

Supporting MSMEs in time of crisis

SMEs and their workers are hard-hit by the present COVID-19 outbreak and related economic downturn. In response to the crisis, governments and enterprises are implementing strategies to minimize the negative impacts, supporting business operations and protecting workers' rights, heading towards resilience.

**What policy options do Governments have to help SMEs maintain their operations and workforce?
What worked in previous calamities to keep SMEs afloat?**

This paper sheds light on what Governments, together with workers' and employers' organizations, can do to preserve business and decent work.

Introduction

Governments have a range of policy and programming options at their disposition to support MSMEs during different types of crises, including the present Covid-19 crisis. These policies can be of diverse nature: fiscal, monetary, financial, foreign exchange, foreign trade, sectoral, labour and social. Which policies and support programmes are more adequate in the present situation, depends on the local context as well as on the resources Governments can invest.

Policies and programs to help MSMEs to maintain their operations and protect their workforce during a crisis can be classified according to the desired impact generated in MSMEs as follows:

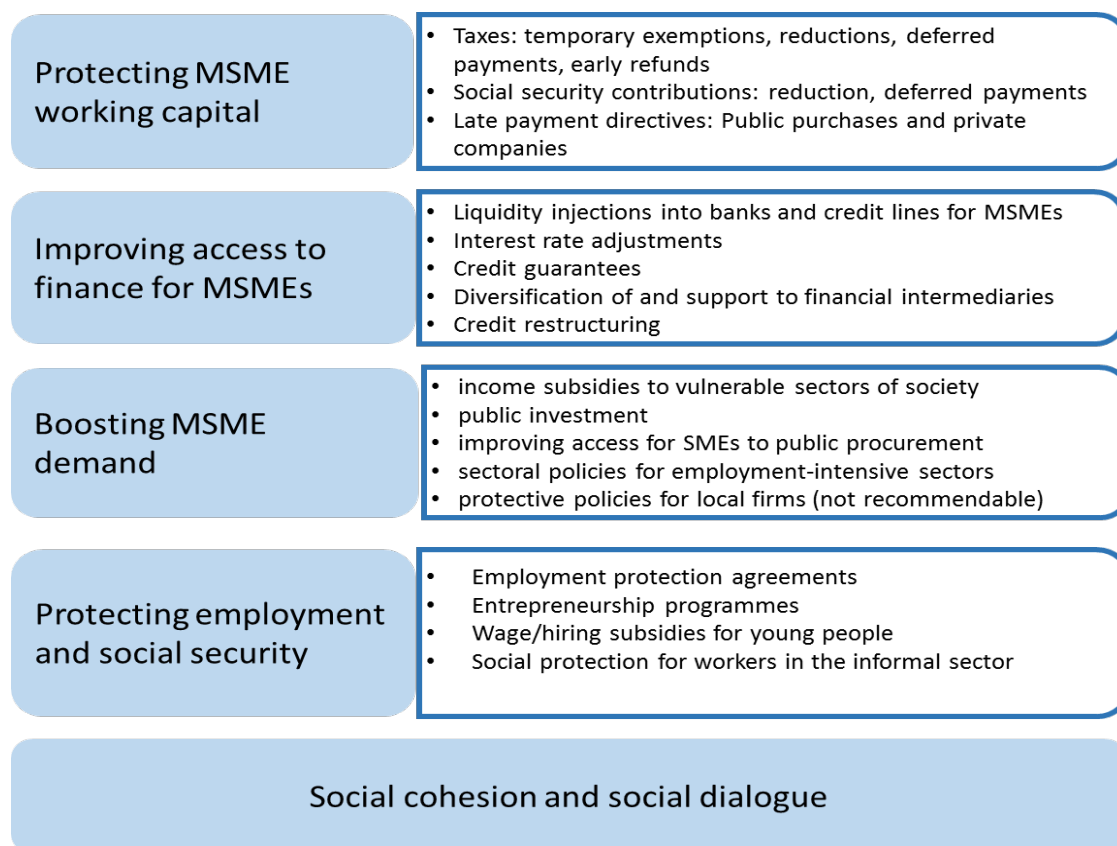
- A. Protecting MSME working capital
- B. Improving access to finance for MSMEs
- C. Boosting MSME demand
- D. Protecting employment and social security
- E. Social cohesion and social dialogue

The below shows the different types of policies or programs implemented in different countries.

Protecting MSME working capital

An immediate effect of any crisis for any MSME is working capital shortage as a result of declining business operations and delays in payments from customers. This may be exacerbated by an increase in expenses, due to higher costs of supplies, financial expenses and the smaller scale of operations. Different countries have formulated measures to alleviate the situation through tax relief (temporary exemptions, remissions, discounts, deferred payments, advance or accelerated repayments, accelerated depreciation, etc.) and reductions and deferments of social security contributions. Some countries have complemented these

measures with measures on the timely payment to MSMEs in government contracting, public procurement and contracts with private companies at large.



Accelerated depreciation is a very effective measure for companies with significant assets, as well as for young or recently expanded companies. It is less effective for micro and small enterprises that have been in business for many years. Deferred payments of taxes and social security contributions, as well as early or accelerated refunding of taxes can provide significant cash flow relief to formal MSMEs. Temporary exemptions and tax breaks can be very convenient measures for MSMEs, but need to be considered in the perspective of business reactivation, in order to avoid situations where they are used to rescue the financial situation of the employer without rescuing the enterprise.

Timely payments to MSMEs by their clients is a topic of great concern to MSMEs worldwide and more so in times of crisis. Since timely payment of public purchases and contracts is under the control of the Government, this should be the first area of attention. Some countries have passed legislation on timely payments by the private sector, with various grades of difficulty in implementation.

Reductions or deferred payment options for social security contributions are measures that help reduce labour costs, contribute to employment stability, especially in countries where the employers' contributions to social security are substantial. These measures should aim to avoid workers' loss of social

protection derived from the non-payment of employers' contributions. These initiatives support all company sizes within the formal economy.

Improving access to finance

In times of crisis, MSMEs mostly require working capital finance and debt restructuring. Investments and innovations are usually postponed, as well as business start-ups. MSMEs need access to timely financial services at a reasonable cost and in adequate amounts. During an economic crisis, financing options tend to be more restricted and more expensive, especially for MSMEs.

The most important policy options to improve access to finance are capitalization of banks, interest rate reductions, credit lines for MSMEs and exporters, increased availability of credit guarantees, diversification of financial intermediaries and credit restructuring facilities.

The impact of policies to improve access to finance for MSMEs is closely related to the depth of a country's financial system, the existence of development banks, the financing sources and channels most frequently used by MSMEs and the effectiveness of credit bureaus, among others.

Injections of liquidity into banks do not always translate into better access for MSMEs to finance, certainly not in countries with a shallow financial market. In most developing countries, it is necessary to strengthen and capitalize financial intermediaries other than banks, reaching smaller enterprises. Likewise, to improve access through (freshly liquidized) banks, it is necessary to improve the impact and outreach of credit guarantee facilities.

In the same way, the lowering of monetary policy rates does not necessarily translate into improved access to finance for MSMEs. In any crisis, banks have a tendency to over-evaluate the risks of smaller companies. The non-transfer of lower rates to MSMEs occurs even if there are complementary guarantee facilities as well as complete historical datasets.

Development banks lending directly or through first-tier private banks, can have a direct effect on improving access to finance for small firms. It is necessary, however, to carefully craft the conditions or rules established for private banks. In many occasions, private banks have ended up lending the State's resources to their regular clients, without generating additionality. These experiences also point to the necessity to strengthen the diversification of financial intermediaries. It is necessary to bear in mind that as companies' defaults increase during the crisis, their financial records in credit bureaus are damaged, impeding their access to finance. Hence, credit availability may exist in banks, but it may be inaccessible to a large number of MSMEs.

Measures related to credit restructuring become very important in the course of a crisis. The financial situation of MSMEs needs to be closely monitored to avoid major problems. Credit Guarantee Funds can play a role in the timely restructuring of liabilities, allowing for the continuation of operations.

It the design of these measures, the characteristics of informal economic units need to be taken into account, due to the large number of jobs in this segment of enterprises, particularly in developing countries. Hence, the importance of supporting microfinance institutions and credit cooperatives in continued access to finance for MSMEs.

Boosting MSME demand

Policies and programmes to increase the demand for MSME services and products during crisis include:

- a) income subsidies to vulnerable sectors of society
- b) public investment
- c) improving access for SMEs to public procurement
- d) sectoral policies for employment-intensive sectors
- e) export financing
- f) protective policies for local firms

The characteristics and impacts of these types of policies differ substantially in terms of their scope, outreach, expected impact, Government expenditure and other impacts of the economy.

Income subsidies for vulnerable sectors of society can have a strong impact on the domestic market, can be relatively quick to implement and are within the sphere of influence of Government. The limitations lie in their financing. It should also be noted that these type of temporary measures to deal with the crisis, imply a risk of becoming costly permanent solutions.

Policies to boost demand have a strong impact on micro and small enterprises, that are predominantly dependent on the domestic market. Demand-boosting measures respond to the notion that small companies tend to have little capacity to resist demand reduction due to their weak structures.

Public investment policies, for instance in social housing or green infrastructure, have the potential to increase demand in certain sectors. Similarly, strategies to improve access to public procurement opportunities can provide MSMEs with access to new markets. In practice, these schemes have shown certain challenges in their implementation. Certain bottlenecks in the public apparatus itself must be dealt with to reach full deployment, which takes some time, especially in the case of infrastructure development.

Sectoral policies such as reducing tourism taxes to encourage the tourism sector, or export credits to promote MSME sales, are markedly influenced by third-party behavior that may also be affected by the crisis. They also have a more narrow impact on certain industries or sectors: construction, automotive, tourism or exporting companies. In this sense, countries have to evaluate the importance of certain sectors in terms of employment. In countries where the weight of microenterprises in construction is relevant, for instance, sectoral initiatives such as mortgage loans and social housing, can be very favorable. Certain

regulatory bottlenecks, such as the agility of construction permits, must also be looked at in order to ensure the effectiveness of the policy.

Promoting the greater participation of MSMEs in public procurement can be a very effective measure in the medium term. This not only involves establishing a target or quota, but also generating the appropriate conditions for MSMEs to participate in calls and tenders. Small enterprises usually need substantial support to be able to participate and comply with the relevant standards, certifications and documentation.

Policies increasing tariffs to protect national production are not exactly the most appropriate to support MSMEs during a crisis, since in the long term, in a globalized world, protectionist policies tend to translate into a loss of competitiveness.

Protecting employment and social security

Among the effects of any crisis, is increasing unemployment as enterprises reduce staff costs and in extreme cases, close the business. Concurrently, many small enterprises affected by crisis move towards informality. Unemployed people, faced with lack of income, seek self-employment solutions, initiating ventures that increase the numbers of the informal sector operators.

Measures that have been implemented in this sense aim to promote job stability through company-worker-government agreements that avoid layoffs, temporarily reduce hours, maintain social protection for workers and subsidize training programs for workers. These programmes are often complemented by measures addressing the situation of unemployed workers, including elements of labor intermediation, training and in some cases, subsidies for hiring workers. Some of these programmes specifically target youth, women, migrants or groups.

State-supported employment protection agreements are of great relevance to MSMEs as they alleviate the labour costs for the company. In many developed countries, agreements on reduced working time are fully or partially compensated through unemployment benefits. It is necessary – but not easy - to take informal enterprises and their workers into account in the design of these policies.

Very often job stability programmes and programmes aimed at unemployed workers have a skills training component. Skills shortages constitute a declared problem in small enterprises and a real bottleneck to productivity. For this reason, many Governments consider that a crisis is a good opportunity to invest in human resource capacities, strengthening and adapting training systems to the reality of MSMEs, if necessary with a territorial and sectoral perspective.

Many Governments offer self-employment and micro-entrepreneurship programmes in the aftermath of a crisis. Although these are positive initiatives, there is often a lack of comprehensiveness. Sometimes these programmes are anchored in microfinance, without considering the need for business development services, training, technical assistance and support in business formalization. Without a comprehensive approach, there is a risk of swelling the ranks of informal micro-businesses.

Subsidy schemes for the hiring of young workers can have a positive impact on MSMEs, reducing labour cost and providing opportunities for youth, provided they are properly designed and implemented. In the design of these programs, the non-replacement of existing workers by subsidized young workers must be made explicit, since this constitutes a fairly frequent temptation in small companies. The quality and duration of subsidized job placements also need to be taken into account.

Strong unemployment benefit schemes that appropriately cover MSME workers are obviously a very important part of the equation when it comes to the protection of SMEs and their workers in times of crisis. In developing countries, workers in MSMEs are generally not covered or not adequately covered. In developed countries the situation is different. In the absence of adequate unemployment insurance coverage, temporary subsidies for the unemployed can play an important role. Any of these measures is more effective when combined with training and labour intermediation for reintegration into the labour market.

In time of crisis, discussions regarding the cost of dismissal and compensatory payments tend to flare up. It is important for MSMEs and their workers to be part of the policy debate on any temporary measures, decrees and interpretations on reasons for dismissal and their related costs, since it contains quite complex elements for them.

Social cohesion and social dialogue

Social dialogue is at the heart of the ILO Decent Work Agenda. Situations of crisis often have important implications for social dialogue. In many crisis situations, be it economical or due to natural or health hazards, industrial relations have been strained. Social dialogue, however, should play a crucial role in achieving an inclusive crisis response and sustainable routes to recovery that involve MSMEs and their workers.

The development of agreements between governments, workers and employers to protect employment and enterprises during crisis are of great importance. The joint search for solutions, the monitoring and evaluation of their implementation, should be part of the agenda. The way in which the actors jointly face and overcome the crisis strengthens the country's social and political cohesion.

When agreements affect MSMEs, it is highly relevant that their representatives – both workers and employers - are an active part of them. The stratum of small companies not only concentrates the bulk of employment, but also represents a very different reality from that of large companies. The experience in different countries includes both bipartite, business-worker and tripartite social dialogue cases, where there is also the Government. All of them have in common the recognition that social protection and employment protection mutually reinforce each other with the economic viability of businesses.

This text was prepared by Linda Deelen based on earlier work done by Lysette Henriquez Amestoy.