

IN PANDEMIC SHOCK, CRITICAL LESSONS FOR MSMEs

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Industry & Services Sector incl. MSMEs and PSUs

Many reasons behind difficulties | Photo Credit: Bashkaran N.

Micro, Small and Medium Enterprises (MSMEs) are critical for achieving the overall objectives of economic development. The sector is a significant contributor in terms of industrial output, employment generation, and the share in gross domestic product and export. But despite many initiatives by governments since Independence, the sector has been facing challenges in its quest for survival and growth. The COVID-19 pandemic has further exposed the vulnerability of the MSME sector. During the pandemic, this sector was among the worst hit on account of the demand and supply shocks caused and the measures taken later to curb the spread of infection. The sector is still struggling to survive and recover from the pandemic-induced shocks.

Let us focus on the impact of COVID-19 on MSMEs. A recent study (by the writers) — as a primary survey of 225 small firms located in the National Capital Region (NCR) and Uttarakhand — observed that the turnover of around 90% of small firms had declined in FY2020-21. Around 53% of firms faced more than a 50% decline in their turnover. Around 29% of firms reported a collapse of their businesses. Around 53% observed a decrease in demand while around 36% faced erratic supply of raw materials.

The main reasons for a fall in turnover included restriction/s on economic activities and mobilities; decrease in demand; shortage of raw materials; restriction on trade; slow recovery of markets; payment delays and labour shortage, among others. These firms faced a 25% reduction in their employment particularly in the informal workers' segment that stood at around 47%. Major challenges faced by firms in their revival included delayed payment issues; reduced demand; a lack of financial resources; supply chain disruptions; increased cost of production; lack of skilled workers and, most importantly, business uncertainties.

Although most of the firms were aware about the initiatives under the 'Atmanirbhar Bharat' package, only half of them found it to be of any help. Given the lack of demand and business uncertainties, firms did not find it rational to avail of financial assistance available under the 'Atmanirbhar Bharat' package. A majority of firms suggested that the Government should have been more focused on creating a revival of demand for products and services.

Nevertheless, not all firms have suffered due to the pandemic-induced recession. Around 10% of firms under the study had either a rise in their turnover or reported no change. The key sectors these firms operated in included human health activities; manufacture of pharmaceuticals, medicinal, chemical and botanical products; food and beverage service activities; and manufacture of apparels, etc. The owners of these firms also reported that they tried to quickly adapt to the use of e-commerce platforms and even switched to other business activities that had demand — i.e., production of masks, sanitizers, home delivery of products, etc. They exploited the opportunity using their own savings to invest in the areas that offered new opportunities. This highlights that a firm's resilience depends upon its financial resources and ability to invest in new technologies or new business opportunities. The firms that suffered, unlike the large firms, lacked financial planning for business uncertainties in order to overcome vulnerable shocks.

COVID-19 is neither the first pandemic nor it is going to be the last. Even during the first two decades of this century, the world went through some other pandemics, viz. SARS in 2002-04, H1N1 influenza in 2009/Swine flu influenza in 2009, MERS in 2012 and the Zika virus in 2015-16. COVID-19 has been the worst among them. Apart from the pandemic, there were also other factors such as a sudden change in government policies, wars, and natural catastrophes such as floods and drought, etc. which caused business uncertainties and affected small businesses. Further, the bulk of MSMEs are in the informal sector which lack registration and the necessary financial documents to avail such benefits. These firms are at great risk of shutting down after a large-scale disaster or economic shock. Therefore, there is a need to develop a mechanism for MSMEs which should help rescue them from shutting down and support their revival during business uncertainties caused by economic shocks.

In order to make the MSME sector resilient we propose the provision of emergency funds for small businesses that should be made mandatory from the beginning. Similar to the public provident fund, the Government can initiate what is called an 'Uncertainty Corpus Fund for Small Businesses'. This fund can be used to meet the financial needs of small firms during business uncertainties. It may be linked with the turnover of firms — a firm could maintain a certain fraction of its turnover to meet the needs of this fund. Although it would be a 'forced saving' it would still be very useful for MSMEs during business uncertainties caused by economic shocks. The Government should encourage small firms by assuring them a lucrative return on the investment through this fund. Further, the Government may also contribute to the corpus fund as a fraction of the contribution of MSMEs for firms up to a certain limit of turnover.

Another measure can be the 'Small Business Insurance Scheme' which can be similar to term insurance. There are lessons to be learnt from the crop insurance scheme. As there are more than 6.4 million MSMEs in the country, there is huge market potential for the insurance sector, if such a scheme is framed properly. In order to encourage firms to invest in such an insurance scheme, the Government may pay an initial premium or a fraction of the premium on behalf of such enterprises particularly micro enterprises and own account enterprises.

Although Budget 2022-23 seeks to lay a foundation and a blueprint to steer the economy over the (Amrit Kaal) next 25 years, it has failed to bring in any plan/ideas that makes the MSME sector resilient. The proposed financial measures suggested above, namely, an 'Uncertainty Corpus Fund for Small Businesses', and 'Small Business Insurance Scheme', can help MSMEs become resilient and sustain their growth during business uncertainties caused by economic shocks. It could enable small firms to meet their working capital requirements, in particular retaining their workforce, and investing in new technology or new business opportunities to cope with uncertainties. In terms of planning, MSMEs can be on a par with large firms. It would boost the confidence of small firms during normal business times and make them more competitive by giving them a sense of security in times of an abnormal business cycle. It would also be of great help to the Government in a time of crisis as the Government can focus on addressing demand issues which is one of the biggest challenges faced by an economy during a shock.

Akhilesh K. Sharma is faculty at the Institute for Studies in Industrial Development, New Delhi. Sushil K. Rai is faculty at the University of Petroleum and Energy Studies, Dehradun. The views expressed are personal

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