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Impact of COVID-19: Micro, Small and Medium Enterprises in India, Pandemic Shock of COVID-19 and Policy Response: A Bird's Eye View

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1. Introduction

India is still in the process of “flattening the curve” of the COVID-19 pandemic. The first case of COVID-19 in India was reported on 30th January (1/30/2020) and the number of reported cases has exceeded five million as of September 21, 2020. Two principal cities of Delhi and Mumbai with populations of 18 and 20 million respectively have reported cases in excess of 184,000 and 246,000 respectively. The pandemic has expectedly had a far reaching impact on the economy and the intensity of its effects has not been well understood. Small-scale enterprises, central to the functionality of India's manufacturing and services sectors have suffered the most. This paper presents a bird's eye view of the impact of COVID-19 on the micro, small and medium enterprises (MSMEs) in these two major sectors of India's economy.

In response to the COVID-19 outbreak, the Government of India (GOI) initiated lockdown measures that involved closure of educational institutions, industrial establishments, hospitality services, and banned domestic road, railway and air travel, services delivery and a whole host of measures. The announced measures explicitly listed a set of non-essential economic activities that are prohibited (e.g. all commercial, private establishments including manufacturing, restaurant services, hotels, courier services etc.,) and another set of permitted activities deemed essential (e.g.



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hospital services, electricity and water, ATM banking) during the lockdown period. The GOI declared a nationwide lockdown for 21 days from March 25th to till 14th April 2020 (Lockdown 1.0); for 19 days from 15th April to 3rd May (Lockdown 2.0); for 14 days from 4th May 2020 till 17th May 2020 [Lockdown 3.0]; and subsequently for 14 more days from 18th May 2020 till 31st May 2020 [Lockdown 4.0]. The strictness of measures depended on the risk profiling of the districts measured by the number of reported total active cases, doubling rate of confirmed cases and the district feedback. Districts were classified into three categories: Red zone (hotspot), and Orange and Green zones. The Union Health Ministry had listed 130 districts in the country in the Red zone, 284 in the orange zone and 319 in the green zone at the beginning of Lockdown 2.0. The lockdown was extremely strict in districts designated as Red zones, while some relaxations were given in districts in the Orange and Green zones. Later, on 30th May 2020, the GOI initiated phased reopening of the economy with some restrictions and strict social distancing norms in place.¹ In short India has experienced a longer period of lockdown than the world average. This has severely affected domestic economic activity and pulled down the GDP growth much more than anticipated at the beginning of the pandemic.

2. Impact of COVID-19 on SMEs

2.1 Growth and Employment: Aggregate Effects

The International Monetary Fund (IMF) has projected a sharp contraction of 4.5 per cent for the Indian economy in 2020, a “historic low” (IMF World Economic Update June 2020). The governor of India’s central bank, the Reserve Bank of India (RBI), has indicated negative growth rate of GDP in the financial year 2020-21. The consumption of petroleum products, proxy for transport activity and oil demand, during the period April to July 2020 recorded a decline of 22.5% as compared to consumption in the same period in 2019.² The impact of the lockdown on industrial production in the first quarter of 2020-21 has been severe. The Index of Industrial Production (IIP) was 35.9 per cent lower compared to its level a year ago.³ India’s overall

1. The lockdown in containment zone is extended till 30th June 2020 and the phases of opening are designated as unlock 1.0 and so on.

2. Ministry of Petroleum and Natural Gas report available at <https://www.ppac.gov.in/>

3. <https://www.cmie.com/kommon/bin/sr.php?kall=warticle&dt=2020-08-12%2020:15:55&msec=630>

exports (Merchandise and Services combined) in April-July 2020-21* are estimated to be USD 141.82 billion, showing a negative growth of (-) 21.99 per cent over the same period last year. Lockdown affects the economy first through labor supply shocks as it restricts people's mobility and forces them to work from home. In a large number of occupations, particularly manufacturing and traditional services, workers would not be able to work from home. Second through demand shocks as workers incur loss of wages, salaries and income either due to job loss or inability of enterprises to pay their employees. One recent study has estimated that 116.18 million (25%) and 78.93 million (17 %) of India's workers were affected in Lockdown 1.0 and Lockdown 2.0.⁴ A large majority of them are found to be those in the unorganized segments of manufacturing and services. The likelihood of working from home is very low for workers employed in occupations within the manufacturing and services sectors. According to the Centre for Monitoring Indian Economy (CMIE), at least five million salaried people have lost their jobs in the month of July, taking the total count of job losses in the category to 18.9 million since April 2020. With all industrial and transport activities shutting down, the coronavirus lockdown has crippled the country's economy. As per the CMIE data, 17.7 million salaried employees had lost their jobs in April. In May, another 0.1 million jobs were lost. 3.9 million persons had gained jobs in June, but five more million employees went jobless in July.⁵

2.2 New Definition of MSMEs

The definition of MSMEs is provided by the Micro, Small, and Medium Enterprises Development (MSMED) Act of 2006. MSMEs are defined as "*all enterprises engaged in production of goods pertaining to any industry specified in first schedule of Industrial (D&R) Act, 1951 & other enterprises engaged in production and rendering of services subject to limiting factor of investment in plant & machinery and equipment respectively*".² The earlier definition of MSMEs was in terms of threshold level of investment in plant and machinery equipment, and the suitability of investment criterion was under the scanner much before the onset of COVID-19. The government changed the criterion for defining MSMEs in response to the COVID-19 crisis.⁶ It revised the definition of MSMEs and added the criterion of

4. See "Impact of COVID-19 Pandemic on Labour Supply and Gross Value Added in India" by Estupinan, Sharma, Gupta and Birla (2020) available at <http://www.igidr.ac.in/pdf/publication/WP-2020-022.pdf>

5. <https://www.cmie.com/kommon/bin/sr.php?kall=warticle&dt=2020-08-18%2011:02:19&msec=596>

6. https://msme.gov.in/sites/default/files/MSME_gazette_of_india.pdf

annual sales turnover in addition to investment, as given in Table 1. The introduction of turnover has facilitated the verification of turnover declared by the MSMEs under the new Goods and Services Tax Network (GSTN).

Table 1.
Revised Criteria for Micro, Small and Medium-Sized Enterprises

Enterprise Type	Existing Definition		Revised Definition: Manufacturing and Services
	Investment in Plant & Machinery (Manufacturing)	Investment in Equipment (Service)	Annual Sales Turnover
Medium	≤\$1.3 Million	≤ \$680,000	Investment ≤\$6.8 Million and turnover≤\$34 Million
Small	≤\$680,000	≤\$272,000	Investment ≤\$1.36 million and turnover≤\$6.8 Million
Micro	≤\$34,000	≤\$13,600	Investment up to \$136,000 and turnover ≤\$680,000

Source: <https://msme.gov.in/>

Note: Rupee values have been converted to US dollar at current market exchange rates.

The idea of revising the MSME definition has been under the consideration of the central government even before the onset of the COVID-19 pandemic. It was reportedly opposed by small-scale industrialists who perceived the threat of competition from larger enterprises who would also become eligible for size-dependent incentives like concessional bank credit. The economic crisis situation created the right time to bring about the change without facing opposition from certain interest-groups. The prevailing definitions of MSMEs that used only the investment were widely believed to have discouraged the size expansion of small enterprises. The new common definition of MSMEs hikes the threshold investment level for the category Micro units to one crore (approximately US\$133,000 at current exchange rates) and brings in the turnover criterion of INR Rs.5 crores (approximately US\$667,000 at current exchange rates). Under the modified composite definition an industrial/service establishment will be classified as belonging to the Micro/Small/Medium category if it falls below either of the two criteria, namely, investment or turnover. In practical terms all units with turnover value below ₹250 crores (approximately

US\$33 million at current exchange rates) constitute the MSME sector. If an establishment crosses both the investment limit as well as turnover limit of the respective category then that unit goes out of that particular category. The intent of higher threshold is to encourage the growth of MSMEs by inducing them to undertake greater investment and achieve economies of scale and cost competitiveness.

It is hard to estimate the exact number of enterprises and workers in the MSME sector at present. A reliable source is the survey of *unincorporated enterprises* that was held last in the 2015-16.⁷ One could get based on 2015-16 survey results some orders of magnitude of MSME enterprises and workers affected by the pandemic COVID-19. In 2015-16 there were 63.4 million enterprises out of which 19.6 million were in manufacturing, 20.6 million enterprises were in the services sector and the remaining 23 million were in the business of retail and wholesale trade. The MSMEs provided employment to 101 million workers that include owner-managers (Own Account Enterprises). Manufacturing and other services had almost equal share of 36 percent each with the remaining 38 percent in retail and wholesale trade. In short MSMEs provide employment and livelihood to 25 percent of India's total workforce and contribute about 30 percent of India's GDP.⁸

More importantly, MSMEs contribute significantly to India's exports. Their share in total exports has hovered around 42% to 48% in the last few years. The five major export products are Gems & Jewelry, Ready Made Garments (RMG), Electrical & Electronic equipment, Organic Chemicals, and Pharmaceuticals. Global slowdown in international trade has severely affected the very survival of MSMEs. Major commodities which have recorded negative growth during July 2020 vis-à-vis July 2019 Petroleum products (-51.54%), Gems & jewelry (-49.61%), Leather & leather products (-26.96%), Man-made yarn/fabrics/made-ups etc. (-23.33%), RMG of all textiles (-22.09%), Cashew (-21.25%), Marine products (-20.14%), Tobacco (-19.49%), Electronic goods (-17.42%), Spices (-11.38%), Mica, Coal & other ores, minerals including processed minerals (-8.21%), Handicrafts(-6.12%),

7. Survey on Unincorporated Non-Agricultural Enterprises (Excluding Construction) conducted in the 73rd round of National Sample Survey Organization (NSSO) during July 2015 to June 2016. The survey was conducted over whole Indian Union with a sample of 290113 Enterprises.

8. Annual Report of the Ministry of MSME 2018-19, page 27. India's total workforce is estimated to be 465 million in 2017-18 (Periodic Labour Force Survey (PLFS), 2017-18).

Tea (-3.97%) and Organic & Inorganic Chemicals (-0.05%).⁹ The extended lockdown is reported to have severely impacted the import of raw materials (sports goods, silk, rubber, etc.,) and their transport from the ports to manufacturing units.

2.3 Impact on Industries and Firms Based on Reported Survey Results:

- In a statement, the Confederation of All India Traders (CAIT) reported that the traders across the country are highly depressed because of very minimal footfall of the consumers, considerable absence of employees, and having serious financial problems.
- Another survey conducted by a non-financial banking institution, in the second half of May 2020, focused on the financial impact of the pandemic on MSMEs and their outlook towards the earnings. It is based on responses from 14,444 MSMEs. Nearly 50 per cent of micro, small and medium enterprises (MSMEs) were reported to have witnessed a 20-50 per cent reduction in their earnings.¹⁰
- According to apparel industry body Clothing Manufacturers Association of India (CMAI), which surveyed 1500 of its members, at least 60 per cent of them anticipated a drop in revenue to the tune of 40 per cent and almost 20 per cent of them were thinking of closing down their business after lockdown. CMAI has around 3,700 members employing over 7 lakh people, mostly MSMEs. Garment industry in India is largely populated by MSMEs.¹¹
- In a survey of 360 enterprises the enterprise owners were asked to estimate their total losses if the lockdown were to end on 17 May. On average, this was reported to be around 17% of their annual sales, which suggests that about two months of revenue has already been wiped out. The smallest MSMEs experienced the biggest losses. Firms with less than eight employees lost 24% of their annual sales, whereas those with over 45 employees lost about 10%, which is significantly lower. The survey data also show that MSMEs were, on average, operating at 75% of their capacity before the lockdown. After the lockdown, MSMEs were operating at an average of only 11% of capacity, with 56%

9. Ministry of Commerce, https://commerce.gov.in/Press_Release_July_2020.pdf

10. The Economic Times, 23 July, 2020, E-Paper.

11. <https://economictimes.indiatimes.com/industry/cons-products/garments-/textiles/lockdown-1-crore-job-cuts-likely-in-textile-industry-without-govt-support-says-cmai/printarticle/75125445.cms>.

producing nothing at all.¹²

- A rapid survey of 1,416 microenterprises across the country was conducted that covered various sub-industries in manufacturing, services, and trade. A first round telephonic survey was conducted between 29 May and 10 June. The median age of businesses in the sample was 12 years, with a median of 2 employees; 67% of the enterprises employ 1-4 people, and 24% employ 5-15 people, while the remaining 9% had more than 15 employees. Overall, the majority of microenterprises were closed, with only 17% partially or fully operational during the lockdown. It is notable that this survey was conducted in midst of the national lockdown. It found that 52% of the essential businesses remained shut, as they were not aware of government classification. In terms of non-essential businesses, 92% of the surveyed respondents remained completely shut. Among those who are fully or partly operational, 72% of the surveyed businesses have reported a significant decline in profits compared to the pre-COVID scenario. The decline is more pronounced in manufacturing and service sectors, where profits suffered a hit of 78% and 81%, respectively. The impact was less pronounced for the trading sector, with 62% businesses reporting a decrease in profits. The microenterprises that were operational during the lockdown reported that their revenue was only 28% of regular pre-lockdown revenues, on average.¹³
- To understand the digital trends among small businesses during the lockdown, Endurance International Group (EIG) administered an online questionnaire to their MSME customers in the segments of retail, educational services, technology services, independent bloggers, consultant, advertising & marketing, travel and finance. The majority of these MSMEs are in the metro cities. The survey was conducted over the first 2 weeks of June 2020. It reported that the negative impact of COVID-19 on MSMEs has been intense with many having to pause or entirely shut their business. In this survey, one third of MSME respondents confirmed that they are temporarily shutting their business until normalcy resumes. This pause in business is more prominent among MSMEs in metros cities and those in the retail and manufacturing verticals. The majority of MSMEs (nearly 60 percent of those surveyed) believe that it will take up to 6 months for business to

12. Rathore, U and S Khanna (2020), " Covid-19 crisis and health of small businesses: Findings from a primary survey", Ideas for India, 17 June, 2020

13. Sharon Buteau and Ashwin Chandrasekhar, "Covid-19: Assessing vulnerabilities faced by microenterprises", Ideas for India, July 31, 2020.

return to normal. MSMEs are seeking support from the government to tide over this crisis. More than 50 percent of MSMEs expect the government to offer tax discounts or exemptions, followed by 36 percent of MSMEs asking for loans at zero interest or cheaper rates. According to the survey, approximately 30 percent of MSMEs started a business website or enabled e-commerce functionality since the lockdown started owing to the COVID-19 pandemic. More than 50 percent of MSMEs surveyed used video conferencing tools and WhatsApp to keep business running during these turbulent times. They were able to offer e-commerce functionality and it helped them to improve their revenue generation. MSMEs in retail and educational services, increase in revenue contribution from e-commerce was 53 percent and 65 percent respectively. According to the survey, lack of technical expertise and the perceived costs of developing a web presence were reported to be the key challenges to creating web presence. MSMEs are seeking support from the government to tide over this crisis. More than 50 percent of MSMEs expect the government to offer tax discounts or exemptions, followed by 36 percent of MSMEs asking for loans at zero interest or cheaper rates.¹⁴

- A survey by the All India Manufacturers' Organization (AIMO) has revealed that about 35% of micro, small and medium enterprises and 37% of self-employed individuals have started shutting their businesses. AIMO is reported to have stated that such a “mass destruction of business” was unprecedented. The survey was based on over 46,000 responses from various associations and industry groupings in the country. The respondent MSMEs in the survey also said (32%) they would take about six months to recover from the shock.¹⁵
- Vinod Kumar from the India SME Forum directed attention to the particularly difficult time being faced at present by the “micro” enterprises. “Of our 86,000 members in the India SME forum, 24,000 members are micro units. Almost 80% of them are going to be in deep trouble and will look at closing down if no funding comes in from the center or states,”¹⁶
- According to the National Restaurant Association of India (NRAI)

14. <http://www.businessworld.in/article/One-Third-of-MSMEs-Enhance-Digital-Presence-During-The-Lockdown-Survey/25-06-2020-291067/>

15. <https://economictimes.indiatimes.com/small-biz/sme-sector/over-one-third-msmes-start-shutting-shop-as-recovery-amid-covid-19-looks-unlikely-aimo-survey/articleshow/76141969.cms?from=mdr>

16. <https://economictimes.indiatimes.com/small-biz/sme-sector/msmes-dont-have-the-capacity-to-deal-with-something-unexpected-like-covid-19-suresh-prabhu/articleshow/75485280.cms>

over 20 lakh, Indians may lose their jobs in the restaurant industry amid the coronavirus pandemic. The NRAI represents over 5 lakh restaurants across India. Dushyant Singh, a Jaipur based entrepreneur who runs three restaurants, informed that the restaurant business involves a lot of overhead expenses and eateries would fire employees to cut down expenses and it would be difficult to start again with the same workforce.¹⁷

3. Responses and Relief Packages:

The government of India has taken the following policy initiatives to support the MSMEs to manage the shock of COVID-19 pandemic. However, we must note that only the registered MSMEs are eligible to get the financial support.¹⁸

- **Relaxing tax returns and due dates:** Several measures to help businesses including MSMEs were announced. Income tax filing due dates have been extended by 30/90 days, in the case of small tax payers (INR < 50 million of turnover) the late payment interest on delayed payment of taxes reduced to 9 per cent till June 2020, and filing due dates for Goods and Services Tax (GST) is extended to June 30, 2020, among many other administrative relaxations.
- **Easing the cost of bank credit:** The Reserve Bank of India has gradually reduced interest rates from 5.15% in February to 4% on 22 May. It has also announced a three-month moratorium on repayment of term loans.
- **Special Package:** The government announced a support package with the specific objective to support the availability of credit to SMEs and microenterprises.¹⁹ The package has the following three components:
(1) INR 3 trillion (INR 300,000 crore) for collateral free loans to MSMEs. Under this scheme commercial banks and Non-banking

¹⁷ <https://curlytales.com/over-20-lakh-indians-may-lose-their-jobs-in-the-restaurant-industry-amid-coronavirus>.

¹⁸ Since September 2015, MSMEs have to register themselves with the Ministry of MSMEs using the Udyog Aadhaar Memorandum (UAM). UAM is a one page online registration system for MSMEs based on self – certification. At present more than 6.8 million MSMEs are reported to have registered themselves under UAM.

¹⁹ On 12 May, the government announced INR 20 lakh crore (INR.20 trillion) support package that included three schemes for MSMEs.

Financial Intermediaries (NBFCs) will provide collateral free loans of four-year tenure with no payments due for 12 months. The banks can lend INR 3 trillion till October 31, 2020. It is meant to finance working capital and eligible firms can access an emergency credit line of 20% of their outstanding credit, with 100% government credit guarantee and a moratorium of 12-months on principal repayment. This will be available to existing firms with credit outstanding of INR 250 million and subject to a turnover threshold of INR One billion. The government expects that 4.5 million firms will benefit from this scheme.

- (2) The government made a provision of INR 200 billion for subordinate debt aimed at helping MSMEs with equity problem. That is those declared as Non-Performing Assets (NPAs) or currently economically stressed MSMEs. Under the Scheme, Promoter(s) of the MSME unit will be given credit facility equal to 15 % of his/her stake in the MSME entity (equity plus debt) or INR 7.5 million (whichever is lower) and the credit advanced through the financial institutions will be guaranteed under the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMCE). The CGTMCE will get an allocation of INR 40 billion to support MSMEs. This is expected to bail out 200,000 ailing small and medium sized companies.
 - (3) The government will set up a fund of funds for equity funding for firms with growth potential. It announced that a fund of funds will be set up with INR 100 billion corpus. It is expected to raise INR 500 billion.
- Global tenders are now excluded from government procurement of up to INR 2 billion to protect MSMEs from foreign competition.
 - The government promised to that receivables from government and central public sector enterprises will be released in 45 days to help firms manage their cash flows.
 - On 14 May, the government announced credit facilities for small, informal businesses and street vendors. These include a 2% interest subsidy on microloans for a period of 12 months for loans up to INR 50,000 and a special lending program for street vendors of up to INR 10,000 to finance their working capital, targeting about 5 million street vendors.

4. Analysis and Implications

The response of the government to the COVID-19 pandemic and the announced measures to support the MSMEs have fallen short of expectations. A major limitation of the announced package is that they all except one (collateral free loan) are relevant only in the medium term. They do not address the immediate survival ability of MSMEs facing a steep decline in revenues but large payment obligations in terms of loan repayments and wage bills of workers. In addition the following two key points may be noted.

- The collateral free loan to MSMEs is a good move. However, there are two basic problems. Banks may be reluctant to lend as they are already seized with the problem of high share MSMEs in their portfolio of NPAs. Loan guarantees scheme may not help because no commercial bank or NBFC would be willing to lend under this scheme because you can only apply to the government to refund a guarantee after 18 months. No bank would be willing to take that hit in its balance sheet. The waiting period needs to be reduced to six months from the present 18 months.²⁰ In short the risk aversion level of financial institutions is already high and may constrain lending to MSMEs. It is reported that banks have sanctioned 36.7 per cent of the targeted INR 3 trillion under the Emergency Credit Line Guarantee Scheme (ECLGS) for stressed (MSMEs), as per Finance Ministry data.²¹
- All Micro and Small Enterprises (MSEs) face serious problems of delayed payments. A recent RBI committee (U.K. Sinha Committee 2020) has recommended that all MSMEs must upload their invoices to an Information Utility. States must have more than one MSE Facilitation Council to cater to the high number of delayed payment cases. To address this issue, the Reserve Bank had introduced the Trade Receivables Discounting System (TReDS) in 2014. TReDS is an electronic platform where receivables of MSMEs drawn against buyers (large corporates, PSUs, Government departments) are financed through multiple financiers at competitive rates. This is done through an auction-based mechanism. To widen the scope of TReDS and to incentivize more players to be part of this platform, banks' exposure

²⁰ <https://thewire.in/business/why-indias-msme-sector-needs-more-than-a-leg-up>

²¹ <https://indianexpress.com/article/business/economy/banks-sanction-36-7-of-govts-msme-package-lag-in-disbursals-6490480/>

through this platform were brought under priority sector lending in 2016. But this facility has not taken off in a big way, constraining working capital finances of MSMEs.

- Above all the fundamental problem of MSMEs in the COVID-19 situation is how to pay wages and salaries for their workers when cash flows are close to zero. Given the state of risk aversion of commercial banks, the MSME sector was expecting much larger fiscal support from the government. The announced collateral free loan scheme is seen to help a small segment of the universe of MSMEs. It will support only the registered MSMEs as we noted above. Budgetary constraints of the central government and the high level of NPAs of financial institutions together perhaps precluded much larger fiscal support. The policy package is widely perceived to have fallen short of putting up a support system for MSMEs that would have enabled them to pay wages, survive the pandemic, and indirectly mitigated the effects of demand shock.

5. Conclusion:

The upshot of the above analysis is the relief packages would be able to help only a small percentage of the MSME units in India. The economic and financial problem of MSMEs in India is unprecedented and threatens their very existence, simply because the extent of damage inflicted on MSMEs due to supply and demand shocks have turned out to be far in excess of what has been anticipated, and it is still evolving. The information on damages to the functioning of MSMEs and to the larger Indian economy is slowly trickling in. The impact of the change in the definition of MSMEs on their economic performance has not yet been investigated and remains an area for future research. Whether it will reduce the access to bank credit to micro and small enterprises relative to medium enterprises is another big issue. Some have argued that commercial banks will be biased against small-scale enterprises because of higher transaction costs. No data is available to evaluate this argument. The policy makers are seriously handicapped by the delayed information filings by the entire spectrum of economic entities including enterprises, corporates, commercial banks, non-banking financial institutions (NBFCs), and statistical agencies due to the pandemic situation. Demand shocks due to second order effects of

the pandemic could perhaps result in deeper damage to the economy in general and the MSMEs in particular. The actual damage to the MSMEs and the wider economy will be known perhaps after a few more months.