The Digital Opportunity: COVID-19 Pandemic Impact on European SMEs
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Executive Summary

It has been over a year since the COVID-19 pandemic began spreading across Europe and around the world, triggering a public health crisis and devastating the global economy. The economic crisis, while challenging to so many, has had a disproportionate impact on small and medium-sized enterprises (SMEs). Periodic lockdowns and public safety guidelines affected consumer spending patterns in particular for local SMEs.

In Europe, SMEs play a critical role in the economy, representing 99% of all enterprises and accounting for over 50% of Europe’s GDP.1 Months of decreased consumer spending, increased public health requirements, and limited access to funding has caused the rate of SME bankruptcy and closure to skyrocket. Many SMEs were left with no choice but to furlough employees, change enterprise operations, and many were forced to close their doors permanently. More closures are expected as the pandemic continues. Encouragingly, this study shows SMEs that adopt digital tools build higher resilience compared to the overall SMEs population.

The analysis in this report is based on 2020 PayPal transaction data from approximately 150,000 SMEs in Europe.* Analyzing year-over-year (YoY) total payment volume growth for these “digital SMEs” produced several interesting results which include:

- **During Q2 2020, Digital SMEs saw 50% YoY growth despite a 15% YoY decline in GDP for the euro area during the same period.**2

- **The benefits were seen by both experienced and newcomers to the digital economy:**
  - Digital SMEs that joined PayPal between March and May of 2020, just as the pandemic was spiking, experienced over 2x the average sales in their first month when compared to SMEs that joined PayPal in the same timeframe in 2018 and 2019.
  
  - Existing Digital SMEs, that created a PayPal account between 2015-2017 experience 45% YoY growth in Q2 2020. Indicating that there are growth opportunities for both new and old digital SMEs.

- **As SMEs across Europe were closing their doors, there is a strong indication that preparation for the pandemic and a ‘shop local online’ mindset drove much of the growth seen in Q2 2020. In-country sales for digital SMEs grew by over 50% while cross Europe and international growth rate was closer to 30% in that period.**

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* SME is defined as a company with a total payment volume (TPV) between €16.7K and €6.3M on PayPal in 2020 with at least 12 transactions.
While Digital SMEs saw growth across the region, the growth rate among rural areas was considerably higher, with digital SMEs in rural areas seeing 1.5X higher growth rates than their urban counterparts in several of the countries we studied.

While some of the expected industries such as travel were strongly impacted, there were other areas that experienced outsized growth. Food and drink, garden equipment and baby products businesses all saw a spike in growth of over 100% in Q2 2020.

These insights showcase the benefits of digital commerce in providing resilience for struggling SMEs and that businesses should be encouraged to adopt a digital footprint to reap the benefits. However, there are still barriers to digitization and economies across Europe continue to struggle with recovery. To further SME digital adoption, implementing policies to help entrepreneurs digitize are going to be essential as the trend towards e-commerce will only continue to accelerate going forward.
State of Europe’s SMEs

The COVID-19 pandemic has completely uprooted every segment of the economy over the past year. Beyond the economic effects, every aspect of our lives have been effected. At the time of writing, in Europe alone, over 23 million people have been infected and countless others have lost their jobs, and been isolated from friends and family members. On March 17, 2020, there was a confirmed case of COVID in every European country and the next day more than 250 million people across Europe were in lockdown.

Vaccines are now being distributed and there seems to be a light at the end of the tunnel, but the negative effects of the pandemic on economies around the world will be felt for years to come. In Q1 of 2020, during which the lockdowns only began in the final weeks, the EU GDP was down 3.2% (Eurostat, 2020 June 9). Over the course of the entire year, GDP fell in Europe by 6.8%, and some countries such as Italy, Spain and France declined closer to 10%.

Small and medium enterprises (SMEs) across Europe, and around the world, were disproportionately impacted by these economic hardships. Many SMEs struggling to adapt to changing dynamics, often because of a lack of employees and financial buffers, were left with no option but to close their doors. Unfortunately, for many, those doors never reopened. Nearly all SMEs in Europe (90%) experienced turnover loss in relation to lockdowns – and approximately 20% of those SMEs experienced 100% decline in revenue for several weeks in a row.

A recent survey found that 50% of SMEs in five major European countries (FR, DE, IT, ESP, UK) felt like they wouldn’t last another 12 months. Moreover, 70% of the same surveyed SMEs reported revenue declines, with 23%-33% reporting revenue being reduced greatly (country dependent).

The pandemic also upended the way that we work, with estimates that 20% of work hours will now take place permanently from home. SMEs are particularly ill-equipped to handle this change in the way that we work. A recent survey highlighted the gap in the ability to telework between SMEs (10-20%) and large firms (48%), citing a lack of digital infrastructure.

Indeed, the pandemic has accelerated the need to be digitally savvy and incorporate digital solutions into business operations. Some estimates have predicted that the pandemic accelerated the digital transition in Europe by 7 years.
Encouragingly, this acceleration can benefit SMEs that embrace digital technology. SMEs that have been able to move online and incorporate digital payment solutions have seen a level of resiliency through the toughest economic periods of the past year.

While there are encouraging signs that digital tools can help SMEs survive and recover, there is more that needs to be done to ensure these resources are available to all. As we explore how digital commerce is helping SMEs and democratizing opportunity, there are also opportunities to do better and enable SMEs to lead economies in their recovery.

The following analysis looks at 2018-2020 sales for European SME merchants with PayPal accounts. For the purposes of this analysis, SME is defined as a company with a total payment volume (TPV) between €16.7K and €6.3M on PayPal in 2020 with at least 12 transactions. TPV does not take into account the firms’ offline sales or online sales through other financial intermediaries, but it provides a unique and useful proxy for overall revenue and provides a view of the digital economy through the PayPal platform.
E-commerce – A Lifeline for SMEs

Online commerce has been becoming increasingly popular among consumers because of its convenience, broad assortment of products and services, as well as competitive pricing. Existing online consumers only increased their behaviors during the pandemic as a way to lower their chances of contracting COVID-19. In addition, there was also a 4% increase in EU-27 internet users conducting online shopping in 2020 compared to the previous year. Older consumers (55-74 years) experienced the most significant shift in adoption of online commerce during the pandemic. The change in consumer behavior underscores the need for SMEs to adopt digital tools to continue generating revenue. Digitization enables small businesses to grow their customer base and simplifies many of the traditional elements associated with running a business such as marketing, customer service, and accounting.

A Silver Lining: Growth

Our analysis of PayPal digital small businesses demonstrates that the digital transition is an opportunity for small businesses to weather the economic hardships of the pandemic. European digital SMEs saw 50% year-over-year growth in Q2 of 2020, compared to a 15% YoY decline in GDP for the euro area during the same period. In fact, even when isolating e-commerce as a whole, in 2020, e-commerce across Europe grew by 31%.

![Figure 1: YOY Growth Rate of European SMEs on PayPal](image-url)
While the growth rates vary from country to country for a multitude of reasons, including severity and timing of the pandemic, it’s clear that SMEs across Europe are resilient. Out of 40 countries, only two saw growth rates of less than 25%. This is stark contrast to an OECD report that shows that some of the hardest hit countries are in Europe, especially Spain, Italy, France and the UK, which all have a project minimum -11% reduction in GDP in 2020.\textsuperscript{11}

**FIGURE 2: TPV YOY GROWTH OF PAYPAL SME BY COUNTRY FOR Q2-2020**

- 90 to 154%
- 61 to 90%
- 20 to 61%
- -11 to 1%

### Growth Opportunity for Both New and Existing SMEs

Even more encouraging, our research demonstrated that it is not too late to digitize. Both new and existing SMEs saw increased growth on PayPal throughout the pandemic. Existing digital SMEs that created PayPal accounts between 2015-2017 experienced a 45% YoY growth in Q2 2020. This growth is largely in line with the overall TPV growth we saw from digital SMEs as a whole in the past year. The acceleration of online commerce meant that SMEs with an existing online presence still had significant room to grow.

On the other hand, SMEs that joined PayPal at the start of the economic lockdowns in 2020, presumably forced to adopt to online solutions as a result of the pandemic, also saw significant benefits. Our research found that SMEs that signed up for PayPal between March and May of 2020 were able to ramp up very quickly, experiencing over 2x the average sales in their first month when compared to SMEs that joined PayPal in the same timeframe in 2018 and 2019. This indicates that there are growth opportunities for both new and old digital SMEs.
It is reasonable to assume older merchants would experience lower benefits since digital maturity is expected to be higher. However, further analysis of existing digital SMEs by signup year show that while YoY growth rates are lower for older merchants, the increase in growth rate from Q1 to Q2 2020 are relatively similar (Figure 3). Surprisingly, when Q1 to Q2 2020 growth is analyzed past 2015 for the United Kingdom and Germany, it reveals that older merchants actually saw larger benefits (Figure 4). While this is counterintuitive, it speaks to the fact that even experienced digital SMEs can further unlock their ecommerce potential.
As public health regulations and guidelines prevented in-store sales, many SMEs turned to ecommerce. Using PayPal account creation date as a proxy for e-commerce adoption date, it is evident that newly digitized “COVID cohorts” were quick to ramp up, exceeding expected baseline sales when compared to cohorts who signed up in similar timeframes in 2019 and 2018.

Small businesses that joined PayPal between March and May of 2020 saw significantly more TPV when compared to SMES in the same timeframe in 2018 & 2019. (Figure 5 & 6). In April 2020, the TPV of the March “COVID cohort” was 2.7 times the TPV of small businesses that created a PayPal account in March 2019, and 2.5 times the TPV of small businesses that joined PayPal in March 2018. Similarly, in May 2020, the TPV of the April 2020 “COVID cohort” had 2.1 times the TPV of small businesses that created a PayPal account in April 2018 or 2019. Assuming the PayPal account creation date is a good proxy for the merchant’s first step towards digitization, it can be concluded that it took much less time, i.e. less than a month, for the “COVID cohorts” to catch up to and exceed the monthly revenue levels of small businesses that were pre-COVID adopters of e-commerce.

In April 2020, the TPV of the March 2020 “COVID cohort” had 2.7 times the TPV of small businesses that created a PayPal account in March 2018 or 2019.
Over time, the TPV multiplier seen by the 2020 cohorts remains elevated in comparison to 2018 and 2019 even in month four and five of transacting on PayPal. In the fourth month of transacting on PayPal (i.e. July 2020), the March “COVID cohort” recorded 1.5 times as much TPV as the 2019 cohort and 1.2 times as much TPV as the 2018 cohort. In the fifth month of transacting on PayPal (i.e. Aug 2020), the March “COVID cohort” recorded 1.4 times as much TPV as the 2019 cohort and 1.3 times as much TPV as the 2018 cohort. Demonstrating that while the benefits were larger directly after a merchant joined, it’s evident that “COVID cohorts” are seeing sustained benefits, not simply at the start.

Digitization is an important tool, regardless of tenure, to allow merchants to quickly combat decreases of in-store sales.

Drivers of growth

One of the tremendous advantages for SMEs that are operating online is reaching new customers across national borders. The digital opportunity democratizes globalization by allowing the smallest of businesses to access new customers around the world. We have seen the advantages of participating in cross-border trade for small businesses in non-pandemic times. PayPal research has demonstrated that digital SMEs from around the world are trading at greater levels which leads to more growth – all of which is experienced equitably regardless of location, business type or size.

When assessing how the pandemic impacted cross border trade (CBT) for European digital SMEs, it was important to inspect whether CBT rates were growing in tandem with the increase in TPV for SMEs. Encouragingly, we did see the rates of cross border sales
increasing with revenue growth. The growth in particular of intra-European trade and in-country spending, demonstrated a move towards supporting local merchants and shopping during the height of the pandemic.

Looking at the revenue by border type, there is a noticeable dip in percentage of TPV coming from cross border sales in Q2 2020 (Figure 7). This reduction was caused not by a reduction in cross border sales but by a significantly larger growth of in-country sales (57%) compared to cross border sales (32%) (Figure 8). The elevated increase of in-country growth compared to cross border only last for Q2. Indicating that while the pandemic has changed shopping behaviors, the behaviors at the onset of the pandemic were slightly different.
At the beginning of the pandemic, Europeans were buying and prepping for a “new normal” as business and movement restrictions were put into place in most European countries which presumably led to higher sales in Q2 2020.12 13 14

Early in the pandemic household goods like toilet paper were in high demand, this behavior shifted as consumers adapt to the new normal. There was also a strong shift to “buying local” to support SMEs across Europe that contributed to significant growth of in-country sales in Q2 2020. A study from Ernst & Young states 46% of consumers across Europe aim to shop more locally in the long term than they did before the pandemic.15

As homes became offices, schools, and gyms, they needed to be furnished so it’s not surprising that there was a large swell in furniture and sports equipment growth in Q2 2020 which then tapered off since many of these purchases would be one-time cost. Additionally, people turned to hobbies like gardening and crafts to fill their free time stuck at home.16 It is reasonable to assume some of these hobbies required an upfront investment in supplies which might be part of the reason these verticals spike in Q2 and tapered off. Another reason these verticals might taper off is because as restrictions lifted, people had other ways to fill up their time therefore were no longer purchasing additional supplies.

**FIGURE 9: VERTICALS THAT SAW THE LARGEST YOY GROWTH IN TPV**
While many verticals saw unprecedented growth, unsurprisingly travel and event related verticals saw significant reductions in growth (Figure 10).

**FIGURE 10: VERTICALS THAT SAW THE LOWEST YOY GROWTH IN TPV**

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**Equity in Resilience**

As demonstrated, digital tools can help SMEs increase sales and build resiliency. However, rural SMEs traditionally lag behind their urban counterparts when it comes to commerce because of a lack of infrastructure needed for traditional small businesses to succeed. The lack of a large number of local customers as well as the inherent complications in shipping from a rural area can be a barrier to small business success. An additional consideration when looking at barriers to rural SMEs is (1) a lack of access to fast broadband internet and (2) a lack of digital skills. This “digital divide” along with the infrastructure gap for rural communities creates a growth opportunity for rural SMEs that digitize, which was proven out in the research that we conducted, showing rural growth outpacing urban growth rates.

For the rural vs. urban analysis, PayPal accounts in Belgium, Switzerland, France, Spain, Italy, Germany, United Kingdom, and Netherlands were mapped to the rural-urban typology as defined by Eurostat. The growth rate among rural areas was considerably higher than their urban counterparts, with 5 out of 8 countries seeing 1.5X higher growth rates in rural communities than urban communities in the same country during Q2 2020. Additionally, in
The benefits of digital tools are multiplied for sectors normally disadvantaged since they create equity and promote inclusion.
Policy Considerations

SMEs have been significantly impacted by the COVID-19 pandemic and resulting closure of economies around the world. While many SMEs have struggled and been forced to close their doors, the crisis has impacted businesses differently, with some able to achieve resilience by expanding their digital operations and successfully pivot.

Full economic recovery will be a long road ahead. Already since the start of the pandemic, governments around the world have acted to mitigate the impact of the pandemic on businesses, and individuals. Small business relief has been a top priority for most government recovery efforts.

In the European Union, member states took deliberate steps to help small businesses, including liquidity measures or partnerships to link entrepreneurs to financial and other support. The European Commission has coordinated a common EU response by agreeing to financial support to member states through the Recovery Plan for Europe, alongside the European Parliament, and member state leaders.

Jointly with the European Investment Bank (EIB), the Commission instituted a several billion EUR relief mechanism for 100,000 European businesses through local bank and other lender support. Many European countries had announced similar financing schemes to support SMEs, with the majority of immediate support being received by the smallest companies.20

Moreover, the European Single Market showed its strength in ensuring that goods and services could continue to seamlessly flow across borders even at a time of declining economic conditions and government measures. Similarly, intra-EU cross border financial services including payment infrastructures proved resilient, supporting seamless business transactions across borders.

While the pandemic has been devastating for small businesses, it would have been much worse if no action was taken. A recent analysis of the support measures indicates that 2020 bankruptcy rates could have almost doubled without government relief21. However, SMEs remain at risk of falling through the cracks if more support is not given. As we enter the next phase of recovery, SMEs will continue to struggle with cashflow. The EU Commission’s Annual Survey on the Access to Finance of Enterprises 2020 showed European SMEs believe the reduced economic outlook reduces their access to capital by 40% - the highest figure to date.22
Due to the acceleration of the digital transformation, businesses need to invest in digital infrastructure to be able to adapt to the changing landscape of digital commerce. Public policy should be geared towards enabling this transformation, in particular for SMEs struggling with cash flow.

Moreover, it will continue to be of critical importance to ensure that SMEs have access to affordable and flexible funding through lending and direct financial support. Public policy should seek to encourage a diverse range of funding organizations to facilitate SME access to finance, in light of dramatic declines in rates on small value loans, which are needed by the most vulnerable smallest of businesses in the aftermath of the crisis.

Government support alone, while important, may not be enough to lessen the impact of the pandemic on the most vulnerable businesses and should be complemented by sound partnerships with the private sector. Private sector engagement can be supported through targeted and impactful public policies supporting small businesses benefit from the recovery ahead.
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*This research paper is primarily authored by Mansi Shah and Paul Disselkoen

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