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COVID-19 Pandemic-led Lockdown and MSME Sector in India: Towards a Revival Strategy

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1. Introduction

The COVID-19 pandemic and the subsequent intense and prolonged lockdown not only created a livelihood crisis but also led to public health, education and humanitarian crises. As varying degrees of lockdowns continue across the globe, many new developmental challenges are emerging. The crisis in the micro-small-medium enterprise (MSME) sector is one such developmental challenge that requires a thorough grass-roots level understanding, futuristic planning and coping strategies. There is growing consensus among academic scholars, policy makers, practitioners, and civil society across the globe that the MSME sector has been one of the worst affected segments of the economy in most countries. The immediate negative impact of the economic slowdown was visible in the form of a steep decline in overall economic growth. The latest available data suggests that the GDP growth rate in the first quarter of 2020-21 (April-June 2020) was estimated at a negative 23.9 per cent¹. Although the Government report claims that the economy has been showing signs of (V-shaped) recovery, this growth pattern has raised concerns for the future growth prospects of the economy. Due to this slowdown in economic growth, combined with demand slump, liquidity crunch, labour shortage, the industry sector in the



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¹ Govt. of India (2020), Monthly Economic Review: August 2020, Dept. of Economic Affairs, Ministry of Finance.

general and small industry sector in particular will face varying degrees of setbacks.

The MSME sector² in India is huge and highly heterogeneous in terms of size and locale of operation, organizational forms, and varied access to markets, for credit, raw materials technology, output and so on. At present, this sector accounts for over 90 per cent of industrial units, 40 per cent of the total manufacturing output and nearly 35 per cent of India's exports. But an issue of concern has been the perpetuation of an abysmally low level of productivity in this sector, caused by various infirmities such as a low level of technology-in-use, limited access to inputs and credits and an unfavourable market environment. Further, these enterprises (both exporting and non-exporting) operate under several size-related disadvantages like inadequate finance, low R&D, management constraints, inadequate market information and so on. About a quarter of these enterprises also work under subcontracting systems, which provide various kinds of assistance in terms of marketing, technology and finance, but are also characterized by problems such as delayed payments, undue price cutting, strict quality control, a sudden slash in orders and lack of work continuity. Further, a low resource base and inadequate managerial capability put these enterprises in a more disadvantageous position. The problem of delayed payment is sometimes so severe that many small firms had to close down business and/or lay off jobs. The MSME sector is also exposed to the export market and its risks and uncertainties. With decelerating growth performance and global economic slowdown, as well as lockdown-led restrictions, the export-oriented MSME sector is also going to be worse affected. The MSME sector already operates at a disadvantageous position as compared to large enterprises and the big corporate sector in terms of access to formal institutions, including finance, market, technology and innovations, low education and skill levels of workers and owners, inadequate access to infrastructure, and so on. The COVID-led lockdown has made these constraints even more challenging for the MSME sector. The present note aims to assess the impact of the COVID-19-led lockdown on MSME sector and provide policy recommendations to help MSMEs in reducing business losses and survive through the crisis. We follow an exploratory methodology with comprehensively reviewing the available literature,

2. As per the latest available Annual Report of Ministry of MSME (2019-20), out of 63.39 million estimated number of MSMEs, 32.49 million MSMEs (51.25 per cent) are in the rural area and 30.9 million MSMEs (48.75 per cent) are in the urban areas. It employs a total of 110.98 million workers.

including Government policy documents, research papers and reports and newspaper articles in the relevant field.

2. Impact of Pandemic-led Lockdown on MSMEs

There are several ways the COVID pandemic and lockdown affect the economy, especially the MSME sector, on both the supply and demand side. On the supply side, the MSME sector experiences a reduction in the supply of labour³, while a severe drop in capacity utilization and disruption in the supply chain has led to a shortage of raw materials, and in some cases, a rise in the prices of raw materials. On the demand side, a sudden slash in demand and earnings may affect their ability to restart and/or cause them to face a severe liquidity crunch. Some small units may also lay off workers, unable to pay salaries and utilities. Overall, there will be a reduction in business and consumer confidence. Small units may lose their consumers, if the lockdown is prolonged. MSMEs are likely to be more vulnerable to social distancing, as a preponderant majority of these enterprises either operate inside household premises or in a very limited work space. These various impacts are affecting both large and small firms, but the effect on MSMEs is severe because of their higher levels of vulnerability and lower resilience related to their size. If the lockdown becomes longer, MSMEs may find it difficult to rebuild their past connections with networks and may lose their business contracts. There is no hard data to assess the full impacts of COVID-19 on the MSME sector in India, but there are evidence and corroborations based on various reports and newspaper articles, which clearly brings out the varying degree of setbacks experienced by this sector. The spell of the lockdown and the responses of the Government to revive and restore the MSME sector will decide the magnitude of impacts on MSMEs.

An OECD study⁴ based on cross-country business surveys indicates severe disruptions and concerns among small businesses. More than half

3. Many workers working in small units located in urban and semi-urban areas, left for their home state. Even though India has announced Unlock 4.0 (on September 2, 2020), many small units located in the urban area are still struggling for workers.

4. OECD (2020), Coronavirus (COVID-19): SME Policy Responses, OECD, July 15, 2020.

of the surveyed units faced severe losses in revenue and one-third fear to be out of business without further support within one month. Risk of shutting down, because of not having adequate working capital, layoffs, decrease in orders, serious cash flow problems, drop in turnover and sales and so on are brought up this report. However, there are large country-specific and sector-specific variations. The negative impacts are not limited to existing enterprises. The impacts may be even harsher for start-ups as well as aspiring entrepreneurs.

3. Policy Responses

To mitigate the ill impacts of economic slowdown, various policies including stimulus packages were initiated by all multilateral and bilateral agencies and also by individual countries. While the first concern is public health, a balance needs to be struck between lives and livelihood, and hence a wide array of measures are being introduced to mitigate the economic impacts of the pandemic on small businesses. While some countries focused on general policies, many countries have introduced MSME-specific policy measures. Appendix Table 1 shows the most widely used instruments in response to the pandemic and subsequent lockdown. The Government of India also initiated several measures to ease the liquidity situation and improve credit flow in the economy to help the MSME sector not only restart their business but also put them on a sustainable growth path. The Ministry of Finance of the Government of India announced measures for relief and credit support related to businesses, especially MSMEs, to support the Indian economy's fight against COVID-19. This MSME stimulus package was a part of the special economic and comprehensive package of Rs 20 lakh crores (about 307.65 billion US Dollars) announced by the Prime Minister of India under the Aatma Nirbhar Bharat Abhiyaan, which is built on five pillars, i.e. Economy, Infrastructure, System, Vibrant Demography and Demand.⁵

⁵ Govt. of India (2020) Finance Minister announce measures for relief and credit support related to businesses, especially MSMEs to support Indian Economy's fight against COVID-19. Posted On: 13 May 2020 6:39 PM by PIB Delhi (<https://pib.gov.in/PressReleaseDetail.aspx?PRID=1623601>)

Following are the key measures announced under the MSME package:

1. Rs 3 lakh crore (about 40.8 billion US Dollars) Emergency Working Capital Facility for Businesses, including MSMEs: To provide relief to businesses, an additional working capital finance of 20 per cent of the outstanding credit as of February 29, 2020, in the form of a Term Loan at a concessional rate of interest will be provided. This will be available to units with up to Rs 25 crore (about 3.4 million US Dollars) outstanding and a turnover of up to Rs 100 crore (about 13.6 million US Dollars), whose accounts are standard. The units will not have to provide any guarantee or collateral of their own. The amount will be 100 per cent guaranteed by the Government of India providing a total liquidity of Rs. 3.0 lakh crores (about 40.8 billion US Dollars) to more than 4.5 million MSMEs.

2. Rs 20,000 crore (about 2.72 billion US Dollar) Subordinate Debt for Stressed MSMEs: Provision made for Rs. 20,000 crore (about 2.72 billion US Dollars) subordinate debt for two lakh MSMEs which are non-performing assets (NPA) or are stressed. The Government will support them with Rs. 4,000 crore (about 543.91 million US Dollars) to Credit Guarantee Trust for Micro and Small enterprises (CGTMSE). Banks are expected to provide the subordinate debt to promoters of such MSMEs equal to 15 per cent of existing stake in the unit subject to a maximum of Rs. 75 lakhs (about 0.10 million US Dollars).

3. Rs 50,000 crores (about 6.8 billion US Dollar) equity infusion through MSME Fund of Funds: The Government will set up a Fund of Funds with a corpus of Rs 10,000 crore (about 1.36 billion US Dollars) that will provide equity funding support for MSMEs. The Fund of Funds shall be operated through a Mother and a few Daughter funds. It is expected that with leverage of 1:4 at the level of daughter funds, the Fund of Funds will be able to mobilise equity of about Rs 50,000 crores (about 6.8 billion US Dollars).

4. New definition of MSME: The definition of MSME will be revised by raising the investment limit. An additional criteria of turnover is also being introduced. The distinction between the manufacturing and service sectors will also be eliminated.

5. Other Measures for MSMEs: i) e-market linkage for MSMEs will be promoted to act as a replacement for trade fairs and exhibitions. MSME receivables from Government and CPSEs will be released in 45 days; ii)

General Financial Rules (GFR) of the Government will be amended to disallow global tender enquiries in the procurement of Goods and Services of a value of less than Rs 200 crores (about 27.2 million US Dollars); iii) Employees Provident Fund (EPF) Support for business and organised workers introduced as part of the Pradhan Mantri Garib Kalyan Package (PMGKP) under which the Government of India contributes 12 per cent of salary each on behalf of both the employer and employee to EPF; this will be extended by another 3 months for salary months of June, July and August 2020. Total benefits accrued is about Rs 2500 crores (about 0.34 billion US Dollars) to 7.2 million employees; iv) Statutory Provident Fund (PF) contribution of both employer and employee reduced to 10 per cent each from the existing 12 per cent each for all establishments covered by EPFO for the next 3 months. This will provide liquidity of about Rs. 2250 Crore (about 0.31 billion US Dollars) per month; v) The Government will launch Rs 30,000 crore (about 4.08 billion US Dollars) Special Liquidity Scheme, liquidity being provided by RBI. Investment will be made in primary and secondary market transactions in investment grade debt paper of NBFCs, HFCs and MFIs. This will be 100 percent guaranteed by the Government of India; vi) Towards providing tax reliefs to the MSME sector, the Central Board of Direct Taxes (CBDT) issued income tax refunds worth Rs 5,204 crore (about 0.71 billion US Dollars) to nearly 0.82 million small businesses since April 8, 2020 and proposes to issue refunds equivalent to another Rs 7,760 crore (about 1.06 billion US Dollars) as early as possible. It also extended the deadline filing Income Tax Return and filing GST returns from March to June 30, 2020.

To supplement measures announced by the central Government, the Reserve Bank of India (RBI) also announced various initiatives. To enhance liquidity in the economy, RBI immediately announced a reduction in cash-reserve ratio (CRR). It also announced Targeted Long Term Repo Operation (TLTROs) of Rs. 100050 crores (about 13.60 billion US Dollars) for fresh deployment in investment grade corporate bonds, commercial papers and non-convertible debentures. It increased the banks' limit for borrowing overnight under the marginal standing facility (MSF), allowing the banking system to avail additional liquidity of Rs. 137000 crores (about 18.63 billion US Dollars). All these measures are expected to benefit the MSME sector directly and indirectly. RBI announced a moratorium for 3 months on payments of instalments and payments of interest on working capital facilities, which is expected help MSMEs meet their urgent needs, including payment of wage bills and utilities.

The Small Industries Development Bank of India (SIDBI)⁶ announced an additional package for MSMEs to help fight against the coronavirus on April 4, 2020. A new scheme, SAFE (SIDBI Assistance to Facilitate Emergency response against coronavirus) Plus, has been introduced to provide emergency working capital against confirmed government orders, under which revolving working capital term loans shall be provided up to Rs. 100 lakh (about 0.14 million US Dollars). With no collateral, the loans will be released in 48 hours, at a rate of interest of 5 per cent. SAFE Plus is proposed to provide emergency working capital to MSMEs which are producing goods and services directly related to fighting the coronavirus, against specific orders from the government / government agencies. SIDBI has also opened an additional financial window for the healthcare sector under a flagship scheme called SMILE (SIDBI - Make in India Soft Loan Fund for Micro Small and Medium Enterprises).

The World Bank on June 30, 2020 approved a \$750 Million Emergency Response Program for Micro, Small, and Medium Enterprises in India⁷. It will address the immediate liquidity and credit needs of some 1.5 million viable MSMEs to help them withstand the impact of the current shock and protect millions of jobs. This programme will support the initiatives of the Government and RBI. It will improve the funding capacity of key market-oriented channels of credit, such as the NBFCs and Small Finance Banks (SFBs), to help them respond to the urgent and varied needs of the MSMEs. It will also incentivize and mainstream the use of fintech and digital financial services in the MSME lending and payments ecosystem.

Amazon India⁸ has announced a new initiative - 'Stand for Handmade' to help over 1 million entrepreneurs including artisans, weavers and women entrepreneurs, rebound from the economic disruption caused by COVID-19. Under this initiative, more than 0.8 million artisans and weavers from the Amazon Karigar program and more than 0.28 million women entrepreneurs from the Amazon Saheli program will benefit from 100 per cent Selling on Amazon (SoA) fee waiver for 10 weeks. Amazon India has also partnered with 22 Government Emporiums and five

6. SIDBI press release 4th April, 2020; (https://www.sidbi.in/files/pressrelease/Press-Release_BL-SIDBI-announces-additional-package-for-MSMEs-to-help-fight-against-coronavirus.pdf)

7. <https://www.worldbank.org/en/news/press-release/2020/06/30/world-bank-approves-750-million-emergency-response-program-for-micro-small-and-medium-enterprises-in-india>

8. <https://economictimes.indiatimes.com/small-biz/startups/newsbuzz/amazon-india-waives-off-fees-for-artisans-weavers-women-entrepreneurs-for-10-weeks/articleshow/76730827.cms?from=mdr>

Government bodies to showcase authentic crafts to craft lovers and increase market connectivity.

Many state Governments also announced different schemes and packages to help MSMEs restart and grow. For instance, the Andhra Pradesh state Government announced a mega boost for MSMEs with a Rs 1,110 crore (about 0.15 billion US Dollar) restart package on May 22, 2020, which will benefit nearly 98,000 units employing more than 10 lakh workers. The state government further announced that it will directly purchase 360 items manufactured by MSMEs and give payments in a period of 45 days, which will further help the sector.

4. Analysis and Policy Implications

There are diverse issues for the huge and heterogeneous MSME sector due to the pandemic-led prolonged lockdown, which was already facing the brunt of economic uncertainties, marketing fluctuations, liquidity crunch and inadequate access to formal institutions. It will be too early to assess the role and impact of various schemes, programmes and packages announced by the Central and state Governments and the Reserve Bank of India (RBI) on MSMEs, but concerns may be raised such as a) whether the MSME package is adequate; b) how these interventions will be implemented; c) whether it adequately addresses the huge and heterogeneous character of this sector; d) whether there is a mechanism in place to monitor the implementation and impact of this MSME package?

A close reading of the MSME package suggests that there are many issues which need more elaboration and clarification for the different stakeholders who are to implement this scheme and also for the intended beneficiaries. First, the government announced that the scheme will be beneficial for around 0.45 million MSME units in green zones, having no due loans and applying for fresh loans. This means 58 million units out of the total of around 63 million units existing today cannot avail any stimulus benefits like collateral-free loans, credit guarantees, subordinate loans or fund of funds. Second, many economists have expressed their apprehensions that despite the 100 per cent government guarantee, risk-averse bankers may

not extend the loan benefits to all MSMEs, given the status of the MUDRA⁹ loans today. Third, given the severe demand slump, no business firm will take fresh loans to start or continue production unless they are certain about the demand prospects. Fourth, changing the definition of MSMEs and disallowing global tenders for government procurement up to Rs. 200 crore (about 27.2 million US Dollar) are welcome steps. The suggested change in the definition will allow them to grow without losing benefits of being an MSME, and disallowing global tenders will create demand for their products. But these are more revival features rather than survival strategies. Whether the MSMEs survive the effects of a longer lockdown to stand up and grow at a later stage is still difficult to predict at this current juncture. Moreover, the Government announcement does not specify the implementation date of the new definition, which also requires the necessary changes in the MSME Act and the RBI notification on the matter. Fifth, the whole package is bank-centric and its success will depend on the smooth delivery of credit. The package fails to address structural issues related to MSME credit. If anything, the 100 per cent sovereign guarantee for uncollateralised, automatic MSME loans will encourage both banks and borrowers to never return the money and to become wilful defaulters. It will discourage banks from willingly lending to these MSMEs in the future. Sixth, the operational modality of the schemes announced is to be elaborated as to the implementation of the schemes by banks. Seventh, this is just a liquidity plus package without any fiscal stimulus. Unlike many other countries (see Appendix Table 1), in India's case, the announcement focused on credit guarantees and liquidity provision, with no direct wage payment support. Eighth, the Government is also silent on how the information about this package will reach the intended beneficiary.

5. Concluding Remarks

MSMEs being critical for employment preservation and growth, a multi-pronged strategy (a proper mix of short-term, medium-term and long-term) needs to be devised to address a set of three challenges: 1. reactivation of business activity; 2. recovery of pre-crisis conditions and 3. future planning

⁹ Prime Minister Micro Units Development and Refinance Agency Ltd (PM MUDRA) is an NBFC supporting development of the micro-enterprise sector in India. It provides refinance support to banks, NBFCs and MFIs.

to grow further. The cloud of COVID-19 will, we hope, be gone sooner rather than later, but a key question that will hunt us for quite some time is how we can reverse these adverse currents.

It is important to create an enabling environment or ecosystem to help MSMEs recover from the lockdown. Towards this strategy, the following steps may be followed: a) identifying micro, small and medium enterprises and their workers, b) developing a vulnerability assessment framework for the MSME sector, c) increasing the capacity of the Samadhaan system to expeditiously clear government dues, and d) improving the creditworthiness of small businesses¹⁰. Given the diverse varieties of enterprises operating in the MSME sector, it is difficult to identify the right unit that needs support. Therefore, first, it is important to develop a real-time information system to identify beneficiaries of government schemes, to be called the MSME Information System for Holistic and Real-time Identification, Incentives and Support (MISHRII). Second, the revival of the MSME depends on tackling vulnerabilities such as financial conditions, demand for products and services, availability of a migrant workforce, and exposure to the export market. Therefore, it is crucial to develop a Vulnerability Assessment Framework for MSMEs to efficiently target support measures by accounting for varying levels of vulnerabilities and sectoral nuances, resulting in the effective use of government resources. Third, very often, the bigger companies delay not only payment for supplies received but also tax payments, which causes the MSME to suffer a double blow. So it is important for the government to increase the capacity of the SAMADHAAN¹¹ system to expeditiously clear government dues to MSMEs. Policymakers should also focus on improving the credit worthiness of small businesses and connect these units to formal financial institutions. Social security measures for workers engaged in the MSME sector will also be very important, especially for those who lost their jobs due to lockdown.

While it is only natural to expect a tough future for the MSME sector, the lockdown can help us learn important business lessons that can help us not only survive but also thrive and be well prepared for any other crisis that might come our way in the future. Measures such as detailed financial assessment and security, re-evaluation of business plans, a strong digital

¹⁰. CEE-NIPFP, Jobs, Growth and Sustainability: A New Social Contract for India's Recovery, June 2020.

¹¹. A portal maintained by the Ministry of MSME, Government of India to monitor delayed payments and other industrial disputes.

ecosystem, a crisis management strategy in place and business continuity plans are going to be crucial for survival and an effective bounce back for businesses, keeping long-term growth and planning in mind. With the prolonged lockdown, disruption in the supply chain and demand slump, the MSME sector will face severe marketing constraints. Therefore, it is important to help these enterprises with innovative marketing strategies and connections to e-commerce. In addition, long-term and continuous handholding and mentoring will also be critical to moderate the negative impacts and put the MSME sector on a sustainable growth path. The bigger challenge for the MSME sector is to think of growth and expansion with the government bringing together credit availability, market exclusivity, and procedural simplification for setting up new businesses. It is time to reach out to each and every MSME unit operating in rural and urban India and start a fresh conversation.

Appendix Table 1.

Overview of SME Policy Responses

Country	Labour			Deferral		Financial Instruments					Structural Policies				
	Wage Subsidies	Self-Employed		Income/Corporation Tax	Value Added Tax	Social Security	Rent/Utilities/Local Tax	Debt moratorium	Loan guarantees	Direct Lending to SMEs	Grants and Subsidies	New Markets	Teleworking/Digitalization	Innovation	Training and Redeployment
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	
China	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	
Brazil	✓		✓	✓	✓		✓		✓						
Germany	✓		✓	✓				✓	✓	✓				✓	
Indonesia				✓					✓	✓	✓				
Italy	✓		✓	✓			✓	✓	✓	✓	✓	✓			
Japan	✓		✓	✓			✓	✓	✓			✓	✓		
Korea	✓		✓				✓	✓	✓	✓	✓	✓			
Malaysia								✓	✓			✓			
Singapore	✓			✓			✓		✓	✓					
South Africa								✓		✓	✓				
Spain	✓		✓	✓		✓	✓	✓	✓	✓			✓		
Thailand	✓		✓		✓	✓			✓						
Turkey	✓		✓	✓		✓	✓	✓	✓	✓					
UK	✓		✓	✓			✓	✓	✓	✓					
US	✓		✓	✓				✓	✓	✓					
Vietnam							✓								

Source: OECD (2020), Coronavirus (COVID -19): SME Policy Responses, OECD, July 15, 2020