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Working Paper

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Suggested Citation: Muduli, Silu (2022) : Impact of COVID-19 Packages on MSME Financing in India, ZBW - Leibniz Information Centre for Economics, Kiel, Hamburg

This Version is available at:

<https://hdl.handle.net/10419/250164>

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Impact of COVID-19 Packages on MSME Financing in India*

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Abstract

The small, micro, and medium enterprise (MSME) sector in India was severely affected during the COVID-19 pandemic. The Government of India and the Reserve Bank of India brought numerous policy measures to revive and provide external liquidity support to borrowers in the MSMEs sector. Credit growth picked up in the MSME sector following the introduction of the Emergency Credit Line Guarantee Scheme (ECLGS) scheme in May 2020, particularly of a loan of size less than 10 lakh. Initially, it benefited borrowers already having a relationship with the bank, later the benefit passed to new borrowers. On the usage of funds, nearly 45 per cent of these loans were used for clearing dues of vendors and 29 per cent to restart the business. On the performance of ECLGS loans, 88 per cent of loans are standard assets and 1.96 per cent are non-performing assets as of March 31, 2021.

Keywords: COVID-19, MSMEs Relief packages, MSME financing.

JEL Classifications: G28, G32, H12.

1. Introduction

The World Health Organization (WHO) declared coronavirus disease (COVID-19) a Public Health Emergency of International Concern on January 30, 2020, later, a pandemic on March 11, 2020. To diminish the infection rate, the Indian government instigated a strict lockdown in the last week of March 2020 and brought several social and economic measures during the phase to ensure the livelihood and secure the human capital of its citizens. The real gross domestic product (GDP) in April to June quarter of 2020 contracted by 24.43 per cent compared to the same quarter in the previous year, and according to the Centre for Monitoring Indian Economy (CMIE) survey data the unemployment rate went above 20 per cent of the total labour force. Inflation went beyond 6 per cent, the upper target of the Reserve Bank of India Inflation Targeting framework, due to supply bottlenecks and other supply-side disruptions. In this turbulent episode, the micro small and medium enterprise (MSME) sector also faced the consequential impacts of the lockdown. Almost all non-essential shops were closed, restrictions on vehicle movement delayed the supply of inputs, migrant workers left the workplace, and the demand for the product sharply fell due to restrictions on community movement. This in turn led to a significant employment loss and a reduction in income.

The MSME sector contributes nearly one-third of the gross value added in India, employs nearly 120 million persons, and contribute around 45 per cent of the total exports from India. Being such a crucial segment of the Indian economy, MSME-specific packages were essential during the COVID-19 crisis.

* The views expressed in the paper are those of the author(s) and not necessarily those of the institution to which they belong.

In the case of MSMEs, the measure adverse shock was the shortage of liquidity during the COVID-19 pandemic. This lower availability of liquidity or cash, led to delays in clearing dues of input suppliers and paying salaries to their staff. Sales revenue is a major source of liquidity for MSMEs. There was a significant decline in sales due to community movement restrictions, hence, MSMEs faced an unbearable liquidity crunch. Non-availability of liquidity also delayed the new investments in the MSME sector. This led to demand for external financial support for the sustenance of their business. For instance, in a study on Ireland, McGeever, McQuinn, & Myers (2020) estimated that agricultural MSMEs require between €2.4 billion to €5.7 billion external liquidity support if they completely shut their business for the next three months. In the United Kingdom, 92.1 per cent of loans were backed by the government and most demands came from the MSME sector during the COVID-19 phase for external liquidity support (Calabrese, Cowling, & Liu, 2021). In South Asia, two-thirds of the MSMEs in Pakistan find it difficult to survive, and 83 per cent were not prepared to handle the kind of liquidity shocks they faced during COVID-19 (Shafi, Liu, & Ren, 2020). A similar kind of MSME crisis was also observed in Indonesia (Tambunan, 2021). At the time of crisis in late December 2019, around 14 per cent of MSMEs find it difficult to survive for the next one month and nearly half of the MSMEs were likely to shut their business in the next three months in China (Zhang, 2020). In the case of India, Rathore & Khanna (2021) find that, during May 2020, firms in the MSME sector retained only 44 per cent of their total employee and 69 per cent of firms expressed their inability to survive in the subsequent quarters. The degree of severity was relatively higher for firms with less than 10 employees.

Considering this thriving situation of small businesses in India, the Government of India (GoI) and the Reserve Bank of India (RBI) introduced several policy measures to abate the adverse effects of lockdown and its consequential effects. This analysis assesses the impact of such measures on MSME financing during the COVID-19 pandemic, particularly the impact of the Emergency Credit Line Guarantee Scheme (ECLGS) scheme, a part of the Self-reliant India campaign or *Atmanirbhar Bharat Abhiyan* announced by the Prime Minister of India during the COVID-19 pandemic. The following section sheds light on some important policy measures aimed at the MSME sector.

2. MSME Packages During COVID-19

Amid uncertainties and unforeseeable future during the first wave of the COVID-19 phase, the Government of India introduced an emergency credit guarantee scheme, named Emergency Credit Line Guarantee Schemes (ECLGS) through National Credit Guarantee Trustee Company (NCGTC) to member lending institutions (MLIs) on Guaranteed Emergency Credit Line (GECL) of up to Rs. 4.5 lakh crore to eligible MSMEs (GoI, 2020). This scheme provides a 100 per cent guarantee to cover loan losses by MLIs, such as banks and non-bank financial corporations (NBFCs), extended to borrowers in the MSME sector. The main objective of the emergency scheme is to facilitate and make it less costly for business enterprises to meet their additional term-loan or additional working capital needs. This scheme removed the credit constraint faced by borrowers with less hard information of their business, particularly in the case of micro-enterprises. As per this scheme, the credit risk associated with the borrowers were completely absorbed by the government, which incentivised the lender to extend credit and facilitated the smooth credit flow during the COVID-19 phase.

Besides the Government of India, the Reserve Bank of India (RBI) also introduced three important measures aimed at MSMEs. *First*, the RBI brought a circular on the restructuring of loans in Resolution

Framework 1.0 up to aggregate exposure of Rs 25 crores in the MSME sector. This scheme allowed the restructuring of the MSME loans which were standard as of March 1, 2020, and directed lenders to treat assets as standard assets those assets slipped to non-performing assets between March 2, 2020 and the date of implementation of the restructuring plan. In the subsequent period, it increased the aggregate exposure limit to 50 crores in its June 4, 2021 circular in Resolution Framework 2.0. *Second*, the RBI also opened a special liquidity facility up to Rs 16,000 crore for the Small Industries Development Bank of India (SIDBI) to meet the funding requirements of micro, small and medium enterprises (RBI, 2021b). This increased the availability of loanable funds for the MSMEs. Since SIDBI is a specialized financial institution for small industries, the scheme helped it to extend more credit to MSMEs. *Third*, the RBI further directed lenders to deduct loans given to *new borrowers* in the MSMEs sector from net demand and time liabilities (NDTL) (RBI, 2021a). The NDTL is used for the calculation of the cash reserve ratio - the minimum balance maintained by scheduled banks with the RBI as a percentage of total NDTL in liquid form. Hence, lower NDTL will lead to a lower cash balance required by the banks to maintain with RBI, and this additional fund further may increase the loanable funds for the MSME sector.

The World Bank Group also extended \$1.25 billion US Dollar through its Raising and Accelerating Micro, Small and Medium Enterprise (MSME) Performance (RAMP) to revive the MSME sector in India (The World Bank Group, 2020). This program aims at bringing a high-level MSME Council set-up to enhance coordination between national and state-level programs that are aimed at MSMEs.

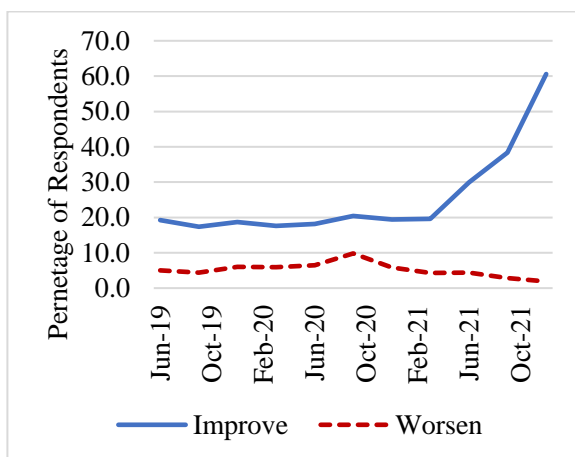
In the following section, the impact of the above measures by the Government of India and RBI has been discussed which were specifically aimed at easing MSMEs sector financing. The analysis uses data published by the RBI, the latest TransUnion CIBIL MSME Pulse Reports, and TransUnion CIBIL ECLGS Insights Report December 2021.

3. Impact of the COVID-19 MSME Packages.

At a macroeconomic level, the expansionary monetary policy in response to the COVID-19 crisis improved the availability of finance in the Indian economy. In the RBI Industry Outlook survey, more than half of the respondents find improvement in the availability of finance, particularly in the last quarter of 2020-21 (Figure 1). Business expectations improved just after the unlocking phase and the second wave did not have any significant impact on the business expectations of the respondents (Figure 2). Looking at the MSME segment, in the aftermath of the announcement of the ECLGS scheme during the *Atmanirbhar Bharat Abhiyan* announcement, small borrowers started enquiring about the loan facilities from the bank and other information on funding sources (CIBIL, 2021b). Search for loans picked up along with the ease in community movement in the initial phases of unlocking as reflected in the Google Community Mobility Index (Figure 3). There was a higher demand for credit, and among lenders, public sector banks and private sector banks got almost 50 and 30 per cent of the total loan applications during the phase, respectively (CIBIL, 2021a). Borrowers with a beforehand relationship with the bank got to know about the schemes from the bank offices, which in turn led to higher credit growth. This is further supported by the credit growth to micro, small and medium enterprises by the scheduled commercial

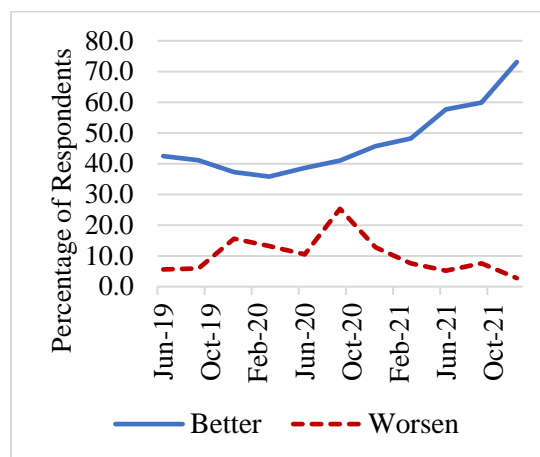
banks (Figure 4)[†]. The trend in this figure shows that credit to the MSME sector sharply picked up after the announcement of the ECLGS scheme.

Figure 1: Availability of Finance



Source: Reserve Bank of India Industry Outlook Survey

Figure 2: Business Expectations



Source: Reserve Bank of India Industry Outlook Survey

An important observation is that only 5.2 per cent of very small borrowers (loan size less than 10 lakh) who applied for the loan were able to access credit, and when asked about the ease at which they get credit, 62.9 per cent of them find it very difficult to access the credit (Table 1). This possibly may be due to the non-availability of the credit history of the borrower, or they are new to the bank. The availed rate increases for borrowers of higher loan size, also they find it easy to access credit. This may be due to their existing relationship with the bank and demand for a higher loan, implicitly indicating that their size of business is relatively more formal and have better financial information which enabled the bank to assess their creditworthiness and extend loans. Hence, the availability of hard information played a crucial role in the COVID-19 phase to access the credit with lesser transaction costs. The introduction of the incentive schemes for MSME by the Government of India and RBI helped in credit offtake, this indicates a favourable sign of recovery in the MSME sector.

Table 1: Availed Rate and Access to Credit

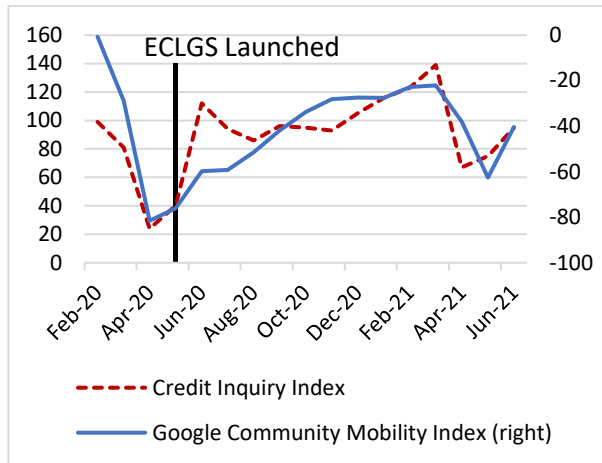
Borrower Size	Availed Rate (in per cent)	Ease of Accessing[†]	
		Not Easy (per cent)	Very Easy (per cent)
Very small (less than 10 lakh)	5.2	62.9	37.1
Micro (10 lakh - 1 crore)	10.6	54.2	45.8
Small (1 crore - 10 crore)	21.0	50.0	50.0
Medium (10 crore to 25 crore)	28.8		

Source: TransUnion CIBIL

[†] In the Figure 4, loan outstanding is normalized to 1 for January month of each calendar year – 2018, 2019, 2020, 2021. The January month serves as the benchmark to analyse the credit disbursement during the particular year.

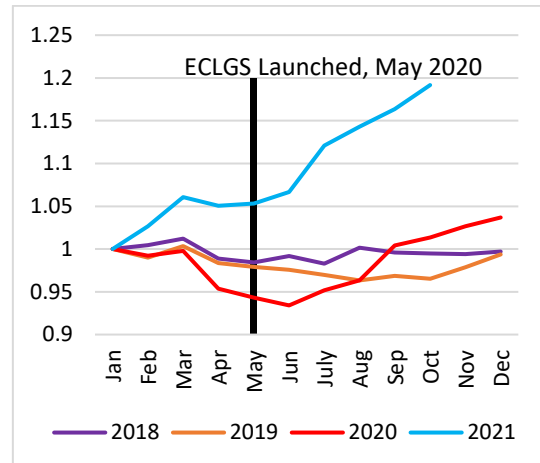
[‡] Ease of accessing information for medium category is unavailable as only two respondents were available in the bucket.

Figure 3: Unlocking and Loan Demand



Source: TransUnion CIBIL and Google Community Mobility Report

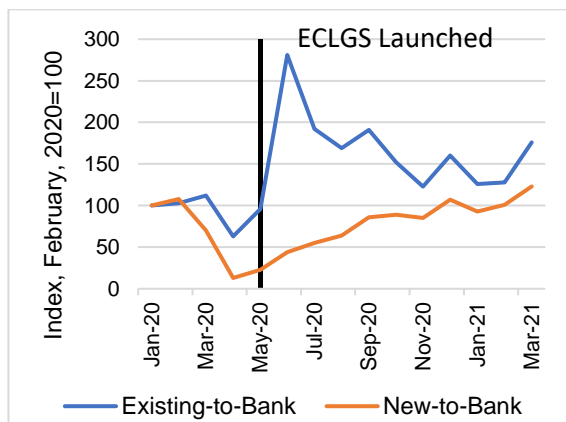
Figure 4: Credit Disbursement: MSME Sector



Source: Reserve Bank of India and author's estimates.

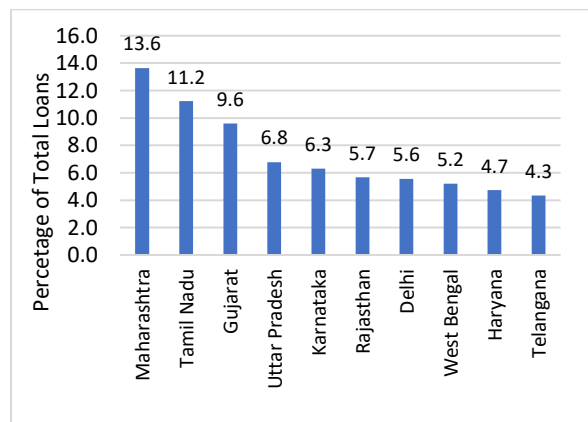
From the perspective of relationship lending, borrowers already having a relationship with the bank benefitted following the announcement of the ECLGS scheme and were able to access the credit. While those borrowers who were new to the bank, their credit offtake went at a slower pace (Figure 5). The plausible explanation could be the benefits of relationship lending and the low degree of information asymmetry that helped banks to extend credit. This divergence was of great concern as it could result in a shutdown of businesses of small borrowers who were new to the bank. To address the issue, in February 2021 RBI incentivised scheduled commercial banks to deduct loans extended to *new MSME borrowers* from their net demand and time liabilities (NDTL), which is used for the calculation of the cash reserve ratio (CRR). This measure further supported the credit flow to new borrowers in the MSME sector. Looking at the state-wise distribution of MSME credits under the ECLGS programme, the top 10 states based on share constitute almost 73 per cent of the total credits. Among these states, one-fourth of the total loans were disbursed in Maharashtra and Tamil Nadu (Figure 6).

Figure 5: Access to Finance: New vs. Old Borrowers



Source: TransUnion CIBIL

Figure 6: ECLGS Loan Disbursement to MSME Sector: State-wise

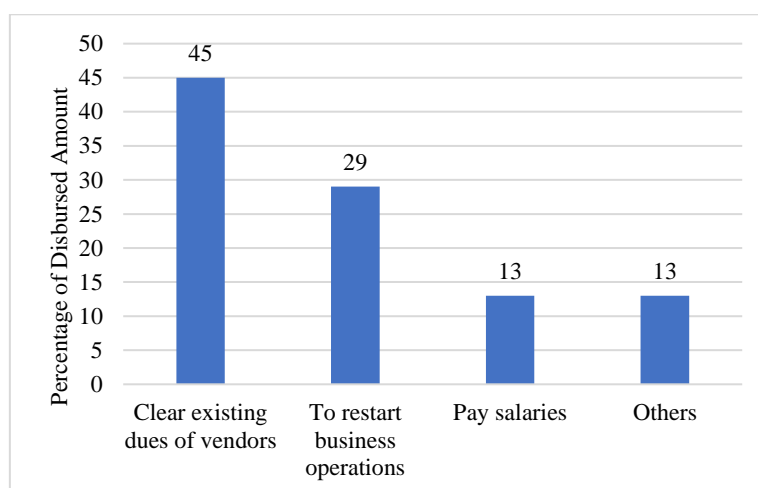


Source: TransUnion CIBIL

3.1 Use of ECLGS Funds

This section sheds light on the use of the ECLGS funds by the borrowers during the COVID-19 phase. Funds accessed by the borrowers in the MSME sector were utilized in clearing dues of the vendors, restarting the business, paying salaries, etc. (Figure 7). Nearly half of the funds accessed through the ECLGS scheme were used for clearing the dues of vendors, and one-third was used to restart the business. Borrowers preferred first to clear the existing dues to smoothen the supply of raw materials and other inputs, next to restart the business, and then pay salaries to the labour employed in the past. As restrictions on community movement turned down the sales revenue, this external emergency fund helped to access liquidity and bring back the business to the normal track. If we look from the *pecking order principle of capital structure*, internal retained earnings are the most preferred source of financing a business as it costs less than debt and equity. The main source of internal retained earnings is revenues generated through sales. Due to the lockdown, the sales revenue slumped, hence, the next best option for a borrower is to finance its operation through loans. Thus, easy access and the ECLGS scheme introduced by the government helped in financing the business of borrowers in the MSME sector and helped them to recover.

Figure 7: Use of ECLGS Funds



Source: TransUnion CIBIL

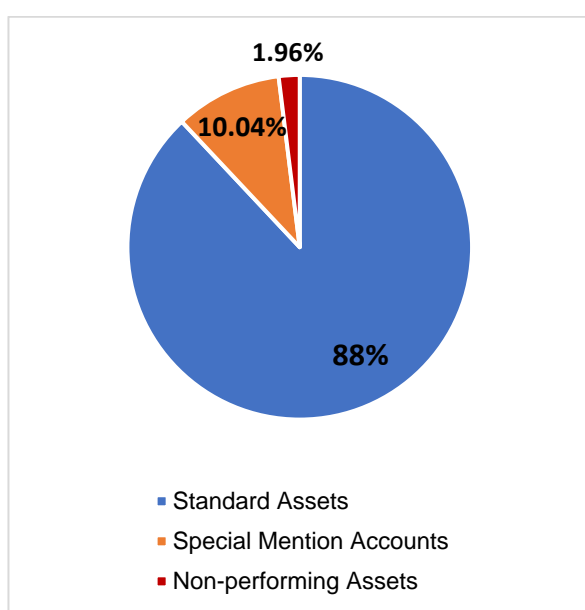
3.2 Performance of ECLGS Loans

Since ECLGS loans are completely insured by the government, there could be a possibility of moral hazard problem from the lender side, *i.e.*, to extend loans to risky borrowers which they would not have done in the absence of 100 per cent credit guarantee. Hence, it is important to have a look at the performance of ECLGS loans in this context. As of March 2021, 88 per cent of the total loans are standard assets, 10.04 per cent are in special mention accounts of the lending agencies, *i.e.*, the repayments are overdue for less than 90 days, and the remaining 1.96 per cent are non-performing assets (NPAs) (Figure 8). Compared to the overall non-ECLGS NPAs ratio, ECLGS have relatively lower delinquencies. However, 10.04 per cent are in special mention accounts. There could be many possible reasons behind it. For instance, the ECLGS scheme was introduced in the first wave of COVID-19 lockdown and evidence shows that micro borrowers access the fund and used it for restarting the business. Later, the infection rate resurged in the second wave and restrictions were again imposed to abate the infection rate. This could have adversely affected the liquidity position of these borrowers,

hence, delay in loan repayment. Thus, gauging the loan repayment behaviour at this stage might not truly reflect the actual behaviour of borrowers. Given the vaccination coverage, the return of normalcy may further improve the asset quality.

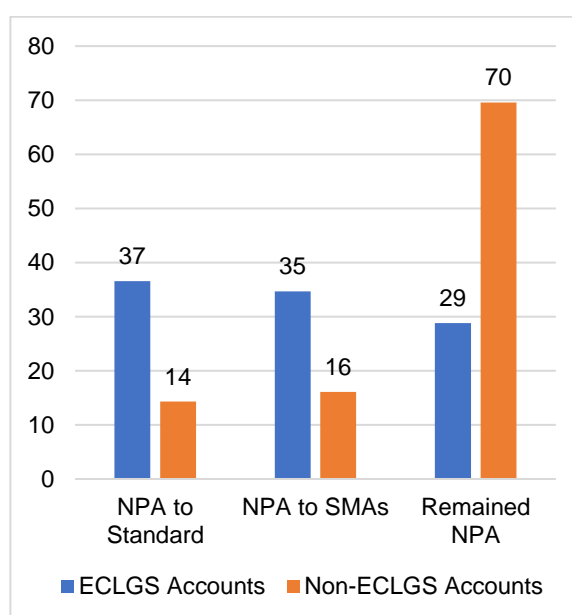
Taking a further deep dive into the borrower behaviour analysis, borrowers with ECLGS accounts show significant upgrading in their asset quality compared to non-ECLGS accounts of the same borrower (Figure 9). Of total non-performing accounts, 37 per cent of accounts move from NPAs to standard assets, while 35 per cent to special mention accounts. So, nearly three-fourths of the account moved out of the NPAs category, but in the case of non-ECLGS accounts, the opposite happened for the same borrower. This implies that borrowers prefer to maintain a healthy credit history to reap the benefits of a credit guarantee scheme, which would help in future to access a higher amount of credit in the situation of a liquidity crunch.

Figure 8: ECLGS Loan Performance



Source: TransUnion CIBIL

Figure 9: Upgradation from NPAs



Source: TransUnion CIBIL

4. Conclusions

Based on the above survey-based evidence, demand for credit picked up in the micro, small, and medium enterprise (MSME) sector following the announcement of the Emergency Credit Line Guarantee Scheme (ECLGS) scheme in May 2020. In the subsequent periods, credit growth significantly increased in the MSME sector. Most of the credits based on the ECLGS scheme were disbursed to borrowers with loan sizes less than 10 lakh. Credit growth to borrowers already having relationships with banks sharply increased following the ECLGS announcement. One-fourths of these loans went to Maharashtra and Tamil Nadu, and loans to the top ten states based on loan share constitute nearly 73 per cent of total ECLGS loans. Of total loans taken under the ECLGS scheme, 45 per cent were used for clearing the dues of the vendors, 29 per cent to restart the business, 13 per cent to pay salaries, and the rest 13 per cent for other expenses. From the perspective of loan performance, 88 per cent of total loans are standard assets, 10.04 per cent are in special mention accounts, and 1.96 per cent are non-performing

assets. In the last quarter of 2020-21, 37 per cent of total non-performing assets were upgraded to standard assets and 35 per cent to special mention accounts. The above evidence exhibits the benefits of the external liquidity support provided by the Government of India and the Reserve Bank of India which saved many MSMEs by making them access external funds with less transaction cost. This may further help in economic value added by the MSME sector and employment generation.

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