

Digital economy Opportunities and risks for small and medium enterprises

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Abstract: The variety of shifts described in the preceding sub-sections present both opportunities and dangers for MSMEs particularly in developing and least developed economies. One set of opportunities arises from the unique new business models of digital economy firms. The other issues from the spread of digitalization, automation, and artificial intelligence in the real-world sectors in which most MSMEs operate. How these play out will depend on how digitally ready MSMEs are and how supportive government policy is.

Keywords: Foreign Direct Investment, FDI, Digital FDI, MSMEs, Sustainable FDI, Sustainable Development.

Opportunities within the digital economy – Digital platforms have suddenly given MSMEs the opportunity to sell internationally, to markets they might not have reached – or known of – on their own. Digital platforms also tend to be more inclusive than physical global value chains (GVCs) since it is in the platform owner’s interest to draw in as many product/service creators and customers as possible. Many platforms thus actively help member MSMEs move up the value chain. Though physical GVCs offer similar support, they only include the few firms that feed directly into to the lead MNEs final output.

Opportunities in traditional economic sectors – In traditional sectors, digital technology is enabling the earlier-described ‘modularization’ and ‘servitization’ of manufacturing across geographies, creating new opportunities for tech-savvy MSMEs. In modularization, the standardized parts of end products can be produced separately (even by different producers, in different locations) from customizable aspects, which are created on special order from customers. In servitization, lead MNEs contract out product and customer services to third parties and digital technologies enable them to monitor these on a real-time basis.

Digitalization and datafication has also given rise to new channels of value creation across traditional and emerging sector sectors. In agriculture and animal husbandry, for instance,

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productivity and efficiency could be dramatically enhanced by using drones, sensors, artificial intelligence, and analytics, creating a host of novel opportunities for MSMEs with the necessary software, manufacturing and computing, and farmer training capabilities. ‘Digital agriculture’ could add as much as US\$500 billion to global GDP by 2030 (McKinsey, 2020). Emerging data value chains are also throwing up a range of opportunities related to the compiling, processing, analysing, and monetizing of data and images, as a subsequent sub-section of this paper will explain.

Risks – The variety of shifts described above do pose risks to developing country MSMEs, particularly those linked to rapidly-digitalizing GVCs, which are currently concentrated in Asia. This is because MSMEs in developing and least developed economies have been slow to adopt digital technologies for a variety of reasons. Often, ICT connectivity is poor, and digital technologies are expensive and require costly retrofitting of existing equipment. Most crucially, many MSMEs still lack digital skills and exposure. Even when connectivity is not an issue, MSMEs are tending to conduct only simple tasks online. For instance, most tend to use the Internet to research potential investment locations, partners, and competitors, rather than to market, sell or manage delivery of their own products and services (UNCTAD, 2019).

There is thus a risk that MSMEs could be marginalized as digitalization progresses, especially in manufacturing GVCs with highly digitalized lead firms. MNEs turning to digital manufacturing technology will find it progressively harder to partner with those using older technologies and will tend to seek out new suppliers with technological capacity more on par with their own. Yet, even MSMEs that remain within such chains might experience a downside, such as growing digital control and standardization by lead firms (UNCTAD, 2017; UNCTAD, 2019).

In the digital world, MSMEs doing business on e-commerce platforms could see profit margins shrink due to the sudden, vastly expanded exposure to competition. They are also likely to experience exclusionary pressure in platforms dominated by a few large buyers (UNCTAD, 2017; UNCTAD, 2019), which tend to favour a handful of trusted sellers at the expense of smaller, less experienced suppliers.

However, as mentioned earlier, government policy and national e-preparedness will be major factors influencing the smoothness of the transition to digitalization and the continued relevance of MSMEs in the evolving value chains of which they are part. Digital economy firms can also be essential partners, by bringing new technologies and novel modes of economic organization to developing and least developed countries. For this reason, the next section explores how governments

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and IPAs might best design investment policy, investment promotion and investment facilitation to draw the most from FDI in their digital economies.

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