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# ANALYSIS OF IMPACT OF COVID-19
## IN SMEs OF NEPAL.

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## Abstract

The COVID-19 pandemic has sparked a crisis across the world and had a severe impact on economies. With the government imposing lockdown and ordering social distancing, the world will wake up to a new normal to a post-pandemic trend. It has affected all sectors of the economy, but hard hit to the Small and Medium (SMEs) Enterprises. This paper focuses on the impact of the COVID-19 pandemic on the Nepalese SMESs sector and reviews the measures and initiatives taken by the Nepalese government with its Central Bank, the Nepal Rastra Bank (NRB), to help the SMEs. It also addresses the challenges faced by the proposed measures and also offers policy suggestions on what can be done to bring relief to the sector and sustain as well as revive the economy.

## 1. Introduction

The small and medium scale enterprise are the backbone of Nepal's economy as they contribute around 22% of the national GDP and provide employment to about 1.7 million people in Nepal. Taking the unaccounted economy of Nepal, the contribution is even higher. In emerging countries, SMEs contribute around 40% of the total Gross Domestic Product (GDP) and 60% of the total employment. The COVID-19 pandemic which took the world under one blanket left none of the economic sectors unaffected. The case of SMEs is also the same and is even more hit by the pandemic in Nepal. The government implemented the lockdown to stop the spread of the pandemic has hard hit to all the business to close down for nearly of 4 months which even made the SMEs sectors more vulnerable. The SMEs sector is essential for Nepal as it promotes a balanced economy, but the impact of the pandemic has proved fatal to this sector. This paper focuses on the impact of the COVID-19 pandemic on the SMEs sector and analyses the measures and initiatives taken by the Nepal Government along with the Central Bank to sustain and revive the SMEs industry. As Nepal steps on the path of economic development and prosperity under the new democratic federal structure of the government with three tiers of government, the role of SMEs sector to create jobs and further economic development had amplified. The role of SMEs is even more crucial in the current economic situation as there is a necessity to produce domestic goods and services to discourage high imports that resulted in the trade deficit in balance of payment which payment which has surpassed NPR 1.1 trillion (USD 9.98 billion). Similarly, the growth ofthe SMEs sector is crucial in supporting the government's objective of achieving higher economic growth and reducing poverty by generating employment, and in line with its vision to graduate from a Least Developed Country status by the 2022. SMEs can play a major role to achieve sustainable development goals as well as play a major driver to uplift Nepal to medium Developed country by 2030. It also addresses the challenges that the proposed measures face and further provides possible policy recommendations on what can be done to provide relief to the sector and revive the economy.

## 2. Impact of Assessment Framework on SMEs:

The COVID-19 pandemic has caused an economic slowdown on a global scale as businesses and markets were unable to operate under the nationwide lockdown in many countries. The import and export of raw material, transportation cycle, the consumption pattern of the people have changed. Companies, especially in the SMEs sector, are the worst hit due to the pandemic and are struggling to sustain as their business activities are near to collapse. In Nepal, the lockdown forced many businesses to shut down temporarily, and many are staring at an existential crisis. Their cash flows cycle was adversely impacted and eroded months of potential profits, leading to tightening of their liquidity positions which make them even more stressful to operate in the new normal scenario.

The SMEs involved in tourism sector, transportation and logistics, hotels and restaurants, education and consulting, micro enterprise engaged in service sectors, small manufacturing units have all been disturbed. Even those who are operating with limited service like grocery, automotive, garages, consumer goods, complain about the sharp drop of business. The enterprise who are highly dependent on import activities like consumer electronics, machinery, pharma, garments have been hard hit in their business because of the shortage in raw material or the labor force who are not easily ready to get back to the work because of the health risk due to pandemic. As a result of the impact of COVID-19, GDP growth in Nepal is estimated at 1.8 1 percent in FY2020, compared to following three consecutive years of substantial economic expansion, with growth averaging 7.3 percent per year.

## 3. Policy Response

The government started the lockdown from March 23 and began easing the lockdown after June 12, allowing certain sectors to open in slowly. Government, private offices, and banks (World Bank , 2020) have reopened from June 15, with government staff working in shifts. Private vehicles were allowed to operate on an alternating odd-even license-plate-number basis, corresponding to the calendar date. The Government provided immediate relief package to the needy people consisting of daily necessity food item. The budget for FY 2077/78 prioritized the health spending to be increased, including by providing additional insurance coverage to all medical personnel fighting the coronavirus, importing additional medical supplies and setting up and managing quarantine centers and temporary hospitals.

The budget included the notable NRS. 100 billion refinancing facility from the central bank and additional NRs. 50 billion financing for the subsidized loans to sector affected by the covid-19 pandemic. The financial package will allow for financing for one year but it could be extended by another year to recover from the crisis. The separate fund will provide loan to the SMEs entrepreneurs who are directly affected by the pandemic at 5% interest to finance their business to manage the need for working capital, retain their employee and to keep their business afloat. However, the effectiveness of this facility is still uncertain as the standard operating policy is still awaited. The government aims to create around 0.7 million jobs to the returning migrant workers which is uncertain for the time being.

The monetary policy also has responded to the COVID-19 pandemic in a positive way. The central bank aiming to limit the inflation rate to 7% and ensure foreign exchange reserve adequate to cover 7 months of goods and services import, aiming of growing money supply by 18% and credit growth to private sector by 20% which is a positive move. The increase of CCD (credit to core capital deposit) ratio from 80% to 85 % which will be useful in increasing the loanable fund to the affected sector of SMEs. The revision of repo rate, cash reserve ratio and bank rates all aimed at increasing liquidity to ensure the growth of economic activities to the hard-hit sectors of the COVID-19.

Moreover, the central bank has supported extended moratorium on loan payments and the decision for allowing restructuring as well as rescheduling of the sectors hit by the pandemic. The loan classification provision for the sectors hit by the covid-19, is not required to classify as bad loans, was another good decision taken by the government. The extended moratorium period gave some relief to the businesses providing them with the much-needed liquidity. During the lockdown, all economic activities were at halt, and with no revenue and more time will be needed to get the economy back to normal. Even after lifting the lockdown, the SMEs are not in a position to generate immediate revenue, making them unable to repay the loan so the extended moratorium period was good response taken by the central bank. The NRB also eased the working of financial capital by sanctioning to borrowers facing stress because of the covid-19 situation giving emphasis on direct lending to the sectors like agriculture, tourism, energy, and micro small and medium enterprises. NRB mandated that the commercial banks have to lend (each loan less than NRs 10 million) at least 15% of total loans to SMEs by 2023/24. Total directed lending has moved up to 40%, up from 25%, for commercial banks. Development banks and finance companies are mandated to lend at least 20% and 15%, respectively, to agriculture, SMEs, energy and tourism sectors by 2023/24. The success of this proposition is, however, questionable since the banking institutions have the discretion to exclude the risky entities. The SMEs involved in tourism sector, transportation and logistics, hotels and restaurants, education and consulting, micro enterprise engaged in service sectors, small manufacturing units have all been disturbed. Even those who are operating with limited service like grocery, automotive, garages, consumer goods, complain about the sharp drop of business. The enterprise who are highly dependent on import activities like consumer electronics, machinery, pharma, garments have been hard hit in their business because of the shortage in raw material or the labor force who are not easily ready to get back to the work because of the health risk due to pandemic. As a result of the impact of COVID-19, GDP growth in Nepal is estimated at 1.8 1 percent in FY2020, compared to following three consecutive years of substantial economic expansion, with growth averaging 7.3 percent per year.

# 4. Analysis

Overall, the measures taken by the government were good steps to revive the economy in the long term. However, with these comprehensive sets of measures come various challenges and problems. The relief package in the budget and the monetary policy bets big on building a strong social framework for Nepali's working class, only a small amount of the package forms the fiscal support that is required to sustain the economy. The supportive role of bureaucracy and the private institution is also required along with the support of developing partners and agencies. It is not clear as to how soon these cash flows will take place to meet the immediate requirements of the sector. These measures may provide relief to some SMEs who have large debts, but it oversees those SMEs which hold the position of operation and marginal gain. Of course, the initiatives of Government will help ease market asset risks for the financial sector; however, they will not completely offset the negative impact of the virus. As much as the Government should be commended for its long-term approach, the package does not meet the direct demand of the SMEs—an immediate and short-term support during the on-going crisis. If not, like major payroll support announced by other countries such as the US, Germany some direct financial transfer would have been helpful for the SMEs. The financial package announced by the government has failed to reach the SMEs; it is also inadequate to make up for the loss of the businesses during the period of lockdown the compliance.

The majority of the economy of SMEs are informal and they are not registered with the authorities, are neither in the banking channel nor they get counted government record. These units include street hawkers, vendors, home-based workers, taxi-drivers, who do not maintain proper books of accounts and were maintaining by themselves. Those workers do not have written contracts, and were not in the banking channel. It is difficult to avail the government facilities by them. The measures taken by the government are not beneficial for the informal sector, even though it is the main contributor to the GDP. There is barely any support for the micro-units, especially in the rural areas. The government has infused liquidity into the system and has supposedly made borrowing easy but the critical question is, would the banks and financial banks and financial institution lend to those micro-units who are not registered, self-employed, home-based workers, knowing their condition i.e. without formal documents and proper way of maintaining accounts and not meeting the regulatory compliance .

# 5. Recommendation

From a fiscal standpoint, Government of Nepal needs to increase financial support to provide relief and rebuild the economy. The monetary and fiscal should be used as a shield against more severe economic downfall by using temporary and targeted measures for all sectors. This will put a financial load on the Government, which can be partially avoided by postponing non-essential expenditure to the next year fiscal year. The announcements made by the government are credit-focused; hence, the government should have flexibility for a reasonable fiscal package with direct benefits. The government should consider direct transfer to the SMEs, which is a viable option and will provide timely relief to the SMEs at least until they start generating revenue. The Government could also have introduces special purpose vehicle to support the SMEs directly.

As the global economy slows, there will be many migrant workers returning home, so the Nepalese Government should also consider building the supply side by prioritizing sectors that are job generators and drivers of growth. and improving the economy. self-reliance that are generators of employment and engines of growth. Most of Nepalese industry is unorganized micro-industries, informal SMEs, and household entities without proper records and paper available in government departments. For fiscal support to reach these entities, especially micro-units, as they have been neglected in previous initiatives, the government should consider a flexible approach that involves local government.

A rescue of utility bills and tax compliance over an extended period would help SMEs tremendously, as just injecting liquidity would not help small businesses revive and could lead to further weakening of the balance sheet. A longer forbearance period on loan principal and interest will help SMEs to plan for a long-term revival. Even if more private organizations come together to help SMEs, for example in China, a Beijing-based JD.com allocated nearly 500 million yuan to support the use of its logistics, e-commerce, financial cloud and intelligence artificial resources; this may not solve the entire problem of the sector, but it will ease some of the burden on the government and there will be more liquidity available.

# 6. Conclusion

The nationwide lockdown of more than 120 days has impacted the SMEs sector in Nepal. As the aforementioned reasons clearly state that the sector has been experiencing excess liquidity crunch during the period of the lockdown, due to which they have not been able to pay salaries to their workers and some of them had to forego their workers or even shut down their business. There has also been a shortage of workers, raw materials, supply chain disruptions and other problems for the SMEs. To revive the economic slowdown, Nepal Government should now focus on lifting price control and tax cuts as Germany. The informal sector and household entities without legal documents of registration and operation should also be provided opportunity as they have been majorly left out in fiscal and monetary policy.

Though Government of Nepal has crafted some measures they are not sufficient to prevent the SMEs from the pandemic crisis. There remains a high questionability on the implementation of the launched program and the program reaching to the target groups. The government should be appreciated for its far-sighted vision; however, it has missed the immediate solutions. Banks and lending institution are the major pillar of the schemes and incentives launched by the government however the question of their lending as they become more prone to risks remains there. It can be concluded that though the government did not entirely fail in addressing the needs of the SMEs, its initiatives did not deliver immediate relief, which was very much expected and required.

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