive trend of the Innovation Index not only reflects past achievements but also sets the stage for future progress, while the EU continues to give priority and promote the innovation potential of its members.

Figure 2. EIS average results for the period 2017-2022



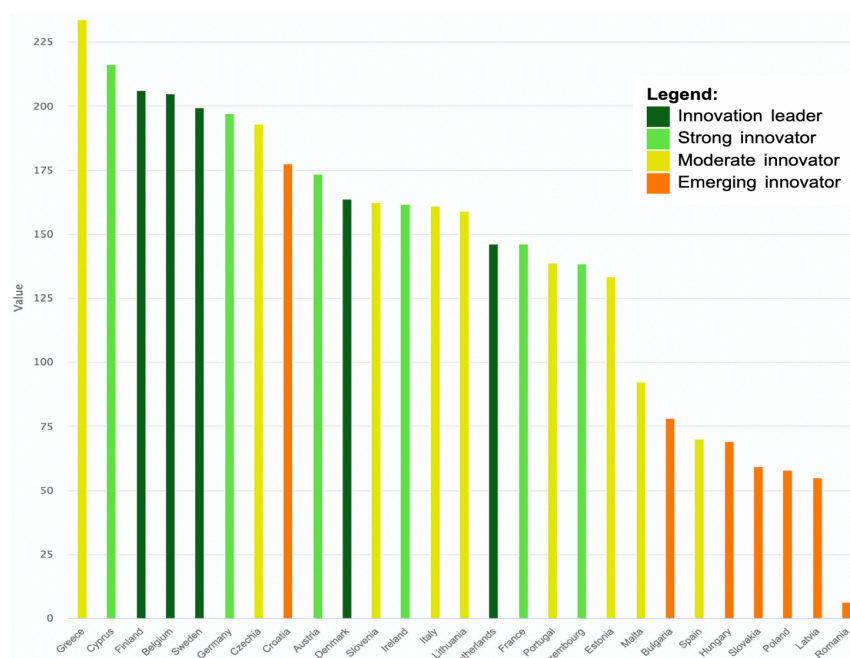
Source: European Innovation Scoreboard

In 2022, the results highlight a notable presence of emerging and moderate innovators within the EU, while only five member states are classified as innovative leaders – Sweden, Finland, Denmark, and the Netherlands, and six follow them as strong innovators. This indicates that there is significant untapped potential within the region that must be harnessed. Although the prevalence of emerging and moderate innovators signifies progress, it also suggests the need for further development and targeted efforts to foster a more robust culture of innovation throughout the EU. By capitalising on the strengths of emerging innovators and facilitating their transition to higher levels of innovation, the EU could uncover new opportunities for sustainable economic growth, improve competitiveness, and address pressing social challenges. Achieving this objective requires targeted policies, strategic investments and collaborative initiatives that

facilitate knowledge sharing, promote research and development, nurture entrepreneurialism, and strengthen the overall innovation ecosystem at both national and EU levels.

Indicator 3.1 'Innovators' includes specific information for SMEs related to both the introduction of product and business process innovations (% of SMEs). What makes this particular ranking intriguing is the presence of two countries among the top seven that are classified as moderate innovators, with Greece claiming the highest position. Greece's remarkable performance could be attributed to a significant number of startup companies that provide innovative software solutions that streamline business processes and enhance productivity (Ionita, 2022). Moreover, Greece has actively supported the adoption of business process innovations, investing in digital transformation initiatives, and fostering a supportive ecosystem for innovation and entrepreneurship. With the establishment of startup incubators, accelerators, and venture capital funds, such as the Athens Center for Entrepreneurship and Innovation (ACEin), Greek SMEs have been provided with vital resources, mentorship, and networking opportunities.

Figure 3. Innovators indicator 2022 data



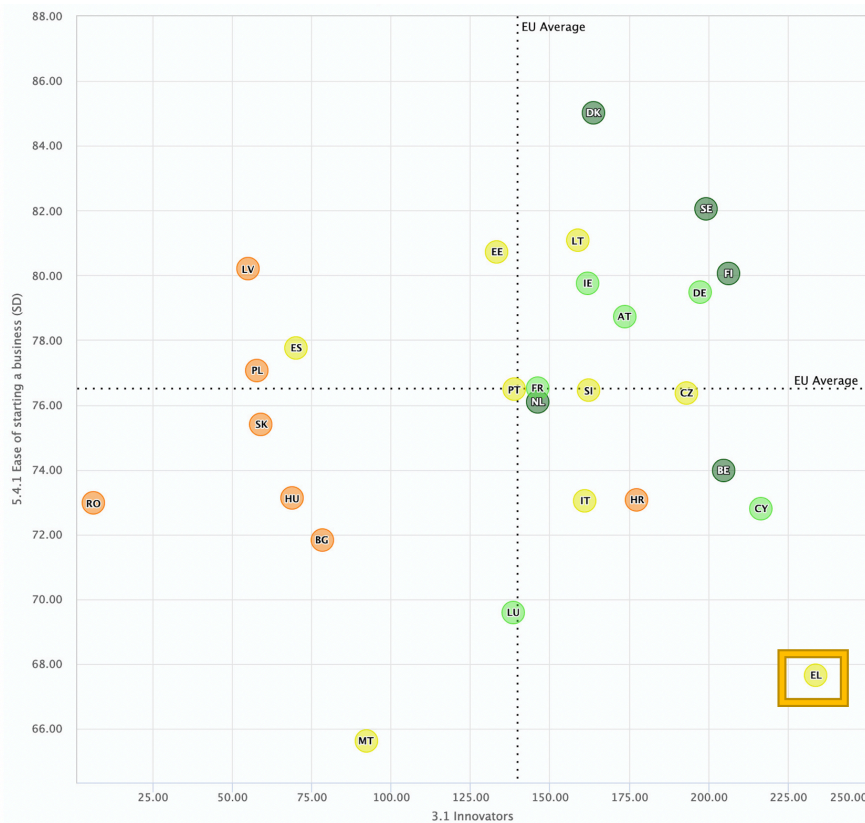
Source: European Innovation Scoreboard, 2022

According to the EC 2022 SME country fact sheet (European Commission, 2022), the startup and scale-up environment in Greece has experienced significant advancements, primarily driven by increased entrepreneurial activity, greater availability of equity funds, and the implementation of public support schemes. A forthcoming legal framework, expected to be introduced this year, aims to streamline procedures related to the establishment and operation of spin-off companies. In terms of SMEs' participation in public tenders, Greece outperforms the EU average, with a higher proportion of bids originating from SMEs. Recent policy developments include the adoption of a new public procurement law in March 2021 and the implementation of an action plan in May 2021, which outlines a national strategy for public procurement from 2021 to 2025, expected to have a positive impact on SMEs. Access to public administration for SMEs is also improving, thanks to recent digitalisation efforts and the implementation of laws aimed at simplifying the business framework. More progress is expected as part of the recovery and resilience plan, with the modernisation of the regulatory

framework to reduce administrative burdens on businesses identified as a key priority under the Greece 2.0 Plan.

The Greek example, where SMEs have demonstrated significant innovation success, raises further questions related to SMEs innovation outcomes and the existence of a sound administrative, regulatory, and legal environment. An indicator such as Ease of starting a business could shed more light on the topic. The level of convenience associated with starting a business enterprise could have a significant impact on SMEs' innovation potential. When entrepreneurs face fewer barriers and bureaucratic complexities when launching their ventures, they are more likely to explore innovative ideas and take risks. A business-friendly environment with streamlined registration processes, reduced administrative and tax burdens, and simplified regulatory requirements allows entrepreneurs to focus their energy and resources on creative and innovative endeavours. Moreover, when the cost and time required to establish a business are minimised, it frees up financial resources and allows SMEs to allocate funds towards R&D activities.

Figure 4. Relationship between 3.1 Innovators and 5.4.1. Ease of starting a business



Source: European Innovation Scoreboard, 2022

The expectations are that innovation leaders and strong innovators would be located in the upper and lower right quadrant, respectively. However, there are exceptions to this trend, such as Greece (EL). Despite having the highest share of innovation SMEs, Greece scores significantly lower on the Ease of starting a business indicator, with an approximate result of 68 out of 100. Additionally, some moderate innovators like Estonia (EE), Lithuania (LT), Spain (ES), as well as emerging innovators like Latvia (LV), and Poland (PL), have scored above the EU average on the ease of starting a business indicator. In contrast, Hungary exhibits a higher percentage of innovation SMEs, but significantly lower scores on the Ease of starting a business indicator. These variations highlight that the relationship between innovation in SMEs and the ease of

starting a business is not always straightforward, and different countries may exhibit unique dynamics in this regard.

Conclusion

Innovation is a key factor driving economic growth, technological advancement, and societal progress. SMEs have emerged as drivers of innovation, with the capacity to shape industries, stimulate job creation, and foster regional development. Their agility, creativity, and entrepreneurial spirit allow them to challenge established norms, disrupt markets, and create niches. However, the relationship between innovation and SMEs is complex and multifaceted. Although there is an expectation that countries with a favourable business environment would foster higher levels of innovation in SMEs, there are exceptions to this trend. Greece, for example, despite having a high share of innovative SMEs, scores lower on the Ease of starting a business indicator. Similarly, some moderate and emerging innovators exhibit higher scores on the Ease of starting a business indicator than expected. This suggests that the relationship between the ease of starting a business and SME innovation is not always straightforward and can vary across countries. Targeted local policies could create a sustainable regulatory and R&D environment and conditions that lead to distinctive positive. By addressing challenges, fostering supportive policies, and creating an enabling ecosystem, countries can unlock the full potential of SMEs as drivers of innovation and fuel sustainable economic growth. By leveraging the collective capabilities and resources of its member states, the EU has the potential to position itself as a global frontrunner in innovation, driving positive change and prosperity for the entire region.

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