The MSME sector is critical in times of Covid-19

While Indian policymakers face the tough task of containing a public health pandemic as well as formulating swift policies to protect the most vulnerable from its adverse economic effect, a committed response to support the MSMEs is essential, imminent and key to easing the impact of the crisis for these entrepreneurs, their employees and the Indian economy as a whole.

A large fraction of India’s firms are small, informal and operate in the unorganised sector. Recent annual reports on Micro, Small and Medium Enterprises (MSMEs) indicate that the sector contributes to around 30% of India’s GDP, and based on conservative estimates, employs around 50% of industrial workers. Over 97% of MSMEs can be classified as micro firms (with an investment in plant and machinery less than ₹25 lakh), and 94% are unregistered with the government.

These MSMEs are uniformly spread across rural and urban areas and are equally represented in the manufacturing, trade and services sectors. Two thirds of MSMEs are operated by socially vulnerable groups (Scheduled Caste/Scheduled Tribe/Other Backward Classes) and 20% by women.

The current coronavirus pandemic (Covid-19) lockdown will substantially disrupt the operations of these MSMEs due to their dependence on the cash-economy that is severely hit by the lockdown, the physical non-availability of workers, and restrictions in the availability of raw materials and transport infrastructure. This will have substantial ramifications throughout the economy and therefore, a robust policy response is essential.

How can Indian policy respond to this crisis?

A useful place to start would be to examine the policy response of other countries in protecting their industries during the pandemic. From the International Monetary Fund's policy tracker (that tracks key economic responses to the Covid-19 pandemic across 192 economies), these policy responses can be broadly categorised into: (a) loan guarantees and immediate liquidity provision; (b) loan extensions and penalty waivers on repayment delays and (c) interest rate reductions on future loans.

In line with the global response, the Government of India slashed interest rates, increased limits on Non-Performing Assets (NPAs) to prevent triggering insolvency, and offered payments from the government's share of Employee Provident Fund (EPF) to avoid layoffs. Several leading banks have announced special purpose loans at reduced rates for up to 10-20% of the firms' working capital limit.

While these policy measures are encouraging, they are biased towards the larger, and more formal/organised firms. However, the measures are inadequate for the smaller, informal/unorganised firms, which form an overwhelming majority of India's industrial landscape. According to the Economic Census data, over 95% of firms (over 55 million firms) employed fewer than five workers, and 94% were not registered with the government. Thus, it is unlikely that these small firms contribute to EPF and may not benefit from the Government's contribution to EPFO.

Additionally, more than 81% MSMEs are self-financed with only around 7% borrowing from formal institutions and government sources (Economic Census, 2013). Credit market interventions (cheaper loans, increased limits on NPAs) therefore may not benefit this sector directly. Since most MSMEs primarily operate on cash, they require immediate liquidity to cope with adverse events. Moreover, many micro enterprises are small, household-run businesses.

Given that other sectors of the economy and in particular, seasonal migration and agriculture, are severely hit by the lockdown, allowing these micro enterprises to operate smoothly could substantially help households cope with this economic shock. Hence, more direct measures of liquidity may be the need of the hour, similar to the initiative of the Confederation of Indian Industries (CII) that sets up a fund targeted directly at easing the liquidity constraints of MSMEs.

Lastly, MSMEs are spatially concentrated, with Uttar Pradesh and West Bengal accounting for around 30% of MSMEs and ten states accounting for around 75% of MSMEs. A joint effort from both the state and central government therefore, is critical. Supply-side interventions, in particular strengthening supply chains for MSMEs, can also help them weather the storm. Ensuring that the MSME sector has access to raw materials and robust downstream supply chains would not only help mitigate production shortages in the health and the essential goods sector, but given its size, also potentially slowdown the adverse impact on the Indian economy as a whole. The Government of India has already appealed to MSMEs producing medical and other essential products to register and sell in the Government's e-marketplace. This should be expanded to other sectors as well with co-ordination across different states to meet local supply and demand requirements.

While Indian policymakers face the tough task of containing a public health pandemic as well as formulating swift policies to protect the most vulnerable from its adverse economic effect, a committed response to support the MSMEs is essential, imminent and key to easing the impact of the crisis for these entrepreneurs, their employees and the Indian economy as a whole.

Ritam Chaurey is assistant professor, Johns Hopkins University School of Advanced International Studies. Gaurav Chiplunkar is assistant professor, Darden Business School, University of Virginia. Vidhya Soundararajan is assistant professor, Indian Institute of Management (Bangalore).

The views expressed are personal.