Note

The impact of COVID-19 on MSMEs in Developing Countries

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Summary

The outbreak of the Covid-19 pandemic has exacerbated the challenges faced by Micro, Small and Medium-sized Enterprises (MSMEs), especially in developing countries. Indeed, they were the most affected by lockdowns, travel restrictions and other measures taken by governments to contain the virus, particularly given their limited savings. This note reviews governments’ responses to support MSMEs in the face of COVID-19, and considers possible avenues to further help them tap into arising digitalisation and market access opportunities.
Introduction

Micro, Small and Medium Enterprises (MSMEs) feature prominently in most governments’ social and economic policies. They also feature in the United Nations Sustainable Development Goals which seek to encourage their growth in order to promote inclusive and sustainable growth, full and productive employment and decent work for all.1 There is no commonly agreed definition of Micro, Small and Medium Enterprises (MSMEs) mainly because the term ‘micro’ is a relatively new phenomenon.2 In the majority of countries, SMEs are defined as firms employing between 10 and 250 people.3 Micro-enterprises are defined as business employing between 1 and 10 people such as small shops and street vendors.4 However, there is widespread consensus of the fact that MSMEs form the backbone of the global economy.5 They are an important engine for progress towards the realisation of SDGs globally.6

According to the World Trade Organisation Report published in 2016, MSMEs contribute to 35 per cent of the GDP in developing countries and around 50 per cent in developed countries.7 Workers from MSMEs account for upwards of 80 per cent of employment in many countries.8 In developing countries, MSMEs create societal benefits that go beyond job creation and other economic gains.9 A significant number of these MSMEs are a source of employment for women and youth which in turn has contributed to women’s equal participation in the work force.

Due to their nature and size, MSMEs are always vulnerable to any economic downturn and that is the reason why they were adversely affected by the COVID-19 pandemic. At the end of December 2019, an outbreak of a disease was reported which was later proved to be caused by a novel coronavirus.10 On 30 January 2020, the World Health Organisation declared a public health emergency of International concern.11 Subsequently, it further declared the disease to be a pandemic in March 2020 as a result of the severity and rate of infections.

The severity of the disease prompted governments to impose a number of COVID-19 containment measures to try and curb the spread of the virus. These measures included widespread lockdowns, travel bans, mobility restrictions, airline suspension, closure of businesses and curfews. As a result, the pandemic has generated a major economic crisis with a halt in production, a collapse in consumption and confidence and stock exchange markets responding negatively to heightened uncertainties.12 UNCTAD posits that the pandemic will have more profound effects in developing countries that will make it difficult for them to implement effective stimulus without facing binding foreign exchange constraints.13 In all this, MSMEs have been the most affected.

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2 Ibid.
3 Ibid
10 Shafiq M et al. (2020), 4
Impact of COVID-19 on MSMEs in developing countries

The economic slow-down stemming from COVID-19 continues to take a toll on MSMEs mainly because they have limited cash reserves. Even during normal times many MSMEs face obstacles that prevent them from reaching their fullest potential. These obstacles include, lack of relevant skills, knowledge about International markets, limited access to trade finance and experience, cumbersome regulation and border procedures. MSMEs generally have smaller inventories, they operate with relatively thin profit margins and smaller supplier networks. In African and Asian countries, these companies account for 90 per cent of all enterprises. As a result, the outbreak of COVID-19 and government actions that followed exacerbated the situation for MSMEs in developing countries. A study conducted by the Asia-Pacific MSME Trade Coalition on 147 MSMEs in the region found that of the 147 MSMEs, almost half had less than a month’s worth of cash reserves. Without any other alternative source of capital, the survival of such entities becomes difficult.

COVID-19 negatively affected supply and demand. The pandemic induced lockdowns in China, the European Union and the United States of America, commonly known as group of three countries had major impacts on products, imports and exports which affected both big and small companies globally. This is so because these countries are major sources of inputs for MSMEs in most developing countries. As a result, enterprises are faced with a decrease in demand, supply chain disruptions, cancellation of export orders, raw material shortages and transportation disruptions. Sourcing from new suppliers or absorbing price increases is more challenging for small firms with limited supply options and capital. This led to a dramatic and sudden loss of demand for supplies which in turn led to a loss in revenue thus severely affecting the ability of most enterprises to function as a result of liquidity shortages.

A study by United Nation Economic Commission for Africa on the impact of COVID-19 on MSMEs in Africa showed that most MSMEs in Africa are mainly concerned about the cash-flow outlook as a result of disruptions in supply and demand. Unlike bigger corporations, MSMEs in developing countries have limited access to alternative financing mainly because most of them are informal and some do not have assets that can be used as collateral for new credit lines with financial institutions. Resultantly, most MSMEs are not in a position to produce and sell to the desired end users yet they still have to pay all the fixed costs associated with running a business including rentals, rates and taxes.

The lockdowns and quarantine measures also caused a reduction of labour as most businesses which were regarded as non-essential were forced to close by governments. MSMEs are generally labour intensive and the COVID-related restrictions on the movement of workers negatively affected the day to day operations of these enterprises. The International Labour Organisation estimates that the impact of the pandemic is likely to result in a rise in global unemployment of between 5, 3 million to 24, 7

17Asia Pacific MSME Trade Coalition (AMTC) (2020), Supporting the Small in a Pandemic; AMTC
4 million signalling that sustaining business operations will be particularly difficult for MSMEs. The rise in unemployment is likely to exacerbate hunger and starvation in most of the developing economies. During the lockdowns, most of the population in the informal sector stopped going to work and as such could not fend for themselves. In India for instance, 90 per cent of the population is employed in the informal sector. With lockdown measures being imposed, they had to go back to the villages with no source of income to provide for their daily needs.

It is imperative to note that in developing countries, MSMEs are largely concentrated in the manufacturing, hospitality services and tourism sectors which were the most affected by the measures imposed by government to curb the spread of the virus. The travel bans that were imposed worldwide exposed MSMEs in the tourism and hospitality sector to the threat of closure thus rendering a significant number of people jobless. About a quarter of the businesses in the hospitality and tourism sector are reported to have closed between January and May 2020 with an increase to 50 per cent being reported in the aftermath. Women led firms operating in these sectors were the most affected and threatened with the high risk of permanent closure due to the pandemic-induced bankruptcy. This will negatively affect the progress that had been made towards gender equality and the financial inclusion of women in most countries.

In addition to the quarantine and lockdown measures that were imposed by governments, an increasing number of governments introduced export or import restrictions notably on agricultural products which has exacerbated the situation, since these are an important source of income for many MSMEs. As of 22 June 2020, a total of 93 countries had imposed temporary export measures including bans and restrictions. A significant number of MSMEs in developing countries depend on international trade for their activities either because they export their products through direct or indirect channels or because they import inputs to manufacture the products they sell domestically. The import and export restrictions therefore adversely affected most businesses to a greater extent. In Africa, two thirds of the MSMEs were strongly affected with 75 per cent reducing sales and 54 per cent facing serious difficulties in accessing inputs.

In trying to cushion themselves from the brunt effects of the pandemic, MSMEs had to employ a number of diverse strategies such as retreating, resilience and transformation. The businesses that retreated had to put in measures which include laying off employees, taking on debt and selling their assets. Some adopted a strategy of resilience which included measures such as scaling down or adjusting businesses temporarily and adopting new strategies such as electronic commerce. Other businesses had to completely transform their businesses by creating novel and new products such as masks, sanitisers and face shields. By and large, the effect of COVID-19 remained adverse on MSMEs operations in most of the developing countries.

Governments’ responses to COVID-19

The impact of the pandemic on MSMEs was of great concern to most governments mainly because of the key role they play in local

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26 DESA Webinar (2020) 4.
28 ITC (2020) 32.
29 WTO (2020) 2.
32 DESA Webinar (2020) 1.
economies and global supply chains. In addition to addressing the health crisis, governments had to come up with ways to try and alleviate the impact of COVID-19 on small business by introducing policies targeted at building their resilience. These policies included offering stimulus packages to businesses. In essence, these stimulus packages included special credit lines, grants, debt relief, tax and social contribution relief, wage subsidies and extension of social protection. The stimulus package was mainly targeted at resolving the liquidity challenges that MSMEs were facing as a result of the pandemic and related measures. As of July 2020, 67 developing countries and 19 least developed countries (LDCs) had introduced payment deferrals on taxes and social security contributions among others. 68 developing countries and 12 LDCs had provided loans and credit facilities to MSMEs as part of the stimulus packaging. For example, in the Philippines, the informal sector provides for crucial economic services such as food selling, transportation and healthcare. The government therefore passed the Economic Stimulus Act of 2020 which provides for investments in expanding infrastructure on health care, education and food security in addition to providing wage subsidies and free-interest loans to MSMEs.

Governments also put in place trade expanding measures meant to facilitate trade during lockdowns and travel bans. These measures included deferrals and reductions of trade-related payment such as customs duties, freight charges and export credits. Some countries also streamlined customs procedures for medical supplies and agricultural products. In 18 developed countries and 3 LDCs, the governments reduced trade related tariffs for essential products such as medical equipment, 9 developing countries and 1 LDC had specific policies for deferral of trade related payments such as customs duties. For example, the Argentinian government temporarily authorised the submission of certificates of origins in electronic format and eliminated the requirements for paper copies.

Furthermore, some measures were put in place to improve the business environment and enhance the ease of doing business amidst the global pandemic. These measures were related to corporate obligations such as taxes and audits. 16 developing countries and 8 LDCs postponed fulfilment of such corporate obligations. In addition, 3 developing countries and 2 LDCs reduced fees and streamlined procedures for business registration and licensing. For instance, in South Africa, ZAR200 billion from the ZAR500 billion COVID relief package was in tax deferrals and reduced fees for licensing. In Kenya, the government reduced the turnover tax rate for all MSMEs from the normal 3 per cent to 1 per cent.

In addition to national strategies, regional and international organisations also put in place measures to strengthen the global ecosystem for MSMEs and their resilience to the devastating effects of the pandemic. The United Nations Secretary General established the Response and Recovery, an interagency fund mechanism to help support low and middle income countries overcome the health and development crisis caused by COVID-19. This funded was to benefit all enterprises including MSMEs.

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33 ITC (2020) 34.
34 Ibid.
35 DESA Webinar (2020) 3.
36 WTO (2020) 5.
37 Ibid.
38 DESA Webinar (2020) 3.
40 WTO (2020) 5.
41 Ibid 2.
42 WTO (b2020) 3.
43 WTO (2020) 5.
44 Ibid.
47 DESA Webinar (2020) 3.
Potential opportunities for MSMEs

Notwithstanding the negative impact that the pandemic had on MSMEs, it also flared up a number of opportunities which if utilised would lessen the costs of doing business and improve business operations.

Digital technologies

During the time the world was in lockdown, digital technology flourished. The pandemic pushed more consumers online thus accelerating the adoption of electronic commerce. Countries had to shift towards embracing digital platforms such as teleworking, remote learning, teleconferencing, online health services and electronic commerce. Enterprises that adopted the resilience strategy harnessed the opportunity. In Uganda, start-ups such as Brango Fresh and Online Butchery were set up to enable people to shop for groceries online and ChapChap Africa developing cashless features to reduce customers’ risk of infection. Some countries also put in place structural policies to help MSMEs adopt new working methods and digital technology. Chile introduced ‘ApoyameAquí’ a MSMEs online initiative through which businesses can access exclusive content on electronic commerce, social networks, payment methods and digital marketing to help increase sales, lower costs and improve relationships with customers and suppliers. Malaysia’s national commercialisation platform PlaTom Ventures helps entrepreneurs turn their ideas into successful products and services.

Digitalisation can help MSMEs overcome the challenges that arose as a result of supply chain disruptions. It creates an opportunity for them to enhance their reach at lower costs thus overcoming the scale of disadvantages they have relative to large players. While benefits of digitalisation differ with sectors and businesses, adoption of digital technologies has a plethora of benefits for MSMEs which include; managing transactions from a distance, delivering goods efficiently, facilitating access to financial services and engaging with new and existing customers.

A survey was carried out in the Asia Pacific region on the benefits of digitalisation involving 1,500 MSMEs. The findings indicated that among other benefits of digitalisation, these enterprises improved their profit margins, revenue, productivity, cost reduction, ability to offer new products and services and also customer loyalty and retention. The outlook clearly shows that MSMEs do not have much choice when it comes to digital technologies, they should therefore adopt them as a way of adapting to the realities of the market and competition.

However, it is important to note that digitalisation also came with a myriad of challenges that especially came to the fore during the pandemic. Some of these challenges include cybersecurity and data privacy issues, digital fraud, asymmetric market power and platform dominance and the digital divide and related infrastructure issues. In most developing countries, the digital divide widened thus exposing MSMEs to further economic marginalisation. As a result, governments have to put in place policies that address the aforementioned challenges to ensure that MSMEs reap the full benefits of e-commerce. Failure to do so will lead to the demise of such enterprises which would greatly undermine all

49 ITC (2020)
51 Zandy (2020) 4.
52 WTO (2020) 7.
53 Zandy (2020) 27.
56 Ibid pg.6.
57 Ibid 7.
efforts being made towards post COVID economic growth and recovery.

**New markets and enhanced access**

The demand for sanitisers, masks and personal protective equipment hit a fever pitch and most countries imposed trade restrictive measures particularly on exports. Protectionism became rampant especially in developed countries. Local enterprises had to rise to the occasion and produce those new products and meet the demand. In some developing countries, governments had to provide financial assistance to enterprises that were locally producing personal protective equipment, face masks and sanitisers to meet the demand within their borders. The pandemic therefore posed an opportunity for MSMEs to diversify their products, penetrate new markets and grow. However, there is need to develop necessary skills and capacity to ensure that the goal is realised.

**Recommendations**

For MSMEs in developing economies to harness the potentials that result from the pandemic, governments should put in place policies that support MSMEs. Governments are inarguably an important player within the MSME ecosystem. As such, for these enterprises to thrive amidst the pandemic, governments have to play a part.

One of the biggest obstacles that MSMEs face even during normal times relate to access to finance. The Asian Development Bank estimates the MSMEs trade finance gap to be at about US$ 1.5 billion per year and is likely to increase due to COVID-19 effects on financial market confidence. A majority of MSMEs are concerned about access to finance and governments have tried to put in place stimulus packages to alleviate the plight of these enterprises. However, the sad reality is that most of these enterprises are not accessing the packages and some lack the relevant information on the processes. As a result, the gap remains wide. Governments therefore have to come up with policies that encourage the financial inclusion for MSMEs for the broader post COVID economic recovery. Similar policies have been put in place in some developing countries such as Morroco, Nigeria, India and Lebanon. These policies can either be in the form of low interest rates or longer repayment periods. In Morroco, the government put in place the MSME Development Project meant to secure funding for MSMEs. The Lebanese government also launched the Innovative, Small and Medium Enterprises (Isme) which is essentially a 30 million dollar investment lending which provides equity investment in innovative young firms. Therefore, other developing countries should introduce policies that support the financial inclusion of MSMEs for post economic recovery.

As already highlighted above, digitalisation poses a myriad of challenges for MSMEs. Online markets raise concerns regarding cybersecurity and data privacy. There is therefore need for governments to put in place laws on cybersecurity and data privacy. Another challenge relates to the digital divide and infrastructure. Most developing countries lack the required infrastructure to support e-commerce. Not all enterprises have the high technology required to operate their businesses virtually. Some lack the technological literacy to make use of the digital tools that are at their disposal. There are also issues relating to internet connectivity and access to data that bedevil most developing countries. Policy makers therefore have to initiate a two prolonged approach which helps MSMEs reap the benefits of digital technology while overcoming the challenges that the digital tools pose. Governments should lower the data costs, invest in the development of high technological infrastructure and provide financial assistance for the digitalisation of MSMEs.

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58 WTO (2020)
60 Ibid.
infrastructure and promote technological literacy.

MSMEs also have a part to play in promoting their resilience and survival post pandemic. There is need to build technical capacity and skills. The new normal post pandemic will be characterised by e-commerce and product diversification. There is therefore need to invest in capacity building so that they remain competitive. MSMEs can also focus on key areas of competitiveness in their value chain, product, and/or operations and identify the best technology levers to enhance competitiveness.62

**Conclusion**

By and large, COVID-19 effects were most felt by MSMEs in developing countries. Most of the enterprises were faced with permanent closure as a result of the COVID related measures that were imposed by governments. Realising the importance of MSMEs in building up economies, governments had to put in place measures to alleviate the plight of MSMEs in their respective countries. These measures included stimulus packages and subsidies. Though they were helpful in sustaining some of the businesses, there is need for more effort to ensure that MSMEs are redeemed from the impact of the pandemic. There is need for concerted effort from both the governments and private sector in ensuring that MSMEs harness the opportunities available for post economic recovery.

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62 Zandy (2020) 8.
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