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## Challenges Related to the Implementation of State Aid Measures for Entrepreneurs Affected by the Covid-19 Pandemic

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**Abstract:**

**Purpose:** The aim of the paper is to identify and discuss many trade-offs which have to be made by public authorities while designing and implementing state aid measures for entrepreneurs affected by the Covid-19 pandemic.

**Design, Methodology/Approach:** Based on the case study - the project "Grant for working capital for micro and small enterprises from the Wielkopolska Region" four interrelated lines of inquiry are pursued concerning: the grant selection process, timelines of support, administrative burden imposed on applicant entrepreneurs and the appropriateness of the amount of aid granted. Specific problems are discussed in a broader perspective of public support programmes design.

**Findings:** Timelines of support and simplicity of the rules of granting aid are imperative in designing the public support delivery for entrepreneurs affected by the Covid-19 pandemic. However, one should not lose sight from other important aspects of allocating limited public funds, as it is usually a matter of striking the right balance by public policymakers between competing objectives in an attempt to ensure effective and fair allocation of limited resources.

**Practical Implications:** State aid that involves granting a selective economic advantage to undertakings imply the question about the allocation method of funds. Given the risk of liquidity shortage for SMEs that makes fast delivery of aid crucial for the aid to achieve its objective, providing public support on the basis 'first-come, first served' principle can be a justifiable rationing device. However, this holds true under certain conditions: all applicants must be in relevantly similar circumstances and have equal prospects to receive a benefit. As these are not fully met in the case under investigation, some recommendations are formulated for future interventions.

**Originality/Value:** Public debate on SME policy responses in times of Covid-19 crisis is often limited to numbers: how many entrepreneurs benefited from the public support and what is the aggregate value of the aid. The uniqueness of the conducted research lies in "looking under the surface" in the quest for ensuring effectiveness of state aid measures in the context of COVID-19.

**Keywords:** Covid-19, state aid, SME policy, effectiveness of anti-crisis measures, liquidity support, measures, aid implementation.

**JEL Classification:** M2, H12.

**Paper Type:** Research paper.

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## **1. Introduction**

Without public support many entrepreneurs, in particular micro and small ones would not survive the negative consequences of the various containment measures adopted by governments aimed at limiting the spread of the coronavirus such as distancing measures, travel restrictions, or lock downs. They often lack savings and therefore have no financial safety net to rely on in the case of unexpected occurrences, such as the coronavirus pandemic (Dębicka and Łuczka, 2019). According to OECD the months of March and April 2020 would probably enter in history books as the period when the highest number of SME policy initiatives were launched (OECD, 2021).

This article deals with liquidity support measures for SME survival, which in many countries like Poland remain a primary concern, and more specifically – the challenges related to their implementation. The purpose of the article is to identify and discuss many trade-offs which must be made by public authorities while designing and implementing state aid measures. Public values are inherent in any policy or managerial decision made in a public sector organisation; however, this problem is particularly acute in times of crises (Sancino *et al.*, 2021). Governments struggle at that time to come to terms with how they should react to ongoing events faced with time pressure, limited budget, and other capacity constraints and as Van der Val (2020) describes it aptly Covid-19 pandemic presents governments with a ‘super wicked problem’.

On the example of aid granted under the so-called ‘Wielkopolska Anti-Crisis Shield’ by Wielkopolska Agency for Enterprise Development (WARP), four interrelated lines of inquiry are pursued concerning: the grant selection process, timelines of support, administrative burden imposed on applicant entrepreneurs and the appropriateness of the amount of aid granted.

Our study is premised on the notion that addressing the SME liquidity gap is not only a matter how much financial resources are allocated for this purpose but also to whom, when and on what terms they are provided. These four issues constitute the four main dilemmas behind every public support programme. Public debate on SME policy responses in times of Covid-19 crisis is often limited to numbers: how many entrepreneurs benefited from the public support and what is the aggregate value of the aid. The uniqueness of the conducted research lies in “looking under the surface” in the quest for ensuring effectiveness and fairness of state aid measures in the context of COVID-19 crisis.

The article is structured in four major sections. Following an introduction, the project “Grant for working capital for micro and small enterprises from the Wielkopolska Region” is presented as a part of the Wielkopolska Anti-Crisis Shield. This case can serve as a good example of the many challenges related to the implementation of state aid measures for entrepreneurs affected by the COVID-19 pandemic. Premised on the notion that producing practical, context-dependent knowledge is imperative for learning, it is worth citing after Flyvbjerg (2006) the insight of Thomas Kuhn that ‘a scientific discipline without a large number of thoroughly executed case studies is a discipline without systematic production of exemplars, and a discipline without exemplars is an

ineffective one'. The subsequent three sections correspond to the research problems raised; first, how to select entrepreneurs for funding – on the basis of the quality of an application (the system of preferences), or the first-come, first served principle; secondly, what rigour should be ensured in the process of funds distribution, i.e. striking the right balance between the control and simplicity of rules underpinning the process of granting support, and finally, how to calculate the appropriate level of aid as there are not enough funds to satisfy the needs (total loss) of all the eligible entrepreneurs. The article ends with conclusions.

## **2. Grant for Working Capital for Micro and Small Enterprises**

Due to extraordinary circumstances caused by the outbreak of coronavirus pandemic, a portion of the cohesion policy funding allocated for Poland for years 2014-2020 had to be reprogrammed to mitigate the negative consequences of the crisis in the economy as well as to support the national health system. The changes included three operational programmes (i.e., OP Smart Growth, OP Infrastructure and Environment and the Regional Operational Programme for Wielkopolska) and concerned 618 million euro (European Commission, 2020). Public support has become imperative to ensure sufficient liquidity for undertakings and preserve the continuity of economic activity during and after the coronavirus pandemic.

Therefore, the Executive Board of Wielkopolska Region as the managing authority of the Regional Operational Programme for Wielkopolska, in an extraordinary mode, selected Wielkopolska Agency for Enterprise Development (WARP) to implement aid for micro and small entrepreneurs from Wielkopolska Region in the form of grants for maintaining financial liquidity, as a part of the Wielkopolska Anti-Crisis Shield under the Wielkopolska Regional Operational Programme for the years 2014-2020, Priority Axis 1 Innovative and Competitive Economy, Measure 1.5 Strengthening the Competitiveness of Enterprises, Sub-measure 1.5.2 Strengthening the Competitiveness of the Key Regional Economic Areas, Project No. RPWP.01.05.02-30-0001/20.

The purpose was to support entrepreneurs who found themselves in a situation of sudden shortage or even lack of liquidity due to the COVID-19 pandemic. Hence, the grants could be utilised to finance working capital, i.e., to cover the costs of the entrepreneur's day-to-day operations, such as: costs related to hiring employees (salaries, social security and other mandatory benefits), rent for premises, utility charges, purchase of materials and services necessary for production and/or running the office, repayment of commitments formerly made (e.g., lease instalments, loans).

Grant recipients could be all micro and small businesses, including the self-employed, with a registered office in Wielkopolska Region, who were running a business as of December 31, 2019, were not in a difficult situation on 31 December 2019 (within the meaning of Article 2(18) of Regulation 651/2014), were not in arrears with payment of taxes and social security contributions as of that date; and have experienced a decrease in turnover (sales revenue) of at least 30% in the period of the selected 1 month in 2020 starting from March 2020 compared to the previous month or the corresponding month of the previous year.

The eligible entrepreneurs could use the grant only once and were divided according to the Polish Classification of Activities (PKD), into type A (those who suffered the most due to containment measures adopted by public authorities to limit the spread of coronavirus, e.g., hotels, tourist accommodation facilities, activities of travel agents, activities connected with organising fairs, exhibitions and congresses), and Type B (entities meeting the requirements for participation in the project but operating in other industries than those in Type A). The total amount of money allocated for this type of support was PLN 94 293 867,92, of which 40% was dedicated for Type A grants (PLN 37 717 547,17) and 60% for Type B grants (PLN 56 576 320,75) (Warunki i zasady udzielania grantów w ramach projektu grantowego „Wielkopolska Tarcza Antykryzysowa”, 2020).

### **3. The Grant Selection Process – too Rapid Delivery of Funds?**

There are two general approaches to the grant selection process. After meeting the eligibility criteria applicants may be awarded grant:

- on the basis of the information included in the application and against the defined award criteria (the quality of an application, system of preferences). This leads to the establishment of the ranking list of applications proposed to receive a grant. Depending on the budget available –those who are scored higher have greater chance to be awarded; or
- based on the ‘first-come, first served’ principle, that means that entrepreneurs meeting the general criteria receive a grant in order in which they apply until the budget is exhausted.

Both approaches have their advantages and disadvantages. The former – the aid is better targeted as it goes to those who can potentially make better use of the aid or suffered the most due to the coronavirus pandemic, but on the other hand, makes the whole process of grant selection more lengthy and costly. The latter, in turn, allows for faster and cheaper distribution of aid. In the case of combating the negative effects of coronavirus the timeline of support is certainly very important, therefore, this approach was taken in the project under investigation. Nevertheless, it can be a source of other problems addressed below.

Although it was known from the very beginning that the demand for aid is many times higher than the available resources, it was hard to predict that the available funds would run out in a fraction of a second. On August 24, 2020, at 9:00 a.m., the call for grant applications in the project "Wielkopolska Anti-Crisis Shield" began and was terminated due to exhaustion of the allocation as early as at 09:01:04.971690. The largest allocation of aid funds of this type in Poland among those launched by the voivodships was distributed in just over one second. The generator registered 50 138 applications for the total amount of over PLN 1 696 000 000. More than 40 thousand clicks took place now of launching the call. Shockingly short duration of the call caused massive dissatisfaction and protests regarding correctness of the application process and resulted in an initiation of the audit procedure by the Marshal's Office of the Wielkopolska Region to check the process of submitting / accepting applications by the IT system.

The doubts concerned the potential interference of the so-called bots, i.e., software application that runs automated tasks (scripts) over the Internet. To verify this issue entrepreneurs whose grant applications were successful were asked to provide the IP address of the network used to apply for a grant. Many of them had a serious problem in obtaining network IP. The competition regulations did not specify recording which network IP was used on the day of enrolment, so entrepreneurs did not keep such data and had to ask their network operators to obtain this information. Consequently, the waiting time for a grant was extended.

The above case shows that in a quest for swift distribution of funds to entrepreneurs affected by the COVID-19 pandemic, the opposite effect can be achieved. The lack of access to the application logs for qualifying applications, which have messages about the IP address, abandoning the captcha tool which helps to tell humans and bots apart does not necessarily optimise the performance of the application but leads to the hard to accept situation when fractions of a second is decisive for obtaining a grant, and the exact payment of funds is delayed anyway. Moreover, it raises the question of admissibility of imposing the additional requirements on applicant entrepreneurs not included in regulations of the competition.

Putting the issue in a broader perspective, John and Millum (2020) provide an account of the moral significance of waiting time, which is widely used in health and social policy as a means for deciding to whom scarce resources are allocated. They argue that applying the ‘first come, first served’ principle to make resource allocation decisions can be a justifiable rationing device, however, under certain conditions that should be considered by policy makers. First, the applicants must be in relevantly similar circumstances and this problem is addressed in section 4. Secondly, there is no line cutting or ‘queue jumping’. Moreover, even when the use of the first come first served principle in allocation scheme offers fair chances in principle, it might be unfair in practice. Hence, it is imperative to ensure that each applicant has in fact an equal prospect to receive a benefit.

It can be argued that increasingly more attention in public debate has been devoted to the introduction of the random allocation mechanisms in funding programmes such as lotteries. This is particularly noticeable in science and innovation policy. Proponents of such allocation mechanisms formulate their arguments on the criticism of expert opinions and peer reviews. Pier *et al.* (2018), for instance, found a low agreement among reviewers scoring of the same application, Fang, Bowen and Casadevall (2016), in turn, found that peer review percentile scores are poorly predictive of grant productivity.

Moreover, lotteries remove potential biases in the selection process and are the chance for the novel projects, that are beyond the mainstream, to be funded (Avin, 2019). Certainly, in our case, the issue is much simpler as the aid is to compensate the loss suffered due to pandemic, however, the parallel can be drawn between ensuring in practice an equal prospect to receive a benefit and such alternative allocation mechanisms as lotteries, where grantees are randomly selected from the pool of those who applied and met the eligibility criteria.

#### **4. Formalisation and Administrative Burden – How to Strake the Balance between Ensuring Control and Simplicity?**

According to the OECD (2009) administrative simplification entails balancing the need to use administrative procedures as a source of information and as a tool for implementing public policies, on one hand, and minimising the interferences implied by these requirements in terms of the resources (costs) needed to comply with them, on the other (p.6). Simply, we can say that administrative simplification is about cutting red tape. The costs of compliance are borne by both sides: public administration and in our case – applicant entrepreneurs. In literature there is a need expressed to consider red tape from the perspectives of multiple stakeholders (Bozeman and Scott, 1996).

Red tape is something that characterises not only public sector organisations but also private ones, however to a lesser degree. Bozeman (1993) makes a distinction between red tape and formalisation. He argues that it is useful ‘to view formalisation as part of the physiology of the organisation and red tape as a pathological aspect of that physiology. Thus, formalisation, in the sense of rules and procedures, is a neutral attribute of an organisation. Although there are many definitions of formalisation, most of them conceptualise the concept by its function in organisational coordination and control (Bodewes, 2002). Bozeman (1993) defines organizational red tape as ‘rules, regulations, and procedures that remain in force and entail a compliance burden for the organization but have no efficacy for the rules' functional object.

Two aspects of a rule are important for labelling the rule as red tape. These are the functional object of a rule and rule efficacy. The functional object of a rule refers to ‘the organizationally sanctioned purpose for which a rule is created, the problem it seeks to solve, the opportunity its exploits’, and rule efficacy denotes ‘the extent to which a given rule addresses effectively the functional object for which it was designed’. Thus, we need to view organisational rules and procedures through the purpose they are to serve and how effectively they do it. Of relevance is the ratio between cost compliance and benefits obtained.

Hence, the OECD’ definition of administrative simplification uses the word ‘balancing’. It should, however, be added that formalisation, as well as red tape, can be measured not only at the organisational level, but at the level of a department or in reference to specific processes (Bodewes, 2002). Unfortunately, in the literature there are many examples of reforms implemented under the banner ‘reducing administrative burdens and improve the business climate’, that failed to meet the expectations (Banović, 2014). The phenomenon that is aptly described as ‘cutting the red ribbon not the red tape’.

In the grant project under investigation- the call for applications was held with the use of on-line generator, however, to consider the applications as submitted it was necessary to deliver a paper version of application documents. It transpired that in overwhelming majority of cases entrepreneurs were called to remove the deficiencies or submit supplementary documents. Against this backdrop, the question can be raised - how to strike the right balance between ensuring control and simplicity. In principle, bureaucracy aims to instil fairness, rationality, discipline, and equity into the public

sphere (Kali, 2020). Undoubtedly, this is vital when dealing with public funds. On the other hand, it can cause excessive formalisation, control, and procedural constraints, (i.e., red tape) (Sievert, Vogel, and Feeney, 2020).

One of the actions in order to reduce administrative burdens resting on citizens and entrepreneurs was to substitute certificates by the statements (Act of March 25<sup>th</sup> 2011 on reducing administrative barriers for citizens and entrepreneurs, Journal of Laws 2011 No 106, item 622). However, this problem is not as simple as it seems. Experience in the implementation of the project: “Working Capital Grant for Micro and Small Enterprises” shows that applicants had frequently a problem with something as basic as establishing the status of SMEs. This is one of the most fundamental issue for the state aid granting in general. Often they were not aware of the fact that decisive for being micro, small and medium enterprise is not only the applicant enterprise’s size in terms of employment and an annual turnover (balance-sheet total), but also the ownership structure – partnerships and linkages to other enterprises which may impact on the overall headcount and financial criteria of an enterprise (Commission Recommendation 2003/361/EC).

The second issue posing a significant problem for applicant entrepreneurs was calculating the full-time equivalent (FTE) employment. FTE is a unit to measure employed persons in a way that makes them comparable although they work a different number of hours per week (e.g., part-time), or are seasonal employees. Both of these issues, i.e., determining the status of a SME and FTE, are relevant not only in this particular case, but very frequently these are decisive factors if not for aid eligibility than for determining the amount of aid an entrepreneur can receive. It can be argued that false statements made by applicants is not only a matter of intentional unfair conduct but also lack of information or rather lack of due diligence in reading the relevant rules and conditions governing the grant procedure. Not so much refusal to provide support, but a ban on applying for any public support within a certain period or holding such persons criminally liable should effectively deter them from this conduct.

## **5. The Appropriate Level of Support – How to Ensure Proportionality of Aid?**

Amount of aid granted should be proportional to the problem tackled, when it constitutes state aid within the meaning of Article 107 of the Treaty on the Functioning of the European Union. On one hand, it should be sufficient to achieve the objective of the aid, on the other – be kept to the minimum that is necessary. (In our case, the grant constitutes state aid aimed at remedying a serious disturbance in the economy within the meaning of Art.107(3)(b) TFUE).

An approach taken in the case under study was to set one general condition concerning the loss suffered – an entrepreneur’s turnover in any month counting from March 2020 compared to the previous month or the same month last year had to fall by at least 30%. The base amount of the grant was 7,845.11 PLN. This sum was multiplied by:

- the number of  $\sqrt{\text{FTE}}$  index (i.e., full time equivalent employment),
- the number of months in which an entrepreneur assumes obligation to maintain economic activity; it could be one, two or three months at the maximum; (almost all

applicant entrepreneurs assumed obligation to maintain activity for a maximum period, i.e., three months).

It follows that the minimum amount possible to obtain by the grantee was 7.845,11 PLN, (for  $\sqrt{\text{FTE}} = 1$ , e.g., a self-employed person and maintaining the activity for 1 month), whereas the maximum amount possible to obtain was 164.747,31 PLN (for  $\sqrt{\text{FTE}} = 7$ , as the grant was dedicated only to small enterprises, thus the upper employment limit was 49 employees and maintaining the activity for three months).

The average aid granted under the grant project amounted to PLN 33 001.90. However, let us consider whether the level of support was appropriate in reference to three selected enterprises who received the grant.

The first example (enterprise A) is a legal office run by one person (no employees). Enterprise A experienced a decrease in March 2020, and its revenue at that time was PLN 3,000. The month indicated as the comparative month was February 2020, the revenue then amounted to PLN 6,500. The difference in the amount between the two indicated months was PLN 3,500 thousand, then the decrease was at the level of 46%. The aid received in this case was equal to PLN 23,535.33; (basic amount of the grant: 7,845.11 has been multiplied by  $\sqrt{1}$  FTE (1 person) and 3 months).

The second example (enterprise B) is a manufacturing enterprise in the field of paper and board production, employing six persons. In March the enterprise B's revenue was PLN 211,578.57, and in a comparative month: April: PLN 132,770.24. Thus, the decrease in the turnover was at the level of 63%. The enterprise was granted PLN 57 649,56; (basic amount of the grant: 7,845.11 has been multiplied by  $\sqrt{6}$  FTE (6 persons) and 3 months).

The third enterprise (enterprise C), is a service provider in the field of plumbing, heating, gas, and air conditioning installation, employing seventeen persons. Enterprise C indicated March 2020 as the month of decline, in which it recorded revenue of PLN 259,350, while in comparative month: February 2020 the revenue was at the level of PLN 259,350. This gives a decrease of 65%. The enterprise received PLN 97,038.66; (basic amount of the grant: 7,845.11 has been multiplied by  $\sqrt{17}$  FTE (17 persons) and 3 months).

Despite fulfilling the requirement of minimal decrease in turnover in all presented cases (A, B and C), one can observe that the amount of aid was not at the appropriate level in none of the examined cases. Enterprise A reported a decrease of PLN 3 500, enterprise B reported a decrease of PLN 78 808,33, while enterprise C reported a decrease of PLN 140 740. Enterprise A received a grant of PLN 23 535,33, enterprise B of PLN 57 649,56 and enterprise C of PLN 97 038,66. That means that enterprise A received a grant much higher than the decrease in its turnover, while the grant in the case B and C did not even cover the reported loss. These cases clearly prove that some adjustment of the level of the aid rate should have been made.



**Table 1.** Relationship of loss in turnover to the amount of grant received

	Enterprise A	Enterprise B	Enterprise C
Benchmark (in PLN)	6 500.00	211 578.57	400 090.00
Decline (in PLN)	3 000.00	132 770.24	259 350.00
Loss (in PLN)	3 500.00	78 808.33	140 740.00
Grant amount (in PLN)	23 535.33	57 649.56	97 038.66

*Source:* Own elaboration.

On the other hand, it must be admitted that studies undertaken in other countries report similar policy failures. For instance, Sawyer (2021), who deals with the problem of the economic policies against the coronavirus crises in the UK writes about self-employed who were granted substantial grants even though they were not badly affected by the pandemic. This is because payments were not directly linked to financial loss experienced during the crises. Moreover, the self-employed, contrary to furloughed workers could continue to work while receiving the grant. Consequently, those who suffered only a small income loss could be better off than if the crisis had not occurred (Adam *et al.*, 2020). It seems reasonable to consider these divergent effects and their scale in future public interventions of that kind.

## 6. Conclusions and Recommendations

Timelines of support and simplicity of the rules of granting aid are certainly vital in designing the public support delivery for entrepreneurs affected by the Covid-19 pandemic. It can be argued that these issues were at the very heart of the grant project “Anti-Crisis Shield of Wielkopolska Region”. One of the key messages formulated by the OECD after one year of SME and entrepreneurship policy responses to COVID-19 is to “ensure rapid delivery of SME and entrepreneurship policy support by simplifying access to support and ensuring effective digital delivery systems, while safeguarding accountability and effectiveness” (2021, p. 9).

However, one should not lose sight from other important aspects of allocating scarce public funds, as it is usually a matter of striking the right balance, making difficult trade-offs by public decision-makers between competing objectives to ensure effective and fair allocation of limited resources. As Giuseppe (2017) points out – it is very important to understand that efficiency alone cannot be a relevant policy objective. The degree to which goals and levels of output are achieved or problems are solved is at least equally important.

First, this is a matter to decide how to select entrepreneurs for assistance as the needs are greater than the resources available. From the two general approaches to grant selection: on the basis of the information included in the application and against the defined award criteria (the quality of an application, system of preferences), and on the basis of the ‘first-come, first served’ principle, the latter one can be considered as appropriate, given the risk of liquidity shortage for SMEs that makes fast delivery of aid crucial for the aid to achieve its objective. Nevertheless, following the line of argument of John and Millum (2020), such a method is justifiable when all applicants are in relevantly similar circumstances and have equal prospects to receive a benefit.

However, the analysis carried above suggest rather the need to adjust the rules of grant awarding considering the type of activity of an entrepreneur and the amount of turnover decrease. Differentiation between the Type A grant and Type B grant to ensure that some share of funds is allocated for those entrepreneurs who are active in the areas the most hit by the Covid-19 pandemic might be not enough. In practice, self-employed entrepreneurs with relatively lower turnover received more in comparison to those entrepreneurs with bigger operations.

A limitation of this study and at the same time a suggested avenue for future research is to supplement evaluation of a single aid scheme with evaluation of a policy mix, which can be defined as ‘a combination of policy instruments embraced by an overarching policy strategy’ (Ossenbrink *et al.*, 2019), in this case - public support for entrepreneurs (SMEs) affected by the Covid-19 pandemic, in order to identify any possible gaps and overlaps in the architecture of the coronavirus-related aid measures. Having regard to the fact that out of 450 thousand of entrepreneurs from Wielkopolska, 50 thousand applied for a said grant and less than 2,9 thousand, i.e., around 6% received support, the aid was only a drop in the ocean of needs.

Moreover, given the shockingly short duration of a call (just over one second) and the resulting doubts over the technical matters that could jeopardise equal access of the eligible entrepreneurs to aid, the question can be raised about an alternative method of allocation such as lottery that can be used instead. This method could be equally efficient in terms of speed of distribution and at the same time might give applicants equal chances to receive a grant.

As a final note concerning the administrative burden of public support, the study suggest caution as to the resignation of the certificates in favour of the statements made by entrepreneurs due to the high percentage of inconsistencies found in the process of verification. However, the control should be limited only to the information that are crucial from receiving a grant and more cooperation between public institutions in terms of information sharing is recommended.

The latter one is also important to form the right attitudes of any potential applicant for public support who would be aware of the severe consequences of making false statements no matter whether it is done purposefully or caused by the lack of due diligence. It is worth noting that in the public management literature increasingly more attention is paid to the implementation phase of public programmes (Chen, 2021; Hudson, Hunter, and Peckham, 2019; Braithaite *et al.*, 2018), and this paper fits into this trend.

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