

THE IMPACT OF COVID-19 CRISIS ON INDIAN SMEs: CAUSES, DIMENSIONS AND IMPLICATIONS

**M H Bala Subrahmanya
Professor
Department of Management Studies
Indian Institute of Science
BANGALORE-560012**

INTRODUCTION

- SMEs occupy a place of strategic significance in Indian economy since independence in 1947. The sector has received consistent policy support for its protection and promotion since then in varied forms.
- Its contribution in terms of employment, national income and exports, among others, has been considerable.
- Of late, its ability to contribute in terms of innovations was recognized, but hardly assessed at the national level, and therefore, goes unnoticed largely.
- Despite continued policy support, the sector continues to face challenges for its emergence, sustenance and growth on varied fronts, mainly, for accessing finance, marketing and human resources.
- But the sector has got accustomed to emerge and operate continuously under constraints/challenges of various kinds.
- However, Covid-19 pandemic has been causing unprecedented damages to economies all over the world since the first quarter of 2020.
- It is against this backdrop, we need to understand the impact of Covid-19 crisis on Indian SMEs.

Nature of Indian SME Sector

- India's SME sector is heterogeneous in many ways: in terms of location, products, size of enterprises, level of technological sophistication, quality and skills of labour, form of organization, nature of registration, extent of market penetration, sources of finance, nature of customers, etc.
- SMEs are spread across the nation, far and wide in dispersed forms as much as in the form of clusters.
- They produce as many as 6000 different kinds of products and services, ranging from the most traditional to the most sophisticated.
- Broadly, they can be classified under two sub-sectors, namely, (i) traditional, and (ii) modern, which in turn would indicate the level of technological backwardness/sophistication. Accordingly, they employ labour of all forms, ranging from totally unskilled to fully skilled and Science & Technology Qualified.
- Another classification is in terms of using/not using hired labour: (i) Own-account enterprises (which exclusively use only household labour) and (ii) Establishments (which use at least, one hired labour).
- In terms of size structure, they are sub-classified as (i) micro enterprises, (ii) small enterprises, and (iii) medium enterprises, defined in terms of size of investments in plant & machinery.
- Another dimension of SME structure is its classification into (i) organized/registered/formal enterprises, and (ii) unorganized/unregistered/informal enterprises (Ministry of MSMEs, 2021).
- In terms of registration under the law, they can be classified as (i) factory enterprises (those registered under Indian Factories Act, 1948), and (ii) non-factory enterprises (not registered under Indian Factories Act, 1948).
- Yet another classification is in terms of their nature of customer relationship: (i) B2C (Business to Consumers) enterprises, (ii) B2B (Business to Business) enterprises, and (iii) B2C & B2B enterprises.

Deficiencies of SME Databases

- Due to SME sector heterogeneity, we do not have a uniform, single, periodic source of data on SMEs.
- A precise description of size of the SME sector has always remained a challenge in India, in the absence of a comprehensive and periodic data generation system in the country (similar to monthly Index of Industrial Production (IIP) and Annual Survey of Industries (ASI) for the large organized industrial sector).
- Therefore, an appropriate measurement of a change in the size of the SME sector from time to time is next to impossible.
- A periodic measurement of the size of the SME sector in terms of number of enterprises and employment (and even income) is of paramount importance to any growing economy.
- This assumes critical significance in times of crisis such as the current Covid-19 pandemic, afflicting the entire nation through a wave after a wave.
- However, it is possible to gauge the likely impact if one can understand the dimensions of supply and demand shocks that have emerged from the Covid-19 crisis, in the context of the nature, structural and regional spread of Indian SMEs.

Covid-19 Crisis: The economic dimensions of its fallout

- **Supply-side effects:** A complete national lockdown to deal with the First Wave (FW) led to the curtailment/disruption in the supply of goods and services, due to the following:
 - Complete stoppage of production activities, during the lock down period, followed by exit and scaling down of a large number of enterprises across the country
 - Disruption locally, regionally, nationally, and globally, which continued even after the lifting of national lockdown in the:
 - supply chains of raw materials/intermediate inputs
 - supply of labour force
 - availability of capital
- Disruption/curtailment in the emergence/operations of new/existing enterprises.
- Reduced labour productivity due to the above factors, apart from labour anxiety, health concerns and work from home schedules.
- Disruption/curtailment in the R&D/technological innovations of existing enterprises, thereby curtailing the flow of new products/services and related intellectual properties including patents.

Covid-19 Crisis: The economic dimensions of its fallout

- **Demand-side effects:** The national lockdown during the FW led to the following:
 - Severe curtailment of consumption expenditure (**C**), due to (a) closure of non-essential shops, malls, hotels and restaurants, entertainment and recreation activities, wholesale and retail trading activities, repair service centres, etc., (b) limited shopping hours for purchasing essential consumer goods, (c) job losses/freezing or reduction of wages/salaries of employees, loss/reduced rental and interest incomes, and foregone/reduced profits, (d) limited movement of consumers due to continued advice of the authorities to remain indoor, thereby reducing “conspicuous consumption”, (e) total prohibition of social functions, and (f) most notably, disruption of families due to the unfortunate demise of their “bread winners”. Private final consumption expenditure declined by almost 10% in 2020/21 (NSO, 2021). It is unlikely to revive in 2021/22 unless and until Covid-19 SW subsides, and the health crisis is reined in, sooner than later.
 - Sharp reduction in investment expenditure (**I**) due to (a) stoppage of production activities, (b) wiping out of enterprises, (c) disruption/reduction in the supply of factor inputs, (d) loss/reduced retained surpluses, (e) loss/reduced profits, (f) reduced flow of loanable funds, and (g) bleak market prospects or low business confidence. Gross fixed capital formation declined by almost 15% in 2020/21 (NSO, 2021). Its revival would depend on the revival of consumption expenditure, among others.
 - Considerable decline in exports/imports (**X & M**), due to (a) reduction in income levels across the globe, and (b) disruption/reduction in the global supply chains of MNCs. Total exports declined by more than 8% in 2020/21. Its revival would largely depend on the recovery of global markets, particularly in the developed world.

Covid-19 Pandemic: Supply Shocks for SMEs

- **Supply shocks** are exhibited as follows:
 - (i) Complete stoppage of production due to the national lockdown (during Covid-19 FW) and regional lockdowns (during Covid-19 SW),
 - (ii) subsequent impact due to a disruption of the supply chain (of inputs and outputs), locally, regionally, nationally and internationally, (during Covid-19 FW) and partial impact (due to Covid-19 SW),
 - (iii) mass movement of labour from metros and cities to towns and villages (during Covid-19 FW) and partial movement (during Covid-19 SW), and
 - (iv) reduced financial flow in the informal money market, thereby adversely affecting the operations and output of informal/unregistered SMEs.
- As a result, Covid-19 FW would have severely curtailed the output emerging from the SME sector (which accounts for about 1/3 of the GDP), which was reflected in the sharp negative growth of Indian GDP in 2020/21.
- The impact of Covid-19 SW is likely to be more devastating, despite the absence of nation-wide lockdown and state governments dealing with only partial lockdowns in most affected regions (which are more developed regions/states of the country comprising metros such as NCR Delhi, Mumbai, and Bangalore).

Covid-19 Pandemic: Demand Shocks for SMEs

1. Severely curtailed consumer demand, which would directly affect B2C SMEs (particularly in consumer goods industries, services such as tourism, hotels, road side eateries, retail shops, mobile cart shops, small transport operators, tailors, barbers, carpenters, brick-makers, artisans, repair services, etc.),
2. Curtailed industry demand, which would affect subcontractors (B2B SMEs – intermediate product manufacturers),
3. Curtailed export demand, which would affect both B2C SMEs (those which export consumer products) and B2B SMEs (those which are linked to the Global Value Chains (GVCs) of MNCs). The contraction of incomes globally would have contracted both direct and indirect export demands for Indian SMEs.

However, only a negligible share of Indian SMEs operates in the export market and therefore decline in incomes globally and disruption in the GVCs of MNCs may not directly hamper Indian SMEs to any considerable extent (Bala Subrahmanya and Muralidharan, 2021).

An Assessment of the Impact of Covid-19 crisis on SMEs

- The Covid-19 crisis through its supply and demand shocks would have impacted SMEs in different ways, due to their differential spread between regions, sectors, and varied size structures.
- The impact of Covid-19 on SMEs would have primarily varied in terms of timescale, sectors and locations. Therefore, the impact can be analyzed from the perspectives of (i) short to medium term, and long-term impacts, (ii) registered/formal and unregistered/informal enterprises, and (iii) urban and rural locations.
- In the short to medium run, SME sector, formal as well as informal enterprises, in urban and rural locations, as a whole would have suffered almost completely due to lockdowns, which would have prevented production, on the one hand, and supply of inputs and labour, on the other.
- The exceptions could be own-account enterprises of the unregistered sector (in both urban and rural regions) which might have worked even during the lockdowns uninterruptedly.
- When the authorities largely eased lockdown restrictions, many formal enterprises in both urban and rural regions have reopened and started their operations, in many instances, with a curtailed workforce.

An Assessment of the Impact of Covid-19 crisis on SMEs

- Overall, the Covid-19 outbreak and the subsequent national lockdown dealt a considerable dent on the employment sector of the country by wiping out a large proportion of MSMEs: the estimated job losses were close to 11 million in 2020 (Saraswathy, 2021).
- According to CMIE estimates, unemployment scenario in the country deteriorated sharply since January 2021.
- But these figures do not cover massive underemployment of labour adopted by firms (due to cutting down the number of working days per week and adoption of automation).
- Together, these would have led to a sharp reduction in consumer demand, followed by a decline in investment demand.

An Assessment

- A larger proportion of unregistered/informal enterprises in urban areas would have got wiped out, resulting in reverse (urban-rural) labour migration (RBI, 2020).
- This, of course, would have led to creation of, at least, some new enterprises in towns and villages subsequent to the lifting of lockdowns, that is, post-May 2020.
- Of course, a major proportion of reverse-migrated labour believed to have joined agriculture, thereby putting pressure on the already strained agricultural sector.
- If the additional influx of labour into agriculture has led to the cultivation of hitherto abandoned agricultural land, then that would result in an increase in agricultural production.
- According to the quarterly and annual estimates of GDP in 2020-21 shows that Agriculture, Forestry and Fishing sector was the only sector, (apart from construction) which recorded positive growth rate of GVA (Gross Value Added) at Basic Prices (NSO, 2021).
- Some of the reverse-migrated enterprising informal entrepreneurs would have started manufacturing/business activities “back home”. This would imply shifting of (informal) entrepreneurship from cities to towns and rural areas.
- The lockdown imposed during Covid-19 SW since April 2021 would have had a similar impact like that of FW lockdown (March-May 2020). Though the SW emerged as unexpectedly as the FW, the re-imposition of lockdown was anticipated.

An Assessment

- Though production has been disrupted during the lockdowns, some of the formal and informal enterprises in urban and rural regions would have 'stored factor inputs' and 'taken care of labour', to reinitiate production soon after the lifting of lockdowns.
- But that would have addressed the supply-side only partially.
- This is because, SME supply would have still suffered due to labour health problems (even after easing of lockdowns), as the proportion of population affected by Covid-19 and its death rates increased considerably in the country, particularly in the better developed states, since April 2021 (Government of India, 2021).
- In addition, the continued constrained demand will act as a major bottleneck for the recovery of the sector. This is because job losses are observed economy-wide: according to CMIE, India lost more than 7 million jobs in April 2021 alone (The Wire, 2021).
- This is compounded by freezing of salaries or pay cuts for the existing employees in business enterprises, irrespective of size. According to reliable sources, some of the firms went for automation, to overcome the problem of labour shortage, thereby giving a blow to employment recovery.
- According to RBI, the second wave hit demand more than supply (Times of India, 2021).
- Added to all these, the negligible number of export enterprises would not have recovered, rather continued to suffer subsequent to the easing of lockdowns after May 2020 till now, due to inadequate export demand.

An Assessment

- Overall, the brunt of lockdowns, national or regional, Covid-19 FW or SW, would have been borne by the formal/registered SMEs and informal/unregistered SMEs, which are primarily confined to metros and cities.
- The SMEs located in towns and villages will bear the brunt, additionally due to a decline in informal finance availability. But some of the own-account enterprises (which are primarily meant for meeting local demand, by making use of local resources and local skills) might have survived and would continue to survive, and some (self-financed) ones might have escaped the brunt altogether, particularly in rural areas.
- However, due to depressed demand conditions, even their lot would not have changed for any better. The rehabilitation packages introduced by some of the state governments in this time of crisis are welcome as it would provide the much-needed immediate relief to SMEs, including unorganized workers.

An Assessment

- In the long run, at what rate the SME sector would suffer or recover would depend primarily on two factors:
 1. How long the Covid-19 pandemic will continue to haunt the economy, and how soon the country will be able to rein in the 'health crisis' through extensive vaccinations of its widely spread population, and as a result, how successful the country will be in preventing the emergence of a third wave? and
 2. How effectively the government would address the concerns of the SME sector through - monetary and fiscal - policy initiatives?

Policy recommendations

- Revitalize the nation-wide network of DICs for the purpose of MSME revival through (a) enumeration of closed formal/informal manufacturing and service enterprises (during Covid-19 FW and SW) district-wise, in the short-run, and (b) periodic data collection of MSMEs (for accounting new registrations and closures), in the long run. For the purpose, all metros and large cities must have multiple DICs (one for each Legislative Assembly constituency). Each DIC must be staffed with well-trained field personnel to gather field data.
- DICs should have the responsibility to prepare an “economic health report” of MSMEs including informal enterprises, on an immediate basis. Based on this report, MSME revival package must be worked out. The district-based SFBs [along with State level SIDBI, NABARD and State Financial Corporations (SFCs)] must be involved in the revival package preparation. The revival package should involve (i) collateral free, concessional finance, (ii) employment criteria-based subsidy, (iii) preferential access to utilities, (iv) training of local labour for up-gradation of skills, (v) enabling ‘e-marketing’, and (vi) forging ‘networks’ among micro enterprises (for overcoming diseconomies of scale) for accessing larger external markets, among others.

Policy recommendations

- There is an urgent need to expand the network of Small Finance Banks (SFBs) in rural areas, with the help of 'financially strong' Public Sector and Private Sector Banks, as soon as possible.
- Allow further opening of new branches in rural India only in the form of SFBs, for promoting non-farm economic activities.
- Establish Rural Business Incubators, with the support from DICs, SIDBI, NABARD and SFCs, to encourage local talent, local ideation, and local resource utilization for generating local start-ups.

Conclusions

- The Covid-19 FW and the national lockdown implemented to contain it during March-May 2020 gave an unprecedented blow to the vibrant SME sector as much as to the whole economy through supply and demand side shocks.
- The Covid-19 SW is likely to make a devastating impact on the SME sector in India, which has become fragile due to the onslaught of Covid-19 FW.
- The fiscal and monetary stimulus introduced by the national and regional governments was very appropriate and justified.
- However, they would have provided only the much-needed short-term succor, but not beyond.
- A revitalized DIC network with the help of SFBs, SIDBI, NABARD and SFCs can play a decisive role in the revival of SME sector.
- The establishment of Rural Business Incubators is an equally appropriate step to strengthen and promote entrepreneurship at the grass-root level.
- Together, it would facilitate the economic rejuvenation of Indian economy in the immediate future.

• **THANK YOU**