IOE Outcome document on Economic advocacy for SMEs to tackle the Covid-19 crisis

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Economic advocacy for SMEs to tackle the Covid-19 crisis

The Covid-19 health crisis and the necessary measures of confinement have created one of the most challenging environments for micro-, small and medium-sized enterprises (SMEs) in modern history and severely disrupted many existing value chains. The impact to the supply and demand during the pandemic has had serious economic effects in the private sector, especially for SMEs. This situation is causing significant loss of income and massive unemployment.

Quarantined workers and restrictions on mobility along with employment measures that SMEs had to implement during the crisis also affects the supply of labour. Furloughed employees and necessary business restructurings have also led to a drop in the reduction of labour.

Moreover, the drastic loss of revenues for companies had an immediate impact on SMEs to keep the business functioning. Liquidity for SMEs has been compromised by the reduced spending and consumption capacity of individuals during uncertain economic emergency situations. Also, the restrictions for business operations in various sectors, such as services, tourism and transport, as well as the fear of contagion by consumers have also contributed to SMEs liquidity shortages that further restricts the sustainability of these companies.

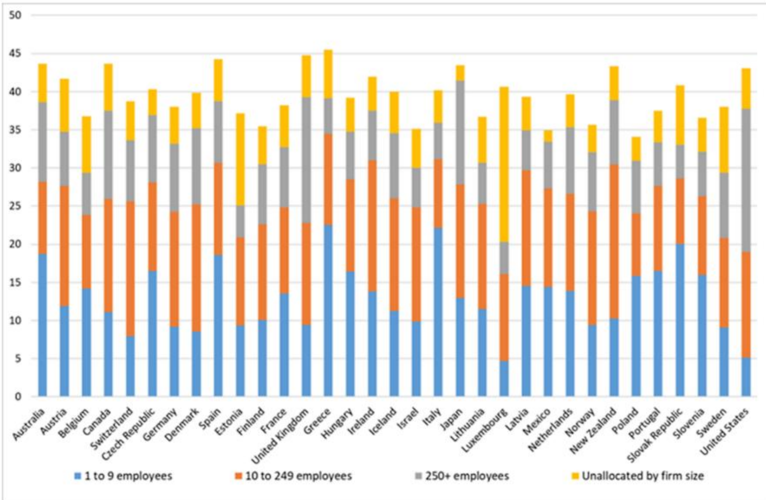
<u>Scope of economic impact</u>

SME's are the backbone of national and the global economy. According to the World Bank estimations, they represent about 90% of businesses and more than 50% of employment worldwide. "In emerging markets, most formal jobs are generated by SMEs, which create 7 out of 10 jobs".

Yet, SMEs are highly vulnerable and less resilient. According to the International Labour Organization (ILO) "Worldwide, more than 436 million enterprises face high risks of serious disruption. These enterprises are operating in the hardest-hit economic sectors, including some 232 million in wholesale and retail, 111 million in manufacturing, 51 million in accommodation and food services, and 42 million in real estate and other business activities".

Some of the most impacted sectors such as tourism and transport where an economic structure of SMEs prevails are more likely to be affected by containment measures. Moreover, the reduction in the global demand of products and services provided within these sectors is leading to serious economic consequences.

According to Organisation for Economic Co-operation and Development (OECD) analysis, SMEs account for the majority in sectors particularly affected by the crisis, which, include transport manufacturing, construction, wholesale and retail trade, air transport, accommodation and food services, real estate, professional services, and other personal services.



For example, in the road transport sector, where small and medium-sized enterprises, account for 80% of industry, many at risk of bankruptcy. According to IRU, revenue declined by 40% for goods transport during the confinement period and new contracts have declined between 60% and 90%. Likewise, passenger transport has been seriously impacted, reporting a revenue decline between 50% and 100%.

A similar situation can be seen in the travel and tourism sector where SMEs also account for 80% the industry. A baseline scenario[1] drawn by the World Travel and Tourism Council estimates that a total of 121.1 million jobs lost in the sector, with a loss of $3,435 billion in global GDP. However, if travel restrictions measures are prolonged, it's more than 197 million jobs that could be lost in the global Travel & Tourism sector resulting in the loss of $5.5 trillion in Travel & Tourism GDP, equating to a 62% drop compared with 2019.

Support for SME business continuity

It is in this context that effective and immediate measures to support SME business continuity are needed for the economic well-being of every country and the international community. Moreover, there is an urgent need to secure that economic and fiscal measures implemented by governments, central and development banks reach the sectors and business most impacted by the crisis, especially SMEs.

There is a wide range of examples of governments implementing measures to ease lending to SME's. In some countries, central banks are also taking action to boost lending. Unconventional monetary policy measures have bought packages of loans to SMEs and global institutional efforts are being deployed. Yet, there are continued challenges that SMEs face to access financing.

However, lending access for SMEs is not the same as for large firms. SMEs access to financing is restricted due to their limited capacity to fulfill required guarantees and collaterals and the lack of schemes fit for their repayment capabilities.

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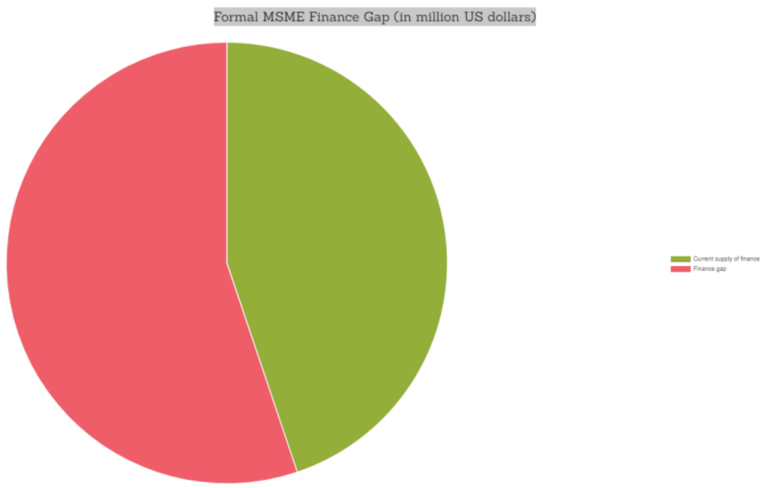
[1] Current restrictions starting to ease from June for regional travel, July for short-haul or local travel, from August for mid-haul, and from September for the long-haul

According to recent World Bank studies, 41% of formal MSMEs in developing countries have unmet financing needs. MSME finance gap in developing countries is estimated to be approximately $5 trillion - 1.3 times the current level of MSME lending.



Finance gap: 55.18% Current supply of finance: 44.82%

SMEs often rely only on own funds, or cash from friends and family, to launch their projects and bear the initial costs to run their business. Interest rates are also higher for SMEs, resulting in cash flow constraints for business sustainability.

Cashflow difficulties, along with a lack of financial expertise and insufficient access to financing have been long standing challenges for SME's that become much more evident and urgent due to the current crisis. The current crisis which defers from previous economic crisis due to its occurrence in the context of a health emergency exacerbates the great vulnerability of SMEs in this respect.

Moreover, the asymmetries in information between SMEs, investors and lenders, along with transactional costs are some of the challenges to have in mind when building up into financial and liquidity measures.

On the other hand, despite the implementation of wide range of economic measures already in place, such as grants, subsidies, fiscal and monetary policies highlighted in IOE paper on economic advocacy and business sustainability, it seems that financing might be falling short if a timely and well targeted allocation of resources is achieved.

In order to better support SMEs on the recovery process, there are other policies that stakeholders should address, such as transparency, technical support for the best use of financing, peer to peer exchange of best practices and innovative solutions to increase access to finance and restore trade and supply chains.

Financial and liquidity Innovative responses

One of the innovative response proposals that is on the table to be further explored and developed is the potential use of insurance companies and asset management companies. These institutions have a wide experience in dealing with stressed companies and risk assessment. Strengthening the use of such actors to provide SMEs with liquidity and financial support can expand the range of solutions and contribute to reduce the financing gap.

Also, bearing in mind the urgent need to provide liquidity for SMEs in a rapid manner, innovative tools such as blockchain technology in trade finance may be particularly useful.

According to the OECD, Distributed Ledger Technologies (DLT) like blockchain are driving new forms of financial innovation, such as Initial Coin Offerings (ICOs) as one of the most prominent applications of blockchain for finance.

"Initial Coin Offerings (ICOs) consist of the creation of digital tokens by small companies to investors, in exchange for fiat currency or first-generation dominant cryptocurrencies, such as the Bitcoin. ICOs are enabled by the use of Distributed Ledger Technologies (DLTs), such as the Blockchain, which facilitate the exchange of value without the need for a trusted central authority or intermediary, allowing for important efficiency gains driven by such disintermediation".

The impact of these new technologies, however, has been limited by the absence of appropriate and realistic regulatory frameworks and uncertainty about intellectual property and data protection rules.

In this context, swift and bold policy responses are key. But huge uncertainty remains. Beyond the need for cash and liquidity, there is an urgent need for clarity on official measures and post-lockdown regulations. Also, there is a need to accelerate policy and regulatory reforms to enable the growth of the digital economy. Policies aiming at facilitation access to communication networks and the promotion of e-government, as well as schemes for SMEs innovation should stand at the forefront of the government's policy agendas for economic recovery.

Country financial and liquidity policy responses
The following are some of the financial and liquidity responses available at national level:

Australia: The Australian Treasury launched a Coronavirus SME Guarantee Scheme that will provide small and medium-sized business with timely access to working capital to help them get through the impact of the coronavirus. The Guarantee Scheme will support up to $40 billion of lending to SMEs where the Government will guarantee 50 per cent of new loans issued by eligible lenders to SMEs. This programme is targeted to SMEs, with a turnover of up to $50 million. It provides for a maximum total loan of $250,000 per borrower. Loans will be up to three years, with an initial six-month repayment holiday.

Austria: The Federal Government announced support for liquidity shortfalls caused by sales decreases. Guarantees for bridging financing amounting to EUR 10 million are offered by the Austrian Economy Service. For SMEs in the tourism and leisure industry collateralisation of bridging finance of up to EUR 500,000.00 with guarantees from the Austrian hotel and tourism bank. This programme is aimed at businesses where a decline in sales revenues of at least 15% compared to the previous year is foreseen.

Canada: The Government of Canada has launched the Emergency Business Account, providing for a $40,000 limited-time, interest-free loan for businesses whose payroll in 2019 was more than $20,000 and below 1.5 million. It has been implemented by eligible financial institutions in cooperation with Export Development Canada.

Malaysia: Malaysian government recently issued a stimulus package to combat the economic impact of the Covid-19 pandemic valued at 35 billion ringgit (US$8.1 billion), bringing the total value of the country's stimulus packages to over 290 billion ringgit (US$67 billion). Some of the measures issued in the National Economic Regeneration Plan (PENJANA) include new tax incentives, financial assistance for small and medium-sized businesses (SMEs), and job protection initiatives. 400 million ringgit (US$93 million) is earmarked for micro enterprises at an interest rate of 3.5%. Eligible businesses can apply up to 50,000 ringgit (US$11,600). The government has also allocated 50 million ringgit (US$11.6 million) to assist women entrepreneurs.

The programme also provides for support to businesses in the tourism industry (airlines, hotel operators, travel agencies, etc.) allowing for a deferral on their income tax instalments and tax exemptions for hotels. More incentives are expected to be issued in July for the tourism sector financing.

Furthermore, employers who implement flexible work arrangements (such as work-from-home policies) are eligible to receive further tax deductions

Also, the Small Medium Enterprise Development Bank (SME Bank) launched a *Go-Scheme liquidity support* that will provide liquidity support to contractors who were awarded projects under previous two stimulus packages. The government has allocated 1.6 billion ringgit (US$373 million) for this incentive. This is expected to benefit 16,000 contractors who do not need to provide collateral

Nigeria: The Central Bank of Nigeria has established a fund to support the country's economy (of 50 billion naira, i.e. EUR 121 million), targeted at households and micro and small enterprises. The interest rate has been cut, a moratorium has been announced on principal repayments for CBN intervention facilities and tax measures are being taken.

Other measures provide for the extension of the due date for filing of value added tax (VAT) and withholding tax returns as well as income tax return, use of electronic platforms for paying taxes, among others.

Moreover, the following additional measures are expected to be passed by the House of representatives the upcoming days: Tax rebate of 50% of the actual amount due or paid as pay-as-you-earn tax, to companies who retain all their employees from 1 March 2020 to 31 December 2020; suspend import duties on medical equipment, medicines and personal protective gears required for treatment and management of COVID-19 for six months, effective 1 March 2020; Introduce a new moratorium on mortgage obligations of Nigerians under the National Housing Fund.

Philippines: The Philippine Guarantee Corporation (PHILGUARANTEE) has made available a credit guarantee facility to support affected micro, small and medium enterprises (MSMEs). The Credit Guarantee Program provides for support of up to P120-Billion in working capital loans to MSME facing economic difficulties as a result of the crisis.

The programme aims at providing small businesses easier access to bank financing. Guarantees extended by the government will help sustainability of small businesses enabling them to pay for fixed costs such as wages, rental, amortizations and interest payments.

Spain: Eight Royal Decrees have been passed including measures that address health and the economy relief measures, with a particular emphasis on the tourism industry, small and medium size enterprises (SMEs), and the self- employed.

The government approved a credit line whereby the State shall cover the financing extended by financial institutions to companies and self-employed persons. The Ministry of Foreign Affairs and Digital Transformation will grant up to EUR 100,000 million in guarantees for funding provided by credit institutions. Furthermore, it has raised the net indebtedness limit of the Spanish official credit institute (ICO) to increase the ICO credit facilities by EUR 10,000 million to provide companies, particularly SMEs and self-employed workers, with additional liquidity.

Companies in the tourism industry, as well as those in the tourism-related retail and hotel and restaurant sectors, hiring or retaining workers under permanent seasonal contracts will be able to apply a 50% reduction of employers' social security contributions for non-occupational contingencies, and for the joint refunding of unemployment benefits, the wage guarantee fund (FOGASA) and vocational training in respect of such workers.

Switzerland: Switzerland's Federal Council is offering rapid access to credit facilities to bridge liquidity shortfalls caused by the new coronavirus pandemic.

Affected companies can apply to their banks for bridging credit facilities representing a maximum of 10% of their annual turnover and no more than CHF 20 million.

Credits of up to CHF 500,000 will be fully secured by the Confederation and will be paid out quickly and with the minimum of bureaucracy. Zero interest will be charged. Credits exceeding CHF 500,000 will be secured by the Confederation to 85% of their value; the lending bank will secure the remaining 15%.

Singapore: The Monetary Authority of Singapore (MAS) has implemented several regulatory and supervisory programmes to focus the financial sector on Covid-19 priorities. Together with the Association of Banks in Singapore, the Life Insurance Association, the General Insurance Association and the Finance Houses Association of Singapore, it also announced a further package of measures to help ease the financial strain on SMEs caused by the COVID-19 pandemic.

The key programmes, measures and schemes being put in place to support SMEs in Singapore provide for Corporate Income Tax Rebate at a rate of 25% t of tax payable, capped at S$15,000 per company; Income Tax Payments Deferral has been granted for three months; Temporary Relief from Legal Action aiming to provide temporary relief and protection for individuals and companies who are unable to fulfil their contractual obligations because of Covid-19; and one hundred percent property tax rebate for qualifying commercial properties that have been more badly affected by the Covid-19 outbreak (e.g., hotels, serviced apartments, tourist attractions, shops and restaurants).

Moreover, Under the Special Financial Relief Program announced by the MAS, SMEs may choose to defer payment of principal and pay only interest on their fully secured term loans up to 31 December 2020, subject to the financial institutions' assessment of the quality of their security.

USA: On June 3, the US congress passed the CARES Act's Paycheck Protection Program providing for loans targeted to small businesses to help keep their workers employed during the coronavirus pandemic This programme has authorized up to $349 billion toward job retention and certain other expenses. It provides small businesses with funds to pay up to 8 weeks of payroll costs including benefits. Funds can also be used to pay interest on mortgages, rent, and utilities.

The OECD has also drawn on a preliminary overview of a wide range of country policy responses among its members. The IMF, has also developed a comprehensive Policy Tracker where the country policy responses can be consulted.

<u>Global and regional financial and liquidity responses</u>

Institutional financial measures at the global level are also playing an important role in the way forward. These are some of most relevant responses that have been implemented by stakeholders at the global level:

European Central Bank (ECB): Increased the amount of money that banks can borrow from ECB and made it easier for them to borrow specifically to make loans to those hardest-hit by the spread of the virus, including small and medium-sized firms. Interest rates are being kept at historically low levels so borrowing costs remain low.

European Commission (EC): To bring immediate relief to hard-hit SMEs, the EU budget will deploy its existing instruments to support these companies with liquidity, complementing measures taken at national level. The Commission has made liquidity measures available to support European small and medium-sized enterprises (SMEs) through COSME, the EU programme for the competitiveness of SMEs.

In particular, the EC has boosted the existing 'Loan Guarantee Facility' (LGF) under the program with additional resources from the European Fund for Strategic Investments to enable banks to offer bridge financing for SMEs. This includes long-term working capital loans (of 12 months or more), as well as credit holidays allowing for delayed repayments of existing loans.

European Investment Bank (EIB): The EIB Group has proposed a plan to mobilise up to EUR 40 billion of financing. The EIB Group has also proposed a financing package that will go towards bridging loans, credit holidays and other measures designed to alleviate liquidity and working capital constraints for SMEs and mid-caps. The EIB Group, including the European Investment Fund, which specialises in support for SMEs, will work through financial intermediaries in the Member States and in partnership with national promotional banks. They will provide 1) guarantee schemes to banks based on existing programmes for immediate deployment, mobilising up to EUR 8 billion of SME financing, 2) liquidity lines to banks to ensure additional working capital support for SMEs and mid-caps of EUR 10 billion, and dedicated asset-backed securities purchasing programmes to allow banks to transfer risk on portfolios of SME loans, mobilizing another EUR 10 billion of support.

International Monetary Fund (IMF): The IMF is making available about $50 billion through its rapid-disbursing emergency financing facilities for low income and emerging market countries that could potentially seek support. Of this, $10 billion is available at zero interest for the poorest members through the Rapid Credit Facility. Also, the IMF has a Catastrophe Containment and Relief Trust that can provide eligible countries with up-front grants for relief on IMF debt service falling due.

Asian Development Bank (ADB): ADB announced a 6.5 billion initial package to address the immediate needs of its developing member countries. The package includes $3.6 billion in sovereign operations for responses to the health and economic consequences of the pandemic, and $1.6 billion in non-sovereign operations for MSMEs, domestic and regional trade, and firms directly impacted.

Africa Development Bank Group (AFDB): has raised an exceptional $3 billion in a three-year social bond to help alleviate the economic and social impact the Covid-19 pandemic.

European Bank for Reconstruction and Development (EBRD): To respond in solidarity with its shareholders, countries of operations, partners, and clients, EBRD has approved an emergency €4 billion “Solidarity Package”. The EBRD relies on commercial lenders to deploy financing, particularly to the crucial small and medium-sized enterprise segment.

Inter-American Development Bank (IDB): The IDB has up to $12 billion in resources that can be programmed to countries requesting support for disease monitoring, testing and public health services. The Bank the IDB Group will concentrate its support in four areas: public health response, safety nets, fiscal policies for the amelioration of economic impacts and assistance to SMEs, through financing programmes and short-term liquidity guarantees, foreign-trade financing and guarantees, loan restructuring, and support for strategic supply chains.

Islamic Development Bank (ISDB): The ISDB Group started preparing a $2 billion package, dedicating a significant portion of it to support and empower the MSMEs sector in member countries.

The aim of the programme is to provide part of the necessary liquidity with preferential modes for member countries through their financial sectors. It is expected to be supported by a lending guaranty programme and incentive packages for MSMEs. This has been designed in order to save direct and indirect jobs, energize economic activity, and help regain the growth pace to overcome the current crisis and its potential future consequences.

The programme is expected to contribute to saving more than 200,000 direct jobs in addition to indirect jobs.

WBG: The World Bank and International Finance Corporation (IFC) Boards of Directors approved an increased $14 billion package of fast-track financing to assist companies and countries in their efforts to prevent, detect and respond to the rapid spread of COVID-19. Within this package, IFC has announced a $6 billion intervention which includes $2 billion to expand trade financing for SMEs in emerging markets; $2 billion to expand working capital finance available through IFC client banks; and $2 billion in direct financing for companies in the healthcare sector or other sectors with Covid-19-related financing needs.

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