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## **Digitalization: A way forward for Filipino MSMEs during the COVID-19 pandemic**

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# Digitalization:

## A way forward for Filipino MSMEs during the COVID-19 pandemic

### Introduction

The coronavirus (COVID-19) pandemic has had an unprecedented impact on Micro, Small, and Medium Enterprises (MSMEs) in the Philippines. In 2019, the Philippine Statistics Authority recorded 1,000,506 business enterprises operating in the country – 995,745 (99.5%) of which are MSMEs. Of the total number of MSMEs, the top five industries include wholesale and retail trade; repair of motor vehicles and motorcycles (462,492), accommodation and food service activities (144,024), manufacturing (115,387), other service activities (65,918), and financial and insurance activities (46,100). Together, the MSMEs generated a total of 5,510,760 jobs or 62.4% of the country's total employment. Microenterprises generated the most employment (29.8%), followed by small enterprises (25.2%) and medium enterprises (7.4%).

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According to a study by the Asian Development Bank (Shinozaki, 2020), Philippine MSMEs, due to quarantine measures, experienced a drop in domestic demand and struggled with a disruption of production and supply chain, among others. During the pandemic, the MSMEs relied mostly on their own funds and informal financing sources, even as they sought the deferrals of loan and tax payments. The study adds that over 70.6% of Philippine MSMEs were forced to close due to the pandemic temporarily — this place the country as the one with the most business closures, followed by Laos (61.1%), Indonesia (48.6%), and Thailand (41.1%). Additionally, 58.8% of Philippine MSMEs reported zero income, while 28% said revenues fell over 30%.

Cushioning this impact are initiatives by the public and private sectors that aimed to support MSMEs, helping them survive and become resilient. With the pandemic, entrepreneurs are presented with a puzzle, the pieces of which they must fit together while the clock is ticking. At the end of the game, what happens to the business?

This article focuses on MSMEs that tried to weather the crisis and those that found innovative means to survive. We discuss the following: (1) the adjustments or innovations that MSMEs have done during the pandemic; (2) what the government has done to support or complement the changes being undertaken by MSMEs; and (3) a call to action meant to address the current survival – and eventually thriving – of MSMEs through digitalization and the rapid adoption of digital technologies.

### State of digitalization in the Philippines

While several definitions of digitalization have been proposed in society, academia, and industry, there is no agreed-upon definition of ‘digitalization’ in the Philippines. Ona et al. (2021) define digitalization in the country through the increased and widespread use of e-commerce, e-banking services, social media, work from home schemes, distance learning, and online hobbies, to name a few. Through the Philippine Digital Transformation Strategy 2022, the Philippine government defines digitalization as “the inclusion of features like social web, user-generated content, the delivery and use of open data, and network effects through more user engagement” (DICT, 2021).

We highlight that digitalization is an early but fast-emerging practice among Philippine MSMEs. As cited in the Philippine Digital Economy Report 2020 of the World Bank, the number of Filipino internet users has more than tripled to 73 million in 2020 from just 23 million in 2010, highlighting the massive market potential for MSMEs (We Are Social, 2020). During the initial stages of quarantine measures in the Philippines, the Department of Trade and Industry reported that online retail’s business registration grew to over 88,000 from around just 1,700 registrations in January to March 2020 (Ramos, 2021). Given these, digitalization has been extensively promoted by both public and private sectors by creating digital transformation roadmaps and strategies, to name a few (DICT, 2021).

While digitalization is still an evolving practice, Philippine MSMEs can already explore many digital technologies, including artificial intelligence, robotics, the Internet of Things, 3-D printing, nanotechnology, biotechnology, and materials science, to name a few (Schwab, 2016). However, the main obstacle in digitalization for MSMEs is the upfront cost of new tools and technologies. A significant amount of work is also needed to empower and train MSMEs with the proper knowledge and skillset (Market Research Philippines, 2021).

Given the variety of definitions, it is also essential to distinguish digitalization from ‘digitization.’ One of the core arguments is that digitalization cannot occur without digitization (Chapco-Wade, 2018). Digitization involves the internal optimization of business processes (e.g., work automation, paper minimization) that results to cost reductions. On the other hand, digitalization consists of a core change to the business model and nature of work – it is not merely the strategy or process of adopting digital technologies.

At its current state, we would argue that Philippine MSMEs are still in the process of digitization and are yet to undergo digitalization; hence, the evolving state of digitalization in the country. Digitalization among Philippine MSMEs will only occur once there is a significant, core change in business models and the very nature of work. Under this current situation, both the public and private sectors are actively promoting the digitalization of MSMEs.

### Adjustments of MSMEs during COVID-19

Since the government imposed the lockdown in March 2020 in Metro Manila, it assisted MSMEs with various stimulus packages, including debt financing and employment support (Shinozaki, 2020). Compared to some ASEAN counterparts such as Vietnam and Thailand, however, the Philippines has not extensively addressed tax relief concerns (i.e., corporate tax reduction, expedited tax returns, incentives for investors, payroll, social security, value-added tax, and land taxes). Business support was also lacking (i.e., reduced utility payments, reduced leasing, waiver of government fees, reduced import restrictions, and vouchers for remote business services). According to a United Nations Development Programme survey (2020), only 40% of Philippine MSMEs reported having received external support.

Given the gaps in supporting MSMEs, businesses had to adjust accordingly to curb the impacts brought by the pandemic. For instance, many MSMEs were forced to temporarily lay off workers, resulting in around eight million Filipinos losing their employment in the first quarter of 2020 (UP Media and Public Relations Office, 2020). MSMEs have also experienced reduced operating hours, disrupted supply chains, the decline in sales per customer volume, and the unavailability of public transport, to name a few (MicroSave Consulting, 2020). Amid these unique challenges brought by the pandemic, some MSMEs were able to weather the crisis and adopt digital solutions.

Esme Palaganas, the founder of the fashion business called Basic Movement, began focusing on her business' e-commerce platform when the government imposed the lockdown. Previously, fashion businesses like hers relied on social media platforms such as Instagram to sell their product lines. From there, the owner or her employees usually perform the rest of the manual legwork, including the consolidation of orders and processing of payments and deliveries, to name a few. However, when the pandemic struck, many businesses like Esme's had to streamline all these processes through an e-commerce platform. Today, Esme shared that Basic Movement is working with a team to develop its e-commerce platform.

Camille Albarracin, owner of Everything Green, a sustainable products and solutions company, initially had to close down temporarily following the lockdown imposition in Metro Manila. A few months into the lockdown, Camille decided to experiment and pivot several of her products, including fashion accessories and wearables, to sustain the business. In the process of creating new product offerings, Camille also jumpstarted the development of her business' e-commerce platform. Through this platform, Everything Green was able to shift its business model from business-to-business (B2B) to business-to-consumer (B2C). In addition to this, the platform is also being used to handle the social campaigns of the enterprise.

Meanwhile, Reden Rojas of The Murang Gulay Shop (The Affordable Vegetables Shop) had to hire more people to handle the increasing number of vegetable orders during the pandemic. The business hired more people for administrative roles (i.e., managing customer inquiries) and handling the deliveries. According to him, their customers were worried they will not have food to eat during the lockdown – this was one of the motivating factors of the business to expand its services. However, even before the pandemic, The Murang Gulay Shop had already been active on Facebook, having over 20,000 followers. This provided the store a strategic advantage when the pandemic struck.

While digitalization is not necessarily the 'silver bullet' in addressing all these challenges, the experiences of these MSMEs show that digital solutions can be used to sustain their business as the COVID-19 situation continues to evolve. However, the challenge is that digitalization had been difficult to introduce to MSMEs even before the pandemic. According to the Department of Trade and Industry (DTI) (2020), Philippine MSMEs are used to "selling anywhere and anytime." The upfront cost of new technologies and tools is also a significant obstacle to digitalization.

## Assessing government action for MSMEs

Even before the pandemic started, several policies and government regulations were meant to support MSMEs in growing and sustaining their businesses. For example, the Barangay Micro Business Enterprise (BMBE) Law or R.A. 9178 is meant to facilitate the establishment of MSMEs and provide corresponding incentives and benefits.

However, the challenge is that a large percentage of micro- and small businesses in the Philippines belong to the informal sector. According to a 2018 report by the International Monetary Fund (2018), from 2004 to 2015, an average of 39.31-percent of businesses in the Philippines consists of MSMEs in the informal sector. These MSMEs are not officially registered, lack documentation, and thus are not eligible to avail of government services, including those provided by the BMBE. For instance, when the pandemic struck, MSMEs in the informal sector could not avail of the DTI's enterprise rehabilitation financing program because they did not have the proper documentation, registration, and financial records to apply for it. Given this, MSMEs in the informal sector are constantly reminded to start formalizing their businesses to participate in various government programs officially.

Another critical point to consider is that it is not only MSMEs that must digitalize during the pandemic but also the government and its policy interventions. One aspect is on helping facilitate the digitalization of MSMEs. Some initiatives have already been implemented, including the Innovative Startup Act or R.A. 11337, which "aims to create initiatives that will provide benefits and incentives to startups and startup enablers in the country." Another is the Ease of Doing Business Act or R.A. 11032, which is being implemented by the Anti-Red Tape Authority (ARTA).

Despite these MSME-related laws, the reality is that digitalization in the Philippines is not proceeding as quickly compared to other ASEAN economies. According to a report by TowerXChange (2019), the Philippines has 17,850 cell sites, Thailand has 52,483, while Vietnam has 90,000. Meanwhile, a similar archipelagic country, Indonesia, has 91,700 cell sites. The lack of adequate information and communications technology infrastructure has made the digital transition more difficult for Philippine MSMEs.

The continuing red-tape inefficiencies among local government units (LGUs) also remain a concern. As per Section 15 of the Ease of Doing Business Law, "local government units, and national government agencies are each given seven working days for the processing and approval of licenses, clearances, permits, certifications or

authorizations to put up and operate telecommunication facilities, broadcast towers, equipment, and services." During the pandemic, the Department of Interior and Local Government released guidelines for LGUs on how to expedite the construction of cell towers. However, much work remains to be done when it comes to supporting the digitalization of MSMEs even after the pandemic.

This is not to say that the government has not helped curb the pandemic's impacts on MSMEs. One such initiative is the Bayanihan to Recover as One Act, which granted the Philippine president additional authority to address its COVID-19 pandemic. As of December 2020, the initiative allotted around P1.6 billion to the COVID-19 Assistance to Restart Enterprises (CARES) program of the Department of Trade and Industry (DTI). The program was able to support 19,449 enterprises in the country (Official Gazette, 2021).

Other programs, such as the Interim Rehabilitation Support to Cushion Unfavorably-affected Enterprises by COVID-19 (IRESCURE) program by the Land Bank of the Philippines, have approved P2.875 billion loans out of the P10 billion allocation. While the IRESCURE program was initially intended for MSMEs, it was modified in October 2020 to include large enterprises such as hotels and airline industries.

Meanwhile, through the Agricultural Credit Policy Council, the Department of Agriculture released a total credit fund of P1.465 billion from the P2.5 billion total funding to 32 partner lending institutions in the agriculture sector. The government allocated this budget to the council's Expanded Survival and Recovery Assistance Program for Rice Farmers (SURE Aid).

In terms of helping MSMEs digitalize during the pandemic, the government has organized some initiatives. One of these initiatives is DTI's "CTRL + Biz Reboot Now!", a series of free webinars introducing MSMEs to digitalization. Among the topics discussed were supply chain, materials management, inventory control, transport management, and cargo handling, to name a few. DTI's partners in the e-commerce ecosystem shared their expertise and experiences in the digital space. They provided insights into the utilization of financial technology.

The Philippine government has also launched two major initiatives to improve internet service and quality: (1) the National Broadband Plan (NBP) and (2) free public Wi-Fi in public spaces (World Bank, 2020). Under the NBP, the government aims to develop an alternative source of international bandwidth, a submarine cable landing station,

and a domestic backbone network. On the other hand, the Free Public Wi-Fi program is intended to provide internet service to low-income areas, but implementation has reportedly been slow.

In the long run, the government's digital reforms can help the Philippine economy become more competitive, resilient, and inclusive (World Bank, 2020). Digital technologies can increase the productivity of businesses and the efficiency of the government, make the country more resilient to external shocks like the COVID-19 pandemic, and make development more inclusive through information sharing and providing service deliveries to those previously unreached and unserved. These are but a few benefits that the Philippines can gain from adopting digital solutions.

### A call to action

The digitalization of MSMEs is one of the 'lowest hanging fruits' and solutions to curb the COVID-19 pandemic's continuing impacts. While several interventions, including a range of fiscal and monetary policies, have been essential for providing economic relief to MSMEs, digitalization is also an important consideration (Karr, Loh, and Wirjo, 2020). A case in point is that the pandemic has led more consumers to adopt e-commerce, which means that MSMEs that haven't yet must start to take the plunge and digitalize their operations. According to a report, Filipinos were found to visit e-commerce websites approximately 4.9 billion times during the lockdown period (Cerezo, 2020) – a figure that has immense implications on the opportunities of 'going digital.'

While the benefits of digitalization will vary between different sectors and firms in the Philippines, it can ultimately help MSMEs in areas such as (1) managing transactions from a distance, thereby taking part in proper social distancing, (2) delivering goods efficiently, thereby ensuring a systematic and orderly transport of goods, (3) facilitating access to financial services through the use of existing financial technologies, thereby enabling cashless and convenient transactions, and (4) engaging with new and existing customers through social media, thereby giving MSMEs the capability to tap a bigger and more diverse market.

Promoting and enabling the digitalization of Filipino MSMEs can help address some economic challenges presented by the pandemic. As with other changes, however, the process of digitalization does not come without risks (Karr, Loh, and Wirjo, 2020). Despite the potential benefits,

some complex challenges of digitalization include (1) cybersecurity and data privacy concerns, (2) exposure to digital fraud, (3) online misinformation, (4) lack of capacity to develop market power and platform dominance, and (5) digital divide and infrastructure-related issues. Given this, supporting the digitalization of MSMEs during the pandemic requires policymakers to develop interventions that help establish digital structures for MSMEs and address the corresponding risks and challenges that such a digitizing initiative entails.

Another vital consideration is properly distinguishing between ‘digitalization’ and ‘digitization.’ While digitalization has become part of the dominant narrative, what is occurring among many Philippine MSMEs is the process of digitization. For instance, many MSMEs are focused on shifting from physical to digital (e.g., selling products online, using collaborative tools and software, etc.) – these are the main processes of digitization and not necessarily digitalization. As highlighted in this article, digitalization involves a more profound, core change in business models and the nature of work itself. Therefore, we suggest being careful not to interchange or misapply the use of the two concepts.

Clearly, the COVID-19 pandemic has proven to be one of the biggest challenges for MSMEs. Adopting digital technologies has been an ongoing process for Filipino MSMEs since the current crisis necessitated it and forced businesses to adapt quickly. Back then, it was merely a secondary option for Filipino MSMEs. However, it has become part of the ‘new normal.’ As the pandemic continues, government and other concerned stakeholders will want to expand and intensify their interventions to digitalize MSMEs not just during the pandemic but even beyond.

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