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Research Paper

Impact of Covid-19 on Indian MSMEs

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ABSTRACT

This report investigates Covid-19's long- and short-term effects, as well as the numerous full, prolonged, or partial lockdowns that followed it. The goal of the study is to determine how Covid-19 has affected the Indian economy overall and the MSME sector. The evaluation is based on a thorough analysis of all the relevant research papers, reports, articles, and interviews with renowned subject-matter experts that are currently accessible. Data were gathered over the course of two rounds of interviews, the first round using an online questionnaire and the second using a phone. Physical face-to-face interaction was prohibited due to the stringent lockdown regulations across many areas of the country. Online surveys provide speedy data collection. They do, however, have a serious disadvantage. People who have access to and a working knowledge of technology are encouraged to do the online surveys. Because of this, the replies frequently do not accurately reflect Indian MSME owners. To counteract this prejudice, the authors and an MSME consultant contacted company owners in their network who worked in a variety of industries, including manufacturing, export/import, services, trading, and retail. Telephonic rounds in the respondents' native language were also used to further address the inherent problem with internet surveys.

Keywords: *COVID-19; MSMEs; Indian economy; lockdown; Manufacturing and Trade.*

Covid-19 is a watershed economic moment that necessitated the world to come to a grinding halt. The crisis has been deemed to be the biggest blow to the economies of almost every nation since the great depression of the 1930s. India too could not escape from its ravages. The Indian economy that was already on a slowing trajectory, encountered a steep decline in GDP growth from 6.1% in FY19 to 4.2 percent in FY20, the slowest in 11 years. Although the final projections are not out yet for 2021, the second wave ensures an equally grim picture. Making India enter a tough phase of recession.

The MSME sector - the second biggest employer after agriculture, contributes to over 30 percent of the GDP and is a cornerstone of the Indian Economy. The sector is severely overwhelmed. MSMEs are struggling with many bottlenecks, such as restrictions on labour mobility, the fall in market demand, and disruptions in logistics. The major challenges vary

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as per the industry. For instance, export firms suffered more than others, due to a freefall in external demand and a lack of vital components that kept them afloat. MSMEs in the residential service sector were hit particularly hard due to the declining demand. Agricultural Sector, too reported problems with logistical disruptions.

Gendered Impact of Covid-19 in the MSME Sector

There are approximately 63 million micro, small, and medium enterprises (MSMEs) in India, and women run a mere 8 million (12.6 percent). Covid-19 and the ensuing disruption has disproportionately impacted these women-led businesses. Women are about to face more unemployment, domestic duties, and societal inequities.

As per a report by Global Alliance for Mass Entrepreneurship (GAME) and LEAD at Krea University, Andhra Pradesh, women-led micro, and small businesses are particularly at risk because they include enterprises working in lower-margin markets and are more prone to facing instability than micro-businesses led by men.

79 percent of the female business owners in the research, which mostly focused on women-owned businesses in urban and semi-urban regions, reported low sales and decreased client footfall. Banks are hesitant to provide loans to women because of operational inefficiencies, collateral restrictions, and a lack of digital data trails. The study found that there are still gender disparities in the accessibility, utilisation, and availability of money.

To make the matters worse, only 17 percent of women entrepreneurs interviewed in a survey for the IFC report were aware of the financial schemes rolled out by the government or financial institutions to help the MSME sector through this pandemic. Even among individuals who were aware, the exact characteristics of programmes, their usefulness in solving their difficulties, and their access points were frequently not accessible.

Similar findings were echoed in an October 2020 Bain-Google-AWE Foundation report. The research, which is not specific to the SME Sector, claimed that 73% of women company owners had been badly impacted by the crisis, with over 20% having seen their companies' revenues almost vanish completely. 35% of the women saw a sharp fall in their firms' revenue (between 25% and 75%). Even in cases where businesses did not see an immediate decline in revenue, growth remained muted.

Fortunately, there is a silver lining to this dark cloud as well. Women entrepreneurs have aggressively adopted means suitable to survive this downturn. A few examples of such pivots include apparel manufacturers that transitioned to manufacturing safety equipment (like masks, gloves, PPE kits, etc.) Coaching institutes, tuitions, and gyms expanded their reach dramatically by holding virtual classes. Small Cafes, boutiques, and shops of baked goods aggressively adopted a DNVB (Digitally Native Vertical Brand) model to stay afloat.
Yet, it is important to take these small wins with a pinch of salt. The bigger picture is embroiled with problems that need immediate attention. None of the policies announced under the Covid-19 MSME relief package were ***gender-sensitive***.

Policymakers did not account for women entrepreneurs and the hurdles they face in getting access to formal forms of credit due to a lack of collateral. A good solution to the problem can be to make benefits available to a woman entrepreneur through regular conduits, such as income tax, GST returns, or her regular bank, instead of a barely understood scheme that requires them to go through extensive red-tapism.

The Negative Impact of Covid-19 on MSMEs

Liquidity Crisis

The problem of liquidity is not new to the MSME Sector. The deficit phase was well ongoing before Covid-19 struck the nation. As per a 2018 IFC report, the Indian MSME sector was back then staring at a credit gap of $240 billion. Although a similar study conducted by IFC in 2012 revealed a credit gap of around $200 billion. A clear indication of the situation becoming worse. But the pandemic and one of the strictest lockdowns of the world has fanned the flames to make the crisis its worst ever. A lack of credit score and substantial assets to pledge as collateral till now have been regarded as the major factors. But the recent soaring cases of default payments of NBFCs, who themselves depend upon market borrowings for further lending, have made banks unwilling to lend to these entities. Consequently, the MSME sector has taken a hit.

Apart from the NBFCs, a major lender to the MSME sector in general and micro ventures are the Micro Financing Institutions - MFIs are suffering a similar fate.

Microlending's tremendous reach which was once heralded as its greatest strength has now become a deep liability. The lending's are mostly to street hawkers, daily wage laborers, or small traders and retailers never exceeding an amount of ₹1,25,000 per borrower. With an increased pace of delayed recoveries due to its customers' livelihood being rooted in the cash economy *(Prior to Covid-19, repayment delays affected about 2 percent of all loans; by the end of September, that number rose to 20 percent before easing to 10 percent to 15 percent in December)* and soaring default rates across the nation, the virus is undoing the business model of a lot of such MFIs. MFIs, just like NBFCs are dependent upon outside borrowings to keep their business running. The borrowers' inability to repay consequently is causing the blacklisting of many MFIs by banks.

Policy Support

The RBI and the government have taken several steps with a special emphasis on MSMEs and the NBFC Sector. The special schemes - Ad hoc Line of Credit and Guaranteed Emergency Credit Line (GECL) scheme have given timely relief to the MSME sector/business community by providing them much-needed liquidity during the crisis period. To ensure similar liquidity support to the NBFC & MFI sector, a partial credit guarantee scheme, a moratorium on borrowing and financing support through SIDBI, NABARD, and TLTRO has been initiated.

Inadequate Demand

The Decline in Domestic Demand

In Asia's third-largest economy, India, where private domestic consumption accounts for nearly 60% of the Gross Domestic Product has seen the demand plummet severely. Just like the liquidity crisis this too had been building before the onset of the pandemic. Domestic demand which is a sum of private consumption, private investment and government expenditure see all three slump, especially private investment that reached a sixteen-year low in September'19 and also the government's capital expenditure that has been reducing as a percentage of India's GDP. Consequently, demand fell.

The strict and extended lockdown heightened uncertainty and caution amongst the already unemployed cash-strapped citizens of the nation and hence, demand plummeted even further. The MSME Sector that contributes nearly 30% to the GDP, 60% of which is composed of domestic demand also faced the brunt of this development acutely.

Policy Support

The relief package announced seemed to have completely missed this issue. The package was exclusively focused on easing supply, restoring liquidity, and building capacity.

Inadequate Exports

As suggested by a report from the Directorate General of Commercial Intelligence and Statistics (DGCIS) MSME-related products accounted for 48.10% of total exports from India during 2018-19. India's major export items run across 30 sectors and include the likes of petrochemicals, gems, jewellery, automobiles and auto components, cotton yarns and textiles, apparel, marine products, and bovine meat. At the onset of the first wave the country's exports shrank by a record 60.28 percent in April to $10.36 billion. Imports plunged by 58.65 percent to $17.12 billion in April, leaving a trade deficit of $6.76 billion as against $15.33 billion in April 2019. Exports declined in 28 of the 30 key sectors except for pharmaceuticals and the iron ore industry.

Gems and jewellery shipments declined 98.74 percent, followed by leather (- 93.28 percent), petroleum products (- 66.22 percent), engineering goods (- 64.76 percent), and chemicals (-42 percent).

The major reasons for the same were attributed to the spill over effects of the disruption of the integrated supply chain and cancelled orders due to lockdowns in various nations throughout the world. The 2 sectors that continued to see some demand trickle faced hardships in sourcing workers in their units since most of them had migrated back to their villages and towns.

The data from recent export figures for April 2021, fortunately, reveal a recovering picture as exports grew nearly 3 folds to $30.21 billion with imports also rising to $45.4 billion as against $17.09 billion in April 2020. This also coincided with India battling with a much more deadly second wave. The reasons for it can be the major countries that India exports to namely the USA (18%), China (7%), UAE (6.6%), Hongkong (3.5%), Singapore (3%) having majorly recovered to pre-pandemic life. Besides, the Indian states using lockdown as the last resort has also helped keep the industry afloat.

Note: This data pertains to the entire Indian Exports, and since MSME products account for 48.10% of them, these numbers can be safely extrapolated to apply to the MSME units within the sector. Our own telephonic surveys also corroborated to point towards a similar trend.

Supply Chain Disruptions

The jolt to both the domestic and foreign demand helped reveal some important facts. As it happens usually when demand falls, prices fall too and that eventually causes deflation. But we saw a contrary situation occur. That is we saw inflation climb. The reason for it is given to be the fact that lockdown disrupted domestic supply chains more than it disrupted consumer spending.

Even now, the localized lockdowns, restrictions and night curfews are imposing impediments to the revival of economic activity. Especially in MSME units. MSMEs, unlike big corporates, are majorly dependent upon neighbouring cities/states for sourcing their raw materials and workforce. Thousands of migrant workers have already or are in the process of fleeing Indian cities back to their villages as the new restrictions in some states to contain the pandemic again stoke fears of joblessness. MSMEs are stressed about another mass exodus, like the one last year.

The supply chain disruption was not exclusive to just India. Worlds over countries realized their over-dependence on China. This has led to the development of a lucrative opportunity for Indian MSMEs as both global firms and Indian companies which are on the lookout to diversify their supply chain out of China.

Policy Support

In a bid to accelerate this shift India's cabinet announced a production-linked incentive (PLI) scheme for the electronics sector with an outlay of over ₹40,000 crores in March 2020.

This, however, does not suffice. India also needs to address several infrastructural, institutional, and labour-related challenges if it wants to be able to, firstly, attract FDI into its manufacturing space, and secondly, retain these flows.

Looking at the Silver Lining

There has not been anything admirable. Both economies and people have been ravaged by the pandemic. However, rapid digitalization is something that springs to mind when considering the bright side of this gloomy cloud. Due of the disruption caused by the lockdowns in the physical channels of consumer contact, MSMEs were compelled to change.

According to a Google-KPMG survey, SMEs with digital capabilities are expected to expand their revenues at a rate that is about twice as fast as offline SMEs. By leveraging technology, small businesses were able to speed up, simplify, and automate various everyday tasks, thereby truly enabling the digitization of 'Bharat'. Research done by the Boston Consulting Group (BCG), also pointed that MSMEs that adopt new technology have 10 points higher job growth and 11 points higher revenue growth than low-tech SMEs.

But a majority of MSMEs that are willing to adopt also cite a lack of knowledge and guidance in using such tools.

Policy Support

The government recently added 146 categories to its public procurement portal GeM that is initiated with a vision of a digital and transparent mechanism of commerce. Besides, Government support via the Digital MSME Scheme is a good policy initiative.

CONCLUSION

The outbreak of Covid -19 has pushed the entire world into a state of ambiguity. As we strive to live in a post-covid-19 world, it is important to facilitate more and more MSMEs in their quest to adopt digital technologies. Capacity building and technical support via extensive training and upskilling programs will be key to generate employment, which is much needed amid this crisis. Programs and policy frameworks will foster the growth of these enterprises to engage successfully in global supply chains not only drive job growth but provide broad economic benefits. Given their role in economic development and job creation, as well as fostering innovation, helping them to expand via global supply chains should be a top priority. After all, a resilient MSME sector will translate into a prosperous economic future for the nation.

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Conflict of Interest

The author declared no conflict of interest.

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