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Supporting SMEs during Covid-19

NORTHAMPTON: Covid-19 has disrupted millions of lives around the world. As governments work towards mitigating the deleterious effects of the pandemic on their respective populations, the private sector has a critical role to play in supporting the country to overcome the crisis through innovative solutions.

This crisis, however, has left no stone unturned and the private sector is just as vulnerable to damage as other sectors of the economy.

Early research on the impact of the pandemic on businesses showed that small and medium enterprises (SMEs), the self-employed and the informal sector were particularly vulnerable.

SMEs play a crucial role in the economy, particularly in developing countries. This article looks at how SMEs have been affected by the crisis in Pakistan and what are some of the steps that can be taken to ameliorate the situation.

Importance of SMEs

SMEs account for a large majority of businesses worldwide. They play a pivotal role in job creation and overall economic development.

The World Bank notes that SMEs represent about 90% of total businesses around the world and account for more than 50% of global employment.

Taking a sample of formal SMEs alone, it has been found that their contribution in emerging economies has been as high as 40% of national income. However, this number is likely to be higher for developing economies having a sizable informal sector.

The World Bank estimates that 600 million jobs would be needed by 2030, which makes the development of SME sector imperative for economic development and growth.

Pakistan and SME financing

Data on SME finance from the State Bank of Pakistan (SBP) shows that although the number of SME borrowers increased by 4.3% in March 2020 relative to the same period of last year, outstanding financing to SMEs fell by a significant 10.6% in the same period.

This is also reflected in the proportion of SME finance in relation to the private sector finance that dropped from 7.7% in March 2019 to 6.7% in March 2020.

An analysis of disaggregated data on financing shows that although there is a decline across all three categories of financing (fixed investment, working capital and trade finance), the largest decrease was recorded in the fixed investment category.

This phenomenon can be explained through financial accelerator theories, which illustrate the process by which adverse shocks to the economy can be amplified by worsening financial market conditions.

Applying this to the case of SMEs implies that SMEs having weak balance sheets can amplify adverse shocks to firm investment.

A key indicator of how economic downturns have adversely affected SME finance is to look at the SME non-performing loan ratio. This ratio ballooned to 20.1% in March 2020 from 16.6% last year.

Economic literature has shown that the financial accelerator effect is asymmetric, being stronger in downturns than when the economy is doing well.

Here one can see that the Covid-19 pandemic, as an event disrupting economic activity, has had a much larger impact on the most vulnerable sectors of the economy.

Recommendations

What are some of the key measures that governments can take to mitigate the effects of the pandemic on sectors most likely to be affected by economic disruptions?

The advisory and policy support for SME finance mainly includes diagnostics, implementation support, global advocacy and knowledge sharing for good practice.

This includes careful assessment by regulatory authorities and determines areas of improvement, especially in regulatory and policy aspects, to enable SMEs to attain responsible finance.

Another key aspect of improvement lies in improving credit infrastructure (credit reporting systems and insolvency regimes), which can lead to greater SME access to finance.

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