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INTRODUCTION

Key Messages:

Consensus exists that not all SMEs will be able to survive Covid-19, which is likely in Pakistan.

1.14 to 1.42 million SMEs out of 3.8 million may face 50% decline in their income.

Based on their existing cashflows, around 0.76-0.95 million SMEs will not be able to survive one-month lockdown

2.43 to 3.04 million SMEs in Pakistan may need assistance with in three months after one-month lockdown to resume business.

4.75 to 9.50 million of non-agricultural jobs will be at risk after one month of lockdown.

SMEs need support beyond financial resources, like getting back to supply chains. Planning and policy to support SMEs in Pakistan need to think beyond access to finance. So far, policy makers in Pakistan seems to be assuming that Covid-19 will incur only financial losses.

The COVID-19 initially started from Wuhan city of China, which has now become a global pandemic. Till 9th April, 209 countries had been affected. The crisis has caused unprecedented health and economic costs worldwide. Measures to tackle Covid-19 spread, particularly lockdowns, are adversely affecting economic activity across the globe. One of the most vulnerable and severely-hit sectors is Small and Medium Enterprises (SMEs).

The SMEs contribute around 55% of GDP in high income countries, 60% of GDP in low income economies and 70% of GDP in middle income economies, (Zafar & Mustafa 2017). A consensus is emerging that not all SMEs will be able to survive Covid-19 in the world. Pakistan is likely to suffer the same fate. SMEs have a vital role in Pakistan’s economy; they contribute around 40% to GDP, 40% to exports, 80% to non-agricultural employment, and 35% in total value additions (Shah 2018).

Hit by COVID-19, Pakistan, after one week of social distancing, is now under official lockdown since 23 March, which is extended till 14th April, 2020. This policy review aims to assess the impact of lockdown on SMEs in Pakistan. Findings from two surveys conducted in China about impact of lockdown on SMEs are used to construct different scenarios for Pakistan.

This study projects the ratio of SMEs surviving one-month lockdown based on cashflows, decline in income of SMEs under lockdown, and jobs at risk. Given the poor state of SMEs sector’s- already sluggish growth, and higher costs of production, an impact stronger than China is expected for Pakistan even during lesser strict lockdown. This “higher side scenario” for Pakistan is calculated by multiplying impact of lockdown on SMEs in China by a factor of 1.25 i.e. 25% higher impact than China.

Figure 1: Number of SMEs in Pakistan and Their Sectoral Distribution (Million)

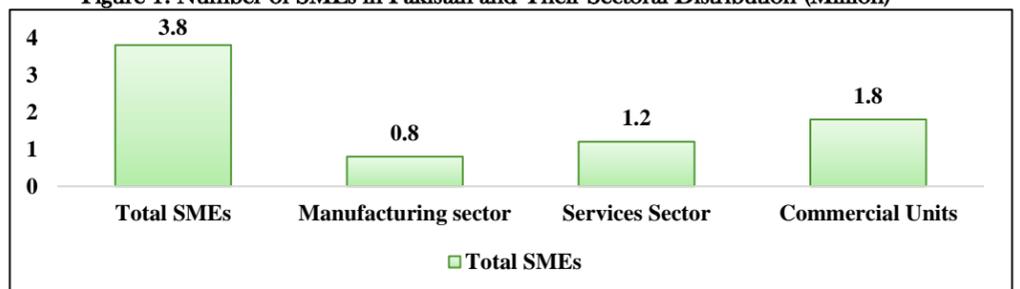


Figure 2: Share of SMEs in Pakistan’s Economy (%)

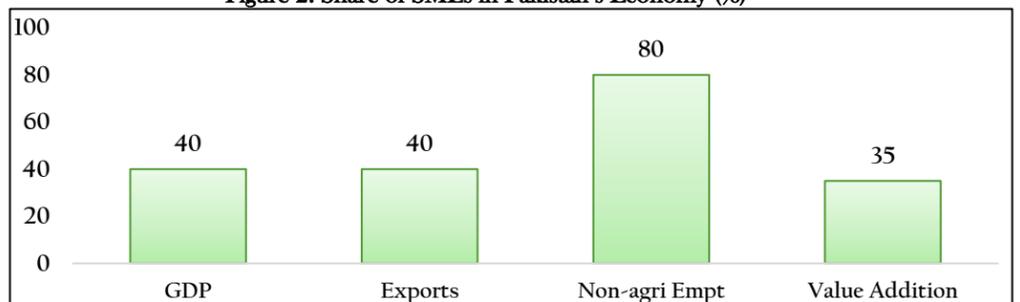
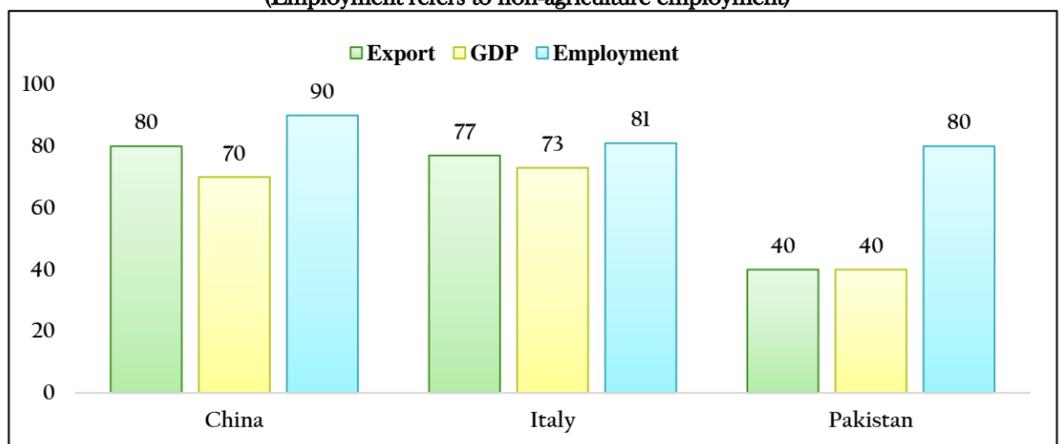


Figure 3: Share SMEs in China, Italy and Pakistan (%) (Employment refers to non-agriculture employment)



- Out of 3.8 million SMEs in Pakistan,
- 0.8 Million (21.05%) are in manufacturing Sector.
- 1.2 million (31.57%) are in services sector.
- 1.8 million (47.36%) are commercial units, which include retail trade, wholesalers, hotels, etc.

SMEs are the backbone of Pakistan’s economy, which contribute:

- 40% in GDP
- 40% in exports
- 80% in non-agricultural employment
- 5% in total value additions

These ratios have taken from SMEDA and a research article (Shah, 2018).

The impact of Covid-19 on SMEs will shape up the economy of Pakistan

We compared the share of SMEs from China and Italy. China went through a serious lockdown and it is the country that provided evidence on the impact of lockdown on SMEs. -SMEs in Pakistan have smaller share in Exports and GDP as compared to China and Italy.

-But share to employment is almost similar, i.e. around 80%.

-Highest impact of SMEs in Pakistan will be on employment. More jobs will be at risk, if smaller number of SMEs survive Covid-19.

PROJECTED IMPACT OF LOCKDOWN ON SMEs IN PAKISTAN

Table 1: Impact of lockdown on SMEs in China and estimates for Pakistan (Survey 1)

Impact of lockdown on SMEs in China	Impact of Lockdown on SMEs in Pakistan (Million) (parameters from survey-1)	Impact of Lockdown on SMEs in Pakistan under Higher side scenario for Pakistan
Number of Surveyed SMEs	2668	N/A
SMEs who are unable to surviving beyond one month on cash flow basis	20%	0.76 million
SMEs who reported not being able to survive beyond three months on cash flow basis	64%	2.43 million
SMEs which could not determine timeframe for reopening	40%	1.52 million
		Calculation: % from survey 1 * 1.25 * 3.8 (million)
		Calculation: % from Survey 1 * 3.8 million
		20 * 1.25 * 3.8 = 0.95 million
		64 * 1.25 * 3.8 = 3.04 million
		40 * 1.25 * 3.8 = 1.89 million

Peking University, China conducted a survey of 2349 SMEs (denoted as Survey 1) in February 2020 around after one month of lockdown. The findings on the impact of lockdown on SMES are reported in left column.

As no data is available in case of Pakistan, we used findings from Chinese survey as a proxy for observing impact of lockdown in Pakistan (right column). Given high informal sector, already slowing economy, higher costs of production (markup/energy prices), we expect 25% higher impact for Pakistan (higher side scenario)

Survey 1 shows that 20% of SMEs will survive only for one month in case of lockdown. This implies that in Pakistan 0.760 million SMEs will not be able to last beyond one month (based on cash flows)

64% of SMEs will not survive after three months if cash flows are not managed. In other words, 2.43 million out of 3.8 million SMEs will not be able to survive if cash flows are not managed in three months.

40% of SMEs, 1.52 million, in Pakistan may be unable to determine the future path of business resumption.

These SMEs need support beyond financial resources. So, SMEs survival planning and policy in Pakistan need to go beyond access to finance. So far, policy makers in Pakistan seem to be assuming that Covid-19 will impose on financial losses.

As in Pakistan the challenges to SMEs are much high as comparing to SMEs in China. So, we build a Higher scenario by multiplying values of survey 1 (which is 14% for one month) with 1.25 for showing its higher impact. This implies that under higher scenario 0.95 million SMEs in Pakistan will not be able to last beyond one month in higher scenario (based on cash flows).

80% of SMEs will not survive after three months if cash flows are not managed in case of higher scenario. In other words, under higher scenario 3.04 million out of 3.8 million SMEs will not be able to survive if cash flows are not managed in three months.

Figure 4: Expected number of SMEs not able to survive beyond one month of lockdown (Million)

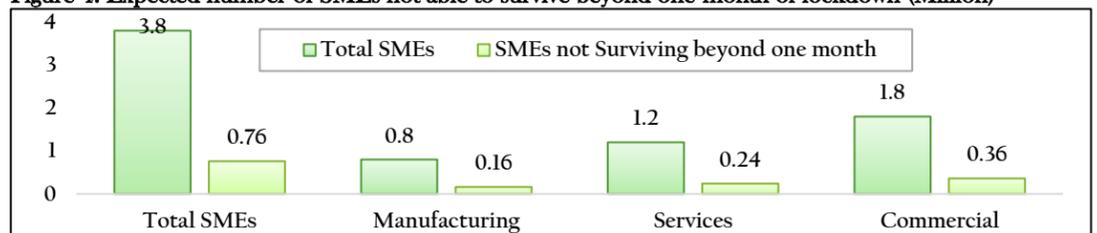


Figure 5: Expected number of SMEs in Pakistan not able to survive beyond three months of lockdown with their current cash flows (Million)



Figure 6: Expected number of SMEs unable to determine timeframe for reopening their businesses after one-month lockdown (million)

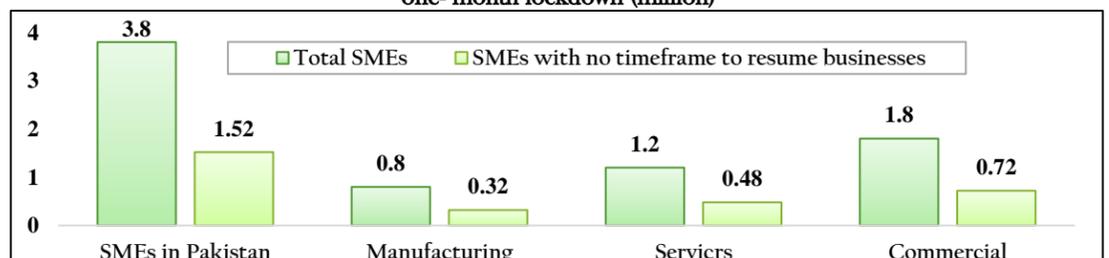


Figure 7: Expected number of SMEs in Pakistan not-surviving beyond one-month lockdown (Million) - (Higher scenario for Pakistan)

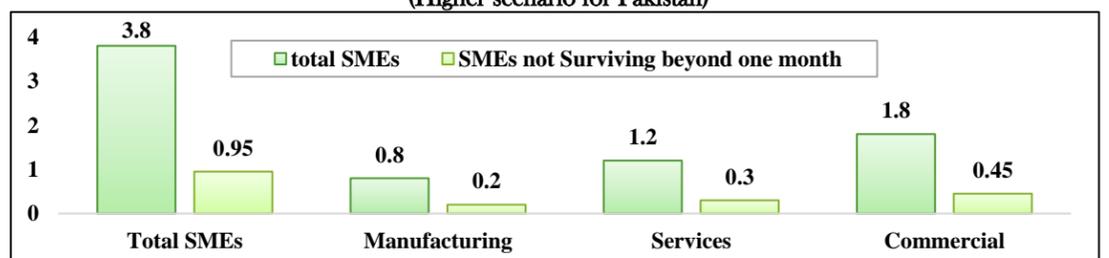
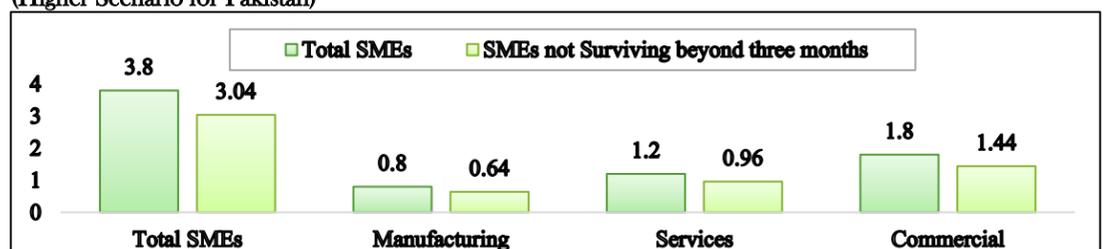


Figure 8: Expected number of SMEs in Pakistan not surviving beyond three months of lockdown (Million) (Higher Scenario for Pakistan)



PROJECTED IMPACT OF LOCKDOWN ON SMEs IN PAKISTAN

In case of higher scenario 1.9 million SMEs may have serious effects leaving them unable to determine the future path of business resumption.

These SMEs need support beyond financial resources. So, SMEs survival planning and policy in Pakistan need to go beyond access to finance. So far, policy makers in Pakistan seems to be assuming that Covid-19 will incur only financial losses.

Another survey of 995 SMEs in China was conducted by Tsinghua University (Survey 2) for observing impact of lockdown on SMEs. According to this,

- Income of 30% SMEs decline by 50%.
- Income of 28% SMEs decline between 20-50%

In other words, **1.14 to 1.42 million SMEs in Pakistan may lose half of their income due to Covid-19. Another 1.06 to 1.33 million are likely to lose income less than 50% but more than 20%.**

In case of lockdown, income of 30% SMEs which accounts around 1.14 million will decline by 50% in which

- SMEs of manufacturing sector is 0.24 million.
- SMEs of Services Sector is 0.26 million.
- SMEs of commercial sector is 0.54 million.

1.14 million SMEs in Pakistan will face decline in income

Income level of 28% SMEs will decline between 20%-50% which accounts around 1.05 million SMEs in which

- Manufacturing SMEs are 0.22 million.
- Services SMEs are 0.33 million.
- Commercial SMEs are 0.50 million.

1.06 million SMEs in Pakistan may face decline in income between 20-50%.

This will put the jobs at risk.

In case of lockdown, income of 37.5% SMEs which accounts around 1.42 million will decline by 50% in case of higher scenario in which

- SMEs of manufacturing sector is 0.29 million.
- SMEs of Services Sector is 0.44 million.
- SMEs of commercial sector is 0.67 million.

1.42 million SMEs in Pakistan will face decline in income

Income level of 35% SMEs will decline between 20%-50% which accounts around 1.33 million SMEs in case of higher scenario in which

- Manufacturing SMEs are 0.27 million.
- Services SMEs are 0.41 million.
- Commercial SMEs are 0.62 million.

1.33 million SMEs in Pakistan may face decline in income between 20-50%.

This will put the jobs at risk.

Figure 9: SMEs that could not determine timeframe for reopening after one-month of lockdown (million) (Higher Scenario for Pakistan)

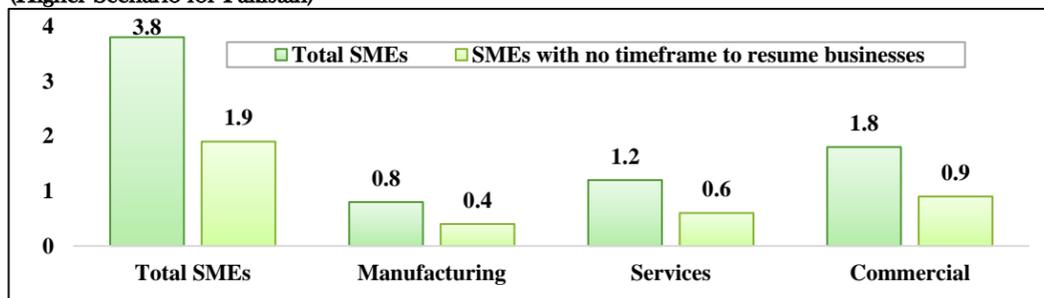


Table 2: Impact of lockdown on SMEs in China and projections for Pakistan (Survey 2)

Impact of lockdown on SMEs in China	Number of Surveyed SMEs in China	Perceived Impact of Lockdown on SMEs in Pakistan (Million) Calculation: % from Survey 1*3.8million	Perceived Impact of Lockdown on SMEs in Pakistan (Higher side Scenario by factor of 1.25) Calculation: % from Survey 1*1.25*3.8million
SMEs with 50% decline in income	30%	1.14	30%*1.25*3.8= 1.42
SMEs with 20%-50% decline in income	28%	1.06	28*1.25*3.8= 1.33

Figure 10: Number of SMEs expected to face 50% decline in income due to lockdown in Pakistan (million)

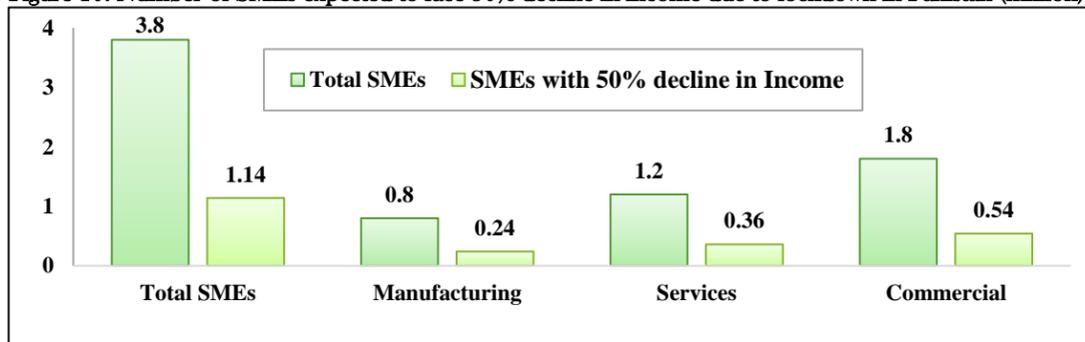


Figure 11: Number of SMEs expected to face 20%-50% decline in income due to lockdown in Pakistan

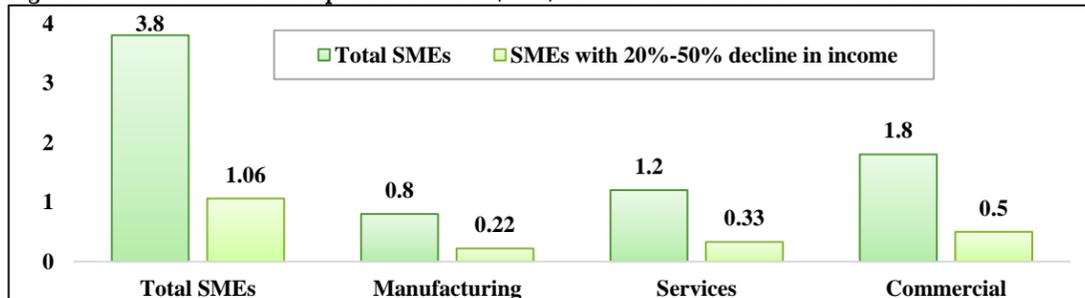


Figure 12: Number of SMEs expected to face 50% decline in income due to lockdown in Pakistan (Higher Side Scenario)

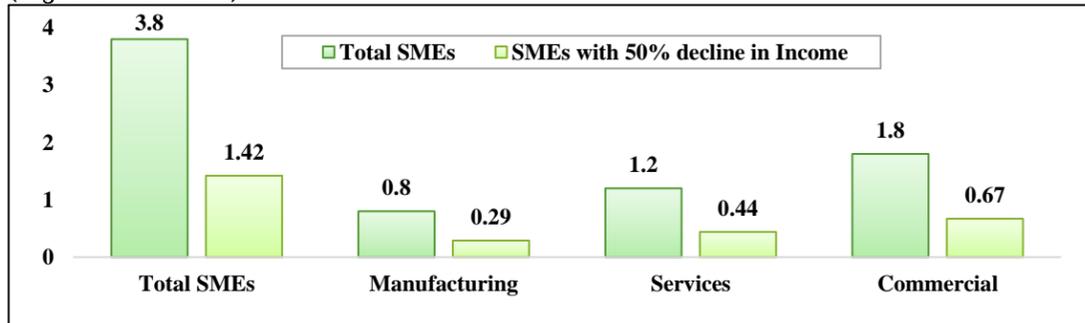
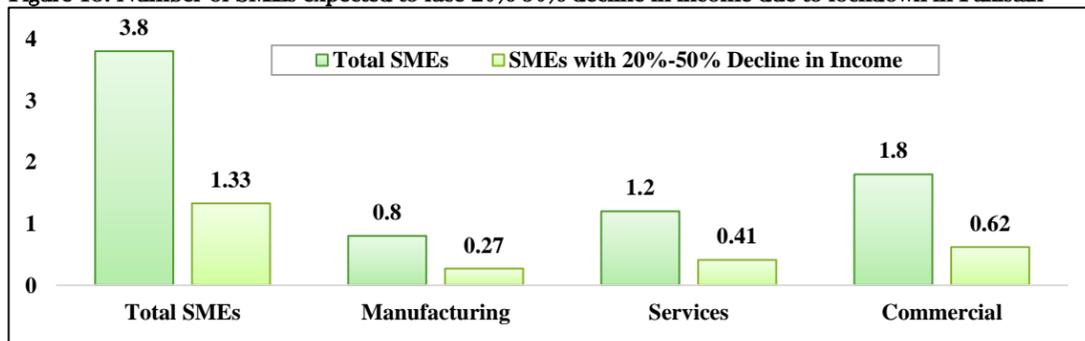


Figure 13: Number of SMEs expected to face 20%-50% decline in income due to lockdown in Pakistan



PROJECTED IMPACT OF LOCKDOWN ON SMEs IN PAKISTAN

Jobs at Risk

We build very conservative scenarios. In scenario 1, we assume 5 jobs at risk. In scenario 2, we assume 10 jobs at risk.
-Total number of jobs at risk after one month of lockdown is from 3.80 million to 7.60 million (normal scenario)
-Total number of jobs at risk after one month of lockdown is 4.75 million to 9.50 million (higher scenario)

After one month of lockdown, up to 3.6 million workers in commercial sector will be at risk of losing jobs.

-Up to 2.4 million workers in services sector and 1.6 million in manufacturing sector may be at risk of losing jobs.

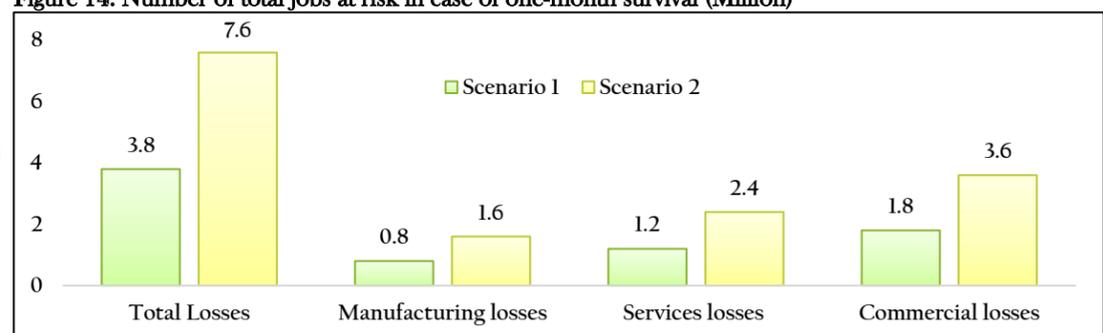
It is important to note that jobs at risk may be higher as Pakistan is undergoing a 6-week lockdown

Table 3: Total Number of jobs at risk in SMEs in case of lockdown in Pakistan due to COVID-19 (Survey 1)

	Total Job losses in SMEs with One Month of Survival		Total job losses in SMEs with one month of survival (Higher scenario for Pakistan)	
	Scenario 1, 5 Employees in each SME	Scenario 2, 10 Employees in each SME	Scenario 1, 5 Employees in each	Scenario 2, 10 Employees in each
Manufacturing Sector	$0.16 * 5 = 0.80$	$0.16 * 10 = 1.6$	$0.20 * 5 = 1.0$	$0.20 * 10 = 2.0$
Services Sector	$0.24 * 5 = 1.2$	$0.24 * 10 = 2.4$	$0.30 * 5 = 1.5$	$0.30 * 10 = 3.0$
Commercial Sector	$0.36 * 5 = 1.8$	$0.36 * 10 = 3.6$	$0.45 * 5 = 2.25$	$0.45 * 10 = 4.5$
Total Jobs at risk (million)	3.80	7.60	4.75	9.50

Note: 99% of SMEs in Pakistan have employees between 1-10

Figure 14: Number of total jobs at risk in case of one-month survival (Million)



Policy Proposals

- ❖ To help SMEs resume operations, the supply chain integration must be supported. The government must ensure that large enterprises cooperate with SMEs. This may require some incentives for large-scale enterprises as well. The loans to large enterprise may be tied with engaging SMEs. Provincial governments must take measures to support SMEs. Going beyond financial relaxations, bringing SMEs back into broken supply chain and logistics will be crucial. Steps must also be taken to create awareness on business-reopening and health regulations after the lockdown phase is over.
- ❖ Not only the government should provide temporary tax reliefs, and tax cuts, but also give subsidies equivalent to 50% of interest expenses to SMEs as State Bank of Pakistan (SBP)'s scheme for deferment is limited to principal amount and has not deferred the payments of mark up across the board¹.
- ❖ Penalties, if any, on late repayment on government contracts over the last three months must be suspended.
- ❖ SMEs employing less than 30 workers may be exempted from paying rent for 2 months after the lockdown is over as they may need to get back to value chain. Payment of electricity and gas bills of March, April and May must also be suspended and SMEs must be allowed to pay these bills in installment over next 81-2 months.
- ❖ The SBP, through cutting the Capital Conservation Buffer (CCB) from 2.50% to 1.50% and increased regulatory retail limit of Rs 125 million per SME to Rs 180 million (permanently), has increased the pool of credit to private sector (microfinance, SMEs, corporates, commercial, retail, and agriculture) to around Rs 800 billion. This does not necessarily mean that SME sector is better off. Loan Risk Assessment needs to be changed in the time of crisis.
- ❖ SBP must clearly mention the period of relaxation in CCB, as this may leave uncertainty and SMEs may be reluctant to avail the offer.
- ❖ SBP has offered schemes for deferment of principal payment on loans and advances by one year. It is suggested that markup may also be deferred for SMEs. This will add no significant impact on size of deferments as SMEs share in credit to private sector is only 7%.
- ❖ Reduction of Debt Burden Ratio (DBR) from 60% to 50% for individual-relevant to home-based businesses as well, seems more a ceremonial measure and will not have meaningful impact². The losses incurred by Covid-19 are expected to be much higher. DBR should be cut to 30% till June 2020 and 45% from onward till August 2020.
- ❖ SBP's Refinance Scheme to Avoid Layoffs, as notified on 10th April³, may look good initiative at face value, but won't work. Business, particularly SMs which are already facing shoot down, are likely not to take loan at 5%/4% to save workers. This scheme seems more Okay to business which is at least meeting it's running costs, and would like not to shut down and continue. It will pay its #workers from loan (at 5%) as it will be better off than shutdown. We need to understand businesses, in Covid_19, are shutdown already
- ❖ Measures should be taken to shift from "lending based" mode of SMEs financing to "services" mode. SMEs, taking loans, may need continued guidance and support on efficient allocations of these loans.

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¹ <http://www.sbp.org.pk/press/2020/Pr-03-Apr-20.pdf>

² <http://www.sbp.org.pk/press/2020/Pr-26-Mar-20.pdf>

³ <http://www.sbp.org.pk/press/2020/Pr-10-Apr-20.pdf>