

**COVID-19 and MSMEs****Rachit Saini**

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**Abstract**

Regarded as the backbone of Indian Economy, MSMEs (Micro, Small and Medium Enterprises) contribute to inclusive industrial development. The purpose of this paper is to study the effect of Covid-19 on Indian MSMEs and how severely each phase of production & demand is affected. The pandemic has thrown up unforeseen challenges that has disrupted the businesses of a large number of such units, forcing some of them to even shut down. The study examines the problems faced by the sector and measures it can take. Further, policies and suggestions to address the situation have been recommended.

**Keywords:** COVID-19, MSMEs, India

**Introduction**

As the confirmed Coronavirus cases cross three million worldwide, the global COVID-19 pandemic seems to be causing a large-scale loss of life, impacting lifestyle, businesses and severely menacing the world economy. With about 162 countries in the lockdown, it seems to be the largest public health crisis which has led to major economic crisis, halting production in the affected countries, leading to collapsing consumption & confidence, and stock exchanges responding negatively to the uncertainties. The Indian economy that was already struggling with rising interest rates, fiscal deficit, unemployment, and sluggish economic growth in the previous year could be severely affected while the COVID-19 outbreak poses fresh challenges. India so far has been managing the impact of the pandemic using unparalleled social, public health, awareness & economic measures, and such interventions are needed to minimize the permanent damage across the spheres. While the current focus is to safeguard the population from this health-hazard and to provide relief to the vulnerable, there has to be a long-term to help the economy, viability of the businesses and the livelihoods of the population. There is a need to mobilize the resources to stimulate the economy. Among the many parts of our economy that require assistance and immediate attention are the MSMEs (Micro, Small and Medium Enterprises).

**The MSME Sector in India**

Over the past few decades, the Micro, Small and Medium Enterprises (MSME) sector has emerged as a vital sector of the Indian economy. This sector helps in the economic and social development of the country. It promotes entrepreneurship and generates largest employment opportunities after agriculture. It contributes to the country's inclusive industrial development. The MSMEs have widened their domain across the sectors of economy and produce diversified range of products to meet the domestic and global demand. This Sector is regarded as the

pillar of the Indian Economy. It approximately comprises of 99% micro, 0.52% small and 0.2% medium enterprises. According to the data of 73<sup>rd</sup> round National Sample Survey, it is estimated that 633.88 lakh unincorporated non agriculture MSMEs are engaged in different economic activities like manufacturing (31%), trade (36%) and other services (33%). As per the Ministry of Statistics & Programme Implementation data, MSMEs employ 11.10 crore population across urban, semi-urban and rural areas i.e., 40% of the country's workforce, contribute around 30% to India's Gross Domestic Product (GDP) and 50% (\$125 billion as of 2017-18) to the country's exports. Hence, it is unquestionable that this backbone requires urgent safety net and financial help amid the COVID-19 crisis that has disturbed the microeconomic cycle. Given the lockdown, disruption in their businesses, revenue losses and the reduced economic activity, a large number of these units are under the threat of being suppressed and permanent shutdown.

**Challenges faced by the MSME Sector**

The MSMEs are at the center of the economic crisis brought by this outbreak more so than affected by any other circumstances ever. This crisis has affected them disproportionately and revealed their vulnerability to supply and demand shock. There is mounting concern among the businesses.

The MSMEs will be impacted at several levels, with the retail and production facilities being hit adversely. Micro enterprises, like the ones in the service sector have also been adversely hit. The ones engaged in food, accommodation and travel & tourism industry have witnessed a crash in their business. MSMEs that work in essential goods and services though operational, yet are facing decreased demands and aren't isolated from this slowdown's impact. Consumer goods, footwear, clothing, automotive and parts segments have seen a major and direct impact. Sectors that are dependent

on imports of raw materials like the consumer durables, pharmaceutical, electronics, etc. are facing problems and the same is the case with the export-oriented sectors due to the reduced global demand. The shocks call for costs, which the enterprises find difficult to cover and are quite rigid in dealing with them.

There are a lot of issues that make this sector vulnerable like the price variations of the key raw materials, production shutdown, cash flow constraints, supply chain disruption, labor force unavailability, negative consumer sentiments, and the reduced exports.

Due to domestic lockdown, and closed international borders because of Covid-19 outbreak there has been liquidity crisis particularly cash crisis and decreased demand being faced by the MSMEs. A study by All India Manufacturers' Organization (AIMO) reveals that around 60 million odd MSMEs are in real danger due to market issues and there has been drop in the sales (specifically domestic sales) by 92% in comparison to the last year. There is almost 100% drop in export sales compared to the same time last year. Moreover, with the Europe and U.S. being affected, the global export demand has come down significantly. Businesses that trade internationally are at risk because they depend on the dollars received that fund a variety of their costs. This will have a long-lasting cascading impact as the global demands aren't going to increase soon.

MSMEs have small cash reserves. Cash flow constraints have always been an issue even before this outbreak came into the picture. There are various government-run companies who owe them payments stuck due to the procedural delays. The National Highways Authority of India, for instance, has to pay an overdue of Rs.25000 crore owed to the contractors. Getting payments in time is anyway critical for the small companies, delay in which adds to their capital cost. It's not just the pending payments from the PSU companies, during this uncertain time period some of the MSME's clients and customers can't afford to pay for the deliverables & services. And losing clients means loss of revenue, and also either low or no profitability. There is an effect on the credit cycle too, leading to shortage of working capital, which directly translates to impacting future investments and expansions in future times. Whether it is the realization of pending bills or easier credit terms, access to finance is also one of the biggest concerns for the small and micro units. They need access to finance at easier terms to sail through this, and generating cash to the businesses is still an issue. The MSMEs are going to face an acute cash crunch due to the sharp fall in businesses with low or zero manpower over the coming weeks.

With the large-scale migration of workers from urban areas to rural areas or their hometowns, small businesses (restaurants, retail shops, hotels, personal care and grooming, and other similar small businesses), factories and other manufacturing units are under more uncertainty even if the lockdown restrictions are eased. Though the bank dues have been deferred by the government, the challenges will be to pay their statutory dues and wages to the employees. Contractual and daily wage laborers seem to be impacted more leading to layoffs, unrest and the fall in this particular class' purchasing power.

Weekly markets in have closed in the semi-urban areas and, shops & malls in the urban areas, due to significant decrease in demand which has impacted the micro-economic cycle. The negative consumer sentiments and the diminished liquidity will further have a bearing on consumer goods industries, retail and service enterprises.

Since not all the goods are in the essential category, there are supply side issues as well. Due to the restrictions on interstate movements of goods and services, finished goods stock have been stacking up, adding to the maintenance and logistics costs. This supply chain disruption has affected the relationships of downstream and upstream enterprises, with both looking for other alternatives. Thus, supply chains have become complex.

Due to the disrupted supply chain, be it supplies from the domestic markets or that from the imports, there is an impact on the availability of some key raw materials and hence their cost.

Moreover, not all the MSMEs are equipped to work from home, and can't bring in the technological innovations or can't implement methods in which this can be done. The digitalization doesn't have a strong base, new technologies are either inaccessible or difficult, thereby making changes in the work processes tough, and working from home hard. For some it is not a possibility considering the businesses they run or goods and services they manage. There are fixed charges of the utility bills too, like that of electricity and water that the units have to pay irrespective of whether the company is closed or operational.

There are many phases that the enterprises will deal with, be it supply chain disruption, demand depression, shutdown or recovery phase. This impact on businesses will have a cascading effect across the value chain. How severely each phase evolves and disrupts will depend on the measures taken either by the MSMEs or the government or by the two together.

#### **Measures that MSMEs can take**

The Coronavirus has had a catastrophic effect on the economies worldwide. MSMEs being the engine of

Indian economy, have a critical role to play in the present and near future, and weather this storm. To ensure that they withstand this storm and are able to recover when the COVID-19 pandemic is controlled, the MSMEs can take various measures.

They can initiate discussions for extension in various contract tenures. If there are any purchase contract that are due within the coming months, backed by some letter of credit, they must initiate a discussion with the involved counter-party to extend the contract period. This will help in mitigation of some financial losses that could otherwise bother.

MSMEs must avoid any capital expenditure or capex plans for the coming months until the economic situation gets stabilized. They must avoid spending or investing in any kind of incremental capacity. The companies must try to maintain a lean inventory position.

Rather than firing or dismissing the workforce, a structured planning could be done to keep at least the important and the trained staff who could act as catalyst in recovering from the losses. Attrition or the loss of critical and well skilled human resource has a consequential financial implication in the short to medium run. Hence, any such decisions of dismissal of the staff must be well planned.

Export oriented companies could consider long term hedge contracts, keeping in mind the present forex scenario. Similarly, the ones dependent on imports can consider short term hedge contracts. This could help in reducing some amount of risk that will emerge as a negative consequence of this pandemic.

MSMEs could also take steps to align their activities so as to maintain some part of the resources in the form of cash or near cash items. This can be beneficial in this time of cash crunch that could prevail for long now, and can keep a check on the liquidity constraints of the future. They can also review their profit and loss statements for the cost elements during this time of lockdown. They must also consider ways to optimize the cost without hampering the overall productivity, and thus use this window for cost optimization avenues.

These are only some limited measures that the small businesses can undertake to stay afloat. At present much of the responsibility to help the MSMEs lies with the government to work out a comprehensive policy framework.

#### **Policy Recommendations**

MSMEs are experiencing specific unforeseen circumstances, government must roll out measures to help them sail through. While the focal point is still the health and wellbeing, certain steps must be

taken to help the businesses cope up with the impacts of the outbreak.

Governments all around the world have been quick-witted to acknowledge the effects and have put in place policies to support them. Measures of deferring payments to address the liquidity (like allowing postponement of tax payments, rental payments, private debt repayments, etc.), measures to mitigate consequences of lay-offs (like wage support and subsidies), measures to provide easy credit, health measures and structural policies are among a few to quote.

India must also consider introducing such financial and safety net measures. As of now, only a few of them have been put into place. To minimize the epidemiological damage to the country, the Reserve Bank of India (RBI) tried to ease the liquidity crisis among the MSMEs through a string of measures on 17 April'2020 like reducing the reverse repo rate to 3.75%; announced a re-financing window of Rs 50,000 crore for financial institutions like NABARD, National Housing Bank (NHB) & Small Industries Development Bank of India (SIDBI); and gave an additional Rs 50,000 crore through TLTRO (Targeted Long-Term Repo Operation) aimed at small and mid-sized NBFCs and MFIs. The 90 days Non-Performing Asset (NPA) norm to exclude moratorium or deferment period is also aimed at relieving the MSME units. As temporary measures to provide relief, many public sector banks have introduced credit lines for emergency whereby maximum loan amount of up to Rs 200 crore (or 10%) of the existing fund-based working capital limits can be availed by the MSME borrowers. SIDBI has also announced a concessional interest rate of 5% for the MSME loans under the SIDBI Assistance to Facilitate Emergency Response against COVID-19. The ones who are eligible for such loans are those who are manufacturing products or those who are delivering services related to the Covid fight. Measures have been initiated by the government to permit delayed GST payments until June'2020, without levy of interest, late fees charges or penalties. Risk-averse lending approach has been noticed where the banks aren't disbursing funds to cash-poor firms despite RBI orders and various other issues are yet to be addressed.

While the above steps could be beneficial to ease the short-term liquidity crunch, the MSMEs expect a comprehensive and far-reaching economic package considering the disruption in supply chains, lack of businesses, short supply of labour because of the prevailing lockdown, payment of wages, statutory, rental and utility obligations. Thus, a policy framework must be designed that takes into

consideration MSME specific measures considering both the demand and supply side impacts, that will help them in the short, medium and long term.

Measures must be taken to mitigate the impact on the MSME labour workforce. The MSME sector comprises 99% micro enterprises and a major chunk of the unorganised sector also includes owner-managed/self-employed firms. The two categories make up the vastly informal enterprises, which implies that a large percentage of the 11-crore people employed in the MSME sector are informal laborers. Thus, wage support should be given to the employees working in these enterprises. Also, to avoid job losses, the government could provide wage subsidy to employers. A wage support or subsidy package will enable employers to pay salaries and other statutory dues to daily wage workers/labourers working in such units. Canada and New Zealand, for example, are providing temporary capped wage subsidies for the coming three months. In India, the government has just directed the commercial establishment to continue paying wages and hasn't announced any wage support or subsidy package that will incentivise the employers to retain their employees. Though who to target and how to identify informal and unregistered units remains a challenge, but this will certainly drive home some relief to the MSMEs. This will also help increase the consumer sentiments and purchasing power.

The government could introduce deferrals in utility and social security contribution payments. Rents, electricity, water and other utility bills add to the cost especially during the liquidity shortfall, thus treatment or slashing of such bills should be examined by the authorities. Turkey, Spain and China, for example, have introduced such interventions. As of now, Government of India has resolved to bear 24% contribution of both employee and employer combined to the Employees' Provident Fund for the coming three months, and they also have an option of withdrawing a part of their EPFO balances. This move will help MSMEs in terms of better cash flows and liquidity. However, only businesses having up to 100 employees and of them earning less than Rs.15,000 per month would be able to avail this benefit. Hence, it is unclear as to how many MSMEs will benefit from this measure and won't be of any help to the tiny and micro units that make up for the 99% of this sector.

Self-employed including the small shopkeepers, those offering private services such as plumbers, electricians, etc. who don't fall in category of regular or casual salaried workers in other enterprises must also be accounted for in the policy framework. One way to do this could be direct cash transfers. The government using their own methods can reimburse

all that is expected to be lost due to lockdown, decreased demand or the restrictions placed. The self-employed businesses who can prove the decrease in their profits or revenues can be compensated based on their past records of revenue, profit and loss statements. But all of this requires focused effort on the part of the officials.

To enhance access to credit, formal credit channels such as banks, financial institutions and NBFCs need to step in to provide easy financing to this sector. SIDBI being a financial institution for developing and financing MSME sector, could play a role in incentivising banks to lend to MSMEs. While it itself is providing loans to the MSMEs engaged in essential goods production (with no need for any guarantee or mortgage), similar steps must be taken for the ones that aren't involved in essential goods or services. Financial institutions must restructure or reschedule the loans and offer a six to nine-month moratorium period as the COVID-19 situation is going to have a long-lasting impact and consumer sentiments and recovery will take time to pick up. Enterprises which have no finance facilities from public sector banks could be offered ad-hoc working capital loans through the Ministry of MSMEs collateral coverage scheme. Moreover, the Central government must direct the government run companies, agencies and public sector units to pay the pending bills (which is around Rs.5.5 lakh crores) as soon as possible. GST and other tax refunds must be credited to the businesses to deal with the lack of fund availability with the enterprises.

Banks must be approached to provide funds for working capital requirement and monthly expense related to rents, payment of wages and utilities. It would be supportive to provide nil-interest loans until the situation normalises. They must be encouraged to determine lending strategies and exercise due diligence. Trade Receivable Discounting System (i.e., TReDS which is a digital platform to support MSMEs to get their bills financed at a competitive rate) should be made effective and the pending payments must be looked into.

There are orders in process whose delivery schedules must be extended till the horrifying situation is normalized and late delivery payments must be kept aside. The above-mentioned orders must be kept alive and continued without cancellation. Owing to the supply chain disruptions, logistics support must also be added to the check list of relief measures.

It is important that the government introduces a policy framework to soften the economic blow rendered to the MSME sectors, not just in the short-term but also for the long term.

The Government eMarketplace (GeM) could be used in the long term to help suppliers and

purchasers match according to the needs. Government can invest some part in online infrastructure while also encouraging small businesses to source locally. This could help improve manufacturing while also cutting on our import costs.

Certain tax and compliance related measures in the medium to long run could also prove helpful once this situation gets controlled. Penalties, in the coming few months, must be relaxed in case of delays in filing of statutory returns, like GST and tax returns. Shipping charges should be waived off for the delivery of all imports being allowed after cooling period of cargo for almost fourteen days, which will help the units that are highly dependent on imported goods used as intermediate product.

The MSMEs have always struggled with cash crunch. Hence, easing financial stress in the sector will have to be looked into even when the pandemic gets settled. In the medium run, banks must be directed to ease the margin requirements. Salaries or wages should be paid through ESIC or some assistance from government's side that will help the enterprises focus on recovering rather than focusing on the various costs. A task force or committee must be constituted that will draw out the sectors & enterprises worst affected by the crisis and to plan a long-term revival plan using targeted measures.

### **Conclusion**

COVID-19 outbreak has proven to be a moving target and doesn't seem to end soon. It has brought about varying degrees of uncertainty. It has posed new obstacles to the business environment and the economic impacts have to be addressed. One of the sectors of Indian Economy that needs immediate assistance is the MSME. The Micro, Small and Medium Enterprises (MSMEs) Sector contributes significantly to the Indian Economy in terms of Gross Domestic Product (GDP), Exports and Employment generation. They contribute around 6.11% of manufacturing GDP, and 24.63% of GDP from service activities. This sector is the backbone of national economic structure, and is strongly affected by the outbreak & containment measures. Their collapse can have strong impacts on the economic growth, perception & expectations, and also on the financial sector.

There are various challenges facing this significant sector given the clampdown on economic activity. Sales have come to a standstill, revenue streams remain dried up, supply chains have been disrupted, negative consumer sentiment & reduced spending, cash flow constraints, complete shutdown of the export-import, migration of workforce are among the many to note. As the sector operates on limited cash reserves, stringent budget and resources, this

pandemic has clearly rattled the sector. While the MSMEs can take a few steps such as postponing the capex plans, or structural planning, a major help still needs to come from the government's side.

The government has taken some steps to keep this segment afloat. The RBI has allowed moratorium on term loans, eased working capital financing and announced reduction in repo rate to provide some relief. It has extended the due date for filing GST till 30 June'2020. Default threshold limit for triggering insolvency proceedings under the Insolvency and Bankruptcy Code 2016 (IBC) for MSME has been increased to Rs. 1 crore. But despite all these measures the MSMEs are still struggling to pay wages, utility bills and the banks are reluctant towards lending to some particular segments of this sector. Such risk averse approach might have to be fixed soon so as to tackle the liquidity issue and provide financing. But there are future challenges too that have to be resolved such as acute cash crunch or limited manpower. Thereby, comprehensive policy must inculcate measures to help the labourers of this sector, measures for owner-managed enterprises & self-employed businesses, measures to defer social security & utility payments, measures to enhance access to easy credit while not putting the banking sector on stake, inclusion of certain goods in essential commodities category and relief in transportation restrictions for exports-imports. Since there are no unified and verified database of the enterprises in this sector, it makes it difficult to roll out targeted measures for relief. Supportive policies must be tailored to the uniqueness of each segment.

While there is a strong focus on initiatives to sustain short term liquidity, framework should include structural policies as well for long term resilience of the MSMEs. Role of fintech lenders could be expanded. Structural policies will help them adopt new technologies, working methods, find new in-country markets, and sales channels. There must be assessment of sustainability of the policies and the needed timeline, considering resources that could be needed for the long-term recovery. The government and MSMEs will have to collaborate to re-start the business when this situation gets normal (or controlled) and bring in the required structural changes.

New challenges to the business environment require measured, thoughtful and informed measures from the enterprises, government, politicians and experienced business leaders. Targeted policies, relaxations and grants would surely turn out to be a saviour for MSMEs given their lower resilience related to their size, and help them weather the negative impacts of this pandemic.

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