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Digital Adoption of MSMEs During COVID-19

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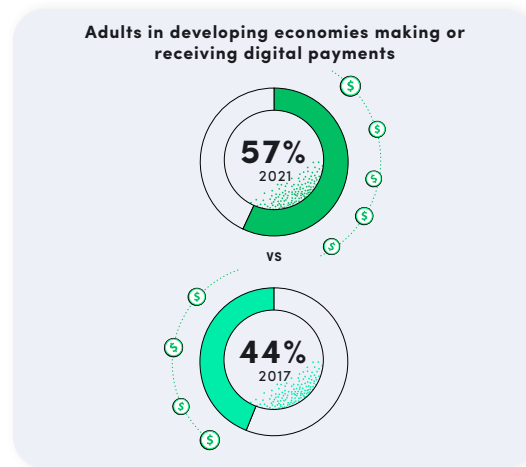
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Introduction

The COVID-19 pandemic accelerated the pace of digital adoption globally. The use of digital payments surged during the pandemic, fueled in large part by mobility restrictions intended to combat the spread of COVID-19. Emerging markets, such as India and Indonesia, are at the forefront of this digital evolution.¹ Fifty-seven percent of adults in developing economies made or received digital payments in 2021 compared to 44 percent in 2017,² and global retail ecommerce sales are expected to grow at 8 percent annually through 2024.³

Likewise, for businesses around the world, COVID-19 sparked a transition to new and digitally enabled ways of doing business. But while micro, small, and medium businesses (MSMEs) are increasingly turning to a range of digital tools for their businesses, the path is not automatic. The Center for Financial Inclusion's (CFI) research found that many MSMEs used some form of digital tool during the pandemic, such as accepting payments via mobile money, marketing products on social media, and selling on ecommerce platforms. But adoption was not uniform nor sustained in many cases. CFI is exploring how MSMEs used digital products during the pandemic, what barriers they faced with digital



adoption, and what can be done to support the growth of MSMEs in the digital economy.

These insights are drawn from CFI's longitudinal survey of MSME owners in Colombia, India, Indonesia, and Nigeria, collecting data every two months over a 12-month period in 2020 and 2021. The surveys were followed by focus groups in the same four countries and Bolivia in March and April 2022 to better understand the perspectives of MSMEs coming out of the pandemic.

TABLE 1

Timeline of Surveys

Timeline	Colombia	India	Indonesia	Nigeria
Wave 1	August 2020	October 2020	July 2020	June 2020
Wave 2	December 2020	December 2020	September 2020	September 2020
Wave 3	February 2021	February 2021	December 2020	December 2020
Wave 4	April 2021	June 2021	March 2021	March 2021
Wave 5	July 2021	September 2021	June 2021	May 2021
Wave 6	September 2021	October 2021	September 2021	July 2021



MSMEs' Adoption of Digital Tools

For individuals and businesses around the world, COVID-19 initiated many unexpected changes to our daily routines. Restrictions to curb the spread of the virus suddenly resulted in empty stores, schools, and office buildings. People limited their in-person interactions with one another, and in many cases, those interactions shifted to digital means. MSMEs in our surveys were drastically impacted by the pandemic and struggled to navigate reduced customer demand, rising costs, and declining profits.¹⁹ The growing digital economy presented business owners with new ways of

serving customers, but digital adoption among MSMEs has been slow and uneven.

While digital tools are not a panacea, they can help to address many challenges that MSMEs face in the wake of the pandemic and ongoing difficult economic conditions. Figure 1 below provides several examples of challenges commonly cited by MSMEs during CFI's focus groups as well as examples of digital tools that could help alleviate these issues.

FIGURE 1

MSME Challenges and Potential Digital Solutions

Value Chain	INPUT LOGISTICS	INVENTORY MANAGEMENT	MARKETING	SALES	OUTPUT LOGISTICS	AFTER-SALES SERVICE
Example of MSME Challenges	Informal credit is not desirable but often the only option to meet short-term needs	Supply chain disruptions require more active management of inventory and liquidity	Fluctuations in demand brought about by the pandemic require new modes of reaching customers	Cash dominates sales transactions, many informal businesses lack documentation to access credit	Delivery is increasingly popular but can be complicated and costly to manage in-house	Offering credit to customers helped keep businesses going, but comes with risks and can be difficult to manage informally
Digital Tools	Supply chain financing, digital credit	Inventory management systems	Social commerce, ecommerce	Digital payments, financial management tools	Delivery platforms, ecommerce, order management tools	Ecommerce platforms offering embedded finance to consumers

Digital adoption can expand access to new markets and customers, and enable MSMEs to operate across greater distances, access a wider range of financial services, and improve business productivity.²⁰ Focus group participants shared some of the benefits they experienced from introducing digital tools into their operations. A restaurant owner participating in a focus group described the benefits of using mobile money for her business: "In my case there are some customers who order takeout, they give time and place, and they don't show up, or they

give us a wrong address. We choose to work with TigoMoney [payment platform for phones], so they deposit 50 percent or 30 percent and then we deliver." The ability to collect deposits allowed the business to minimize losses associated with fraudulent orders.

To better understand the costs and benefits of adoption, it is useful to separately consider "low-stakes" digital tools from "high-stakes" digital tools. Low-stakes digital tools are low cost and adoption

does not require a financial or temporal commitment — for example, communicating digitally with customers or marketing a business on social media. High-stakes digital tools, on the other hand, require formal business registration and include a financial transaction or commitment.

While many MSMEs in our survey reported using low-stakes digital tools during the pandemic, high-stakes digital adoption involving financial transactions was less common, especially among women. And even among those business owners who tried high-stakes digital tools, usage was inconsistent and many reverted to their old ways of doing business.

TABLE 2

Low-Stakes vs. High-Stakes Digital Tools

Type of Digital Tool	Definition	Examples
Low-stakes	Low cost, does not require resource commitment	Communicating digitally with customers (e.g., WhatsApp) or marketing their business on social media (e.g., Facebook, Instagram)
High-stakes	Requires formal business registration and often includes a financial transaction or commitment	Use of delivery platform, ecommerce platform, online store





Social Media Was Widely Used for Marketing and Communicating With Customers

Many MSME owners in our focus groups reported using social media platforms to connect with customers. Business owners extensively used platforms such as Facebook, WhatsApp, and Instagram to communicate with customers and to market their business. A business owner who advertised on social media, for example, found that social media marketing enabled him to reach new customers from more expensive neighborhoods who may not have otherwise been aware of his business: “By advertising, my clients come all the way up to ‘El Alto’ [where the shop is located], they ask, ‘How much is it?’ [and] I say, ‘500.’ They say, ‘All right.’”

Social platforms allowed many business owners to not only continue operations during lockdowns, but also to increase sales and reach new customers. This is an example of low-stakes digital adoption – where business owners incorporated technology into their business in a way that has minimal risk. In this case, their use of digital tools was mostly limited to information exchange, while financial

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transactions were handled separately – usually in cash. Even when payments could have been facilitated via the platform, many MSME owners and customers felt skeptical or uncertain about using digital tools for financial transactions.





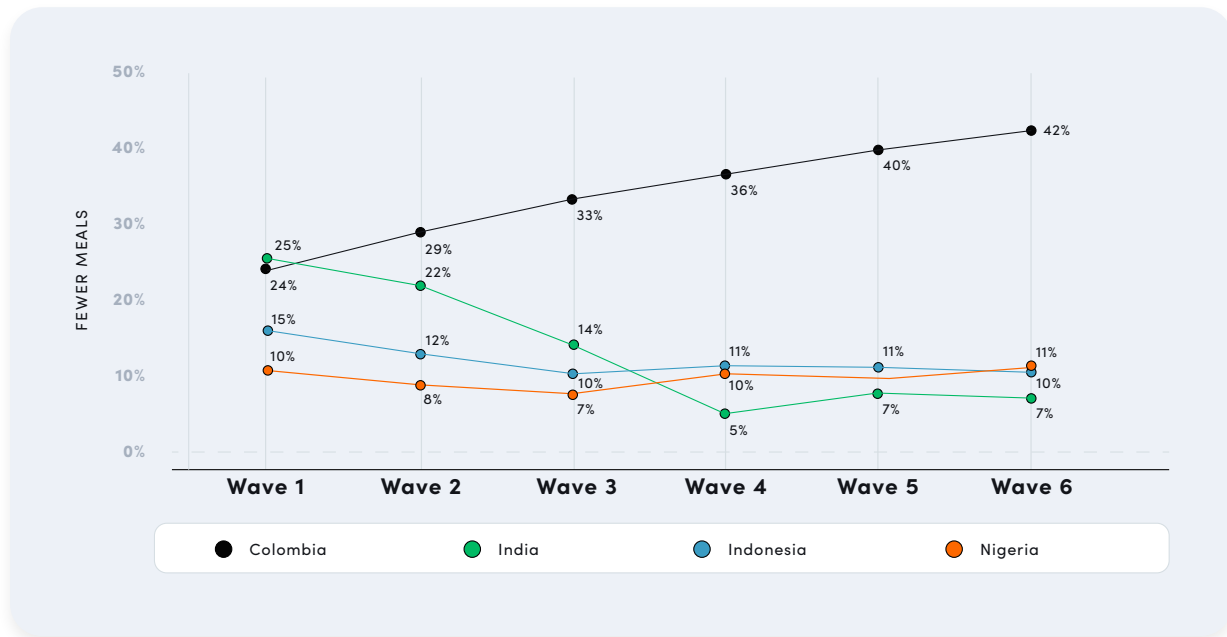
Few MSMEs in Our Sample Sold on Digital Platforms During the Pandemic

While MSME owners saw a benefit in marketing and communicating via digital platforms, when it came to selling or conducting transactions digitally, many MSMEs were hesitant to adopt this higher-stakes digital tool into their business. Few MSMEs in our sample sold products – that is, conducted direct-to-consumer transactions including payment – on digital platforms during the pandemic.

In Nigeria, the percentage of MSMEs selling on digital platforms remained steady at around 10 percent across all survey waves. In India and Indonesia, the number of MSMEs selling on digital platforms decreased during CFI's study. The exception was in Colombia, where sampled business owners tended to be more digitally savvy, as they already were working with robust digital product offerings. The share of businesses that sold on digital platforms in Colombia consistently increased throughout the pandemic, reaching 42 percent in wave 6.

FIGURE 2

Percentage of MSMEs Selling on Digital Platforms



Survey data also revealed that many business owners who sold on digital platforms in the early waves of the pandemic did not continue to do so in all the subsequent waves, indicating that many businesses experimented with digital platforms, but adoption was inconsistent and not sustained. Focus group participants provided further detail on why there was hesitation to sell on digital platforms; reasons included difficulty competing with low online prices, concerns about intellectual property, unsuitability of the platforms for their business, unreliable mobile coverage, and lack of knowledge to effectively use the platforms.

In addition, some business owners in the focus groups, particularly in India, were hesitant to conduct business digitally because of the perceived need to operate formally, or as business owners in India put it, “in white.” These business owners were concerned about additional compliance requirements and tax implications if they conducted more business digitally.

However, despite the overwhelming hesitation to sell digitally, businesses that did sell products on digital platforms were more resilient to the impact of the pandemic. Analysis using a composite index of 19 indicators of resilience — including the ability to keep the business open, cover expenses, and maintain or improve profit trends — showed that selling on digital platforms was associated with resilience. Focus group participants described a range of benefits of selling on digital platforms, such as being able to continue operations during movement restrictions and accessing customers from a wider geographic span. This suggests that implementing higher-stakes digital tools can have a significant benefit on the financial health of MSMEs.

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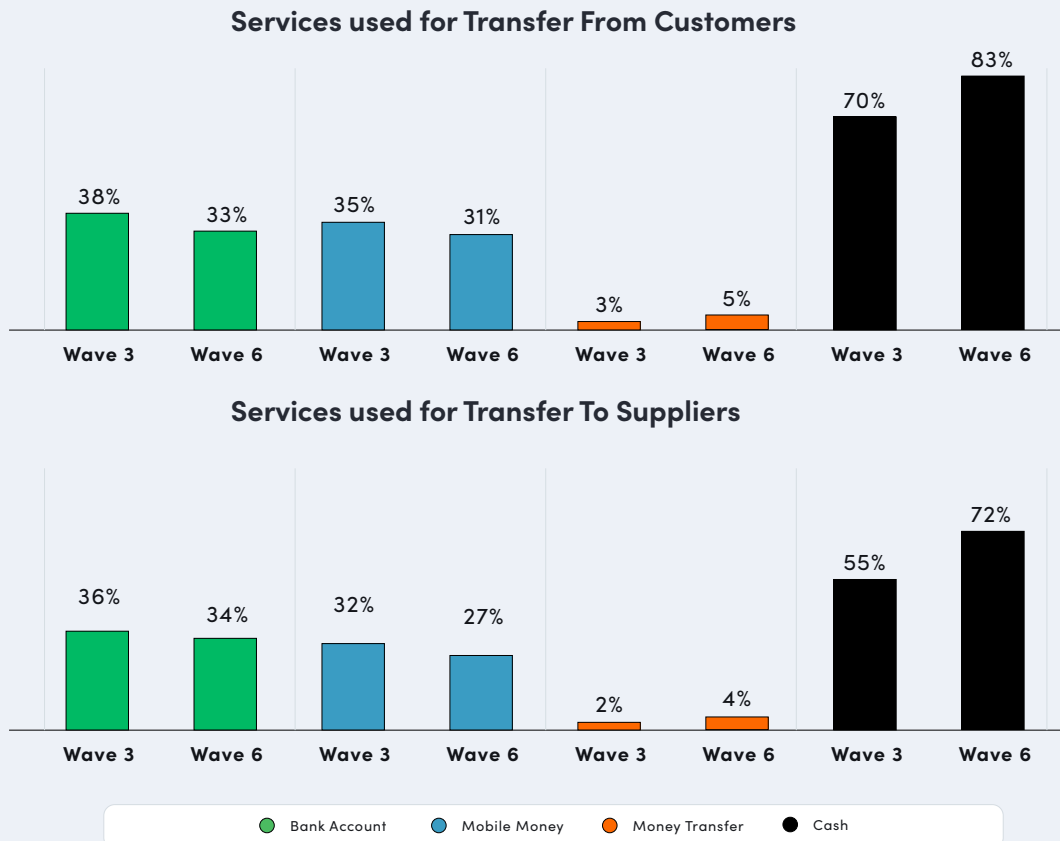
Many Business Owners Used Mobile Money, but Cash Remained Dominant

MSMEs in our survey also were inconsistent in their adoption of mobile money – another example of a higher-stakes digital tool. While some business owners used digital payments earlier in the pandemic, driven in part because of restrictions on personal mobility and consumer apprehension of COVID-19, many reverted to cash months later, demonstrating that cash continues to remain dominant in many markets.

Mobile money was used by many businesses in our surveys to pay suppliers and to accept payments from customers. A business owner of a general services firm in Colombia described the importance of mobile money and payment platforms to continue operations during the pandemic. However, despite the benefits some businesses saw from the use of mobile money, the use of mobile money decreased after an initial spike early in the pandemic. Thirty-five percent of respondents were using mobile money to receive payments from customers in wave 3 of CFI's data collection, but by wave 6, that number dropped to 31 percent. Over the same time frame, the percentage of business owners receiving payments from customers using cash increased from 70 percent to 83 percent. The same trend is observed and even more pronounced when examining transactions between business owners and suppliers.

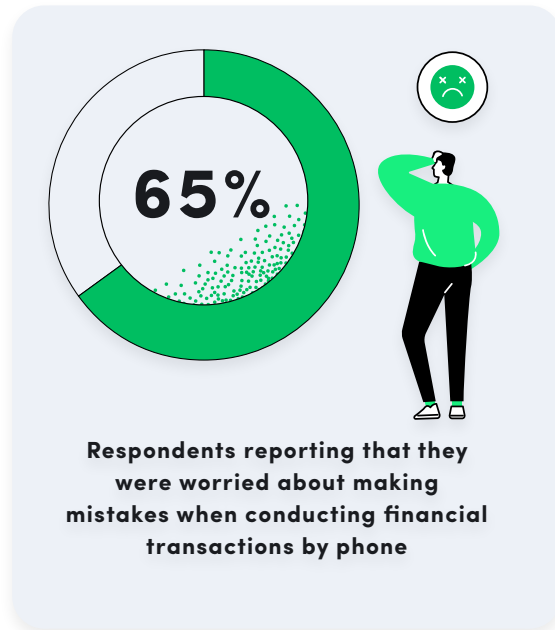
FIGURE 3

Modes of Payment Between MSMEs, Suppliers, and Customers



Our surveys revealed several challenges with the higher-stakes decision to adopt mobile money. For one, business owners did not fully understand the costs associated with mobile money, and 42 percent of respondents with a mobile money account said they did not know about all the fees associated with their account. Additionally, many MSME owners were not confident in using mobile money, with 65 percent of respondents reporting that they were worried about making mistakes when conducting financial transactions by phone.

While women in our sample were as likely as men to own and use a smartphone, they were less likely to conduct financial transactions using a phone. Women were also less likely to understand pricing models and redress policies. Some women reported that they avoided mobile money because they didn't know what to do or who to contact if something went wrong with a transaction.





Understanding the Transition From Low-Stakes to High-Stakes Digital Adoption and Its Enablers and Barriers

There are numerous barriers that MSMEs face in digital adoption, including concerns around fraud, identity theft, and personal data protection, as well as lack of transparency on fees or unclear recourse processes if something goes wrong. There are also often social norms that can limit the use of digital tools, especially for women. Because of these barriers, tech-touch approaches or hands-on support can be valuable to helping MSME owners begin to use digital tools — especially high-stakes ones.

One participant in Bolivia spoke about the critical role their financial service provider played in helping set up an online presence for their business: “The [FSP] offered to create a web page, online store, a website where you could offer your products. They have paid the hosting for a year ... I went to lessons, I did everything that they requested from me, and it’s been great because when I started with [a] Facebook page ... people looked for me, asking about catalogues and prices. I can’t say that I have sold a lot, but I have had plenty of publicity ... Through Facebook they could enter the website and [allow customers to] look at the catalogue. They looked [at] my things and called me, they told me ‘I’ve seen your catalogue,’ it has helped me a lot.”

These types of initiatives and hands-on support may be critical in supporting MSMEs on their digital journey. For a small segment of early adopters, such support may not be necessary. But CFI’s research suggests that digital adoption may not come easily for the rest.

In addition to tech-touch approaches that improve MSME owners’ digital capabilities, there are several other enabling factors that impact whether MSMEs adopt digital tools. These enablers include making sure the infrastructure and resources necessary are available and in place, including smartphone ownership, internet connectivity, and digital

FIGURE 4

Barriers and Enablers to Digital Adoption

Barriers and Enablers to Digital Adoption

BARRIERS	ENABLERS
■ Consumer protection concerns (fraud, identity, personal data)	■ Smartphone ownership
■ Transparency on fees	■ Internet connectivity
■ Lack of clear recourse processes	■ Digital capability
■ Social norms limiting women’s access	■ Digital payments infrastructure
	■ Regulatory frameworks
	■ Data privacy and protection laws



payments infrastructure. Additionally, regulatory frameworks and data privacy and protection laws are important to support consumers’ rights and convince MSMEs that there will be little fallout to their business if they test new digital ways of operating.



Looking Ahead: How to Support MSMEs' Digital Adoption?

As we envision a post-pandemic world with a growing digital economy, MSME owners' practices and digital adoption continue to be influenced by their peers in the market, suppliers, customers, and competing firms. How business owners adapt is influenced by individual factors of the business owner, such as entrepreneurial psychology and financial and business capability.^{vi} More research is needed to understand the interactions between MSMEs and the ecosystem within which they operate, how this context impacts digital adoption, and the costs, benefits, and most effective approaches for supporting the digital adoption of various segments of MSMEs.

CFI identified three key opportunities for further action:

■ 1. Conduct research to better understand the transition from low-stakes to high-stakes digital adoption for various MSME segments.

Research should aim to improve our understanding of why, how, and under what conditions various segments of MSMEs adopt and benefit from digital tools. Particular attention is needed to understand the specific challenges of women-owned MSMEs, for whom the operating context and support mechanisms are likely to be critical influencers of success. Donor support is needed to invest in this research to build our collective understanding of effective approaches to digital adoption of MSMEs.

■ 2. **Invest in digital infrastructure.** Many markets are well known for ubiquitous mobile money or other forms of digital payments; however, in others, such infrastructure is not as widely available (or used). Further, many countries are still grappling with the rapid changes brought forth by the digital economy, and policy and regulation have not kept pace. The infrastructure and enabling environment for a well-functioning and responsible digital ecosystem will be essential components of further digital adoption of MSMEs.

■ 3. Set up frameworks and policies to help MSMEs advance their digital adoption.

Governments should take the lead in ensuring that frameworks are in place to foster innovation, support investments in infrastructure, and guide responsible lending and data practices. Government policies should address the barriers to formalization and help MSMEs advance in their digital adoption journey without incurring administrative burdens and repressive costs. Additionally, research is needed to understand the effectiveness of government policies in cultivating a safe and effective operating environment.

Business owners in the focus groups recognized the increasingly crucial role of digital tools for their business. In the vision of one focus group participant, "Physical stores in the future will no longer be needed, everything will be virtual ... there is going to be some platform where we can make safe sales."



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