



**Policy Brief**

# **COVID-19 and Micro, Small, and Medium-sized Enterprises (MSMEs) in Selected CAREC Countries**

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## Disclaimer

The policy brief is excerpted from the project titled “Impact of COVID-19 on Micro, Small and Medium Sized Enterprises in Selected CAREC countries.” The project was completed by Chris Weafer, Max Yacoub, and Artur Abinov from Macro-Advisory Eurasia Strategic Consulting under the supervision of Dr. Ghulam Samad and Dr. Qaisar Abbas and guided by Dr. Iskandar Abdullaev from the CAREC Institute. The Asian Development Bank (ADB) financially supported this study. Colleagues from ADB have provided valuable comments and suggestions on the policy brief, including Ms. Lyaziza Sabyrova, Principal Regional Economist, Central and West Asia Regional Department, ADB.

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## Introduction

The COVID-19 pandemic caused an unprecedented and massive simultaneous global supply and demand shock, causing severe disruptions, which first and foremost affected more vulnerable smaller businesses. Various surveys have been conducted on the economy-wide effects of the COVID-19 pandemic, however these have rarely focused especially on MSMEs and developed actionable recommendations on mitigating the effects of disruptions on MSMEs in the CAREC region. Given the importance of the MSME sector, the CAREC Institute commissioned a study specifically looking at how smaller firms coped with the pandemic and to see what lessons can be learned for policymakers in the region. Consequently, this policy brief specifically looks at MSMEs, summarizes what effects business disruptions caused by the COVID-19 pandemic had on them, how they coped, what government interventions assisted in their recovery and what, if any, lessons can be learned by policymakers.

A survey of 1,145 firms across Pakistan, Kazakhstan, Uzbekistan, and Georgia was conducted over the period of December 2020 - January 2021, nine months after the imposition of containment measures by governments, giving enough time to properly gauge how MSMEs coped with the business disruptions.

## Main Findings

Across the four countries studied, MSMEs form 84% -99% of all registered businesses, and account for up to 60% of GDP, and three-quarters of employment. Given the large informal sectors in the countries studied, MSMEs probably play an even bigger economic role than official government figures suggest. Pandemic-related economic shocks hit MSME revenues particularly hard throughout the countries of this study. The hardest hit were Georgian MSMEs with almost one-half seeing a drop in sales of more than 50%, whereas only 9% of Pakistani MSMEs reported similar falls. 60% of Georgian MSMEs, just under one-half of Pakistani and Kazakh MSMEs, and one-third of Uzbek MSMEs had to resort to temporarily closure of their businesses.

Employment held up better than revenues. With the exception of Kazakhstan, around three-quarters of MSMEs did not lay off permanent employees. However, 35% of Kazakhstani MSMEs needed to reduce the headcount in November 2020 compared with February 2020. The picture was similar in terms of the employment of temporary staff. Clearly, MSMEs had either recovered employee numbers by November 2020, or they found other ways to cope with the business slowdown. A bigger impact was felt on employment conditions, such as wages and working hours though.

In addition to various lockdown measures, national governments across the region implemented various business support measures, including fiscal relief for firms. MSMEs were asked whether they perceived government support to be adequate or not. Responses ranged from two-thirds of Uzbek MSMEs rating their government's support as adequate (although Uzbek firms had the lowest share of firms receiving government assistance), to 87% of Pakistani firms who had a negative view of government assistance. This could be the result of either inadequate support, poor targeting of government assistance, or firms simply not being made aware of what assistance was available.

In general, the largest group of MSMEs did not receive any form of external support during the pandemic, government or otherwise. Among those firms that did access government support measures such as tax relief, concessionary loans, and other measures to support the cash flow, were the most popular.

Primary effects on MSMEs were through various government-imposed lockdown measures which severely impacted business operations, trade, transport, demand, and employment. Larger, more advanced economies were able to implement massive stimulus measures including furlough schemes and direct business subsidies. Emerging economies, such as those in the CAREC region, had only limited capacity to offer similar relief measures. As smaller enterprises secure the bulk of employment in these countries, and with more limited social and income support generally available to the population, both MSMEs and incomes more generally were more dramatically impacted than in richer countries.

The vast majority of MSMEs across Pakistan, Uzbekistan, Kazakhstan, and Georgia, suffered due to the pandemic, with the primary consequence being a sharp contraction in demand caused by various lockdown measures, the inability of workers to get to their places of employment, and disruptions to the supply chains. More MSMEs are engaged in trade and services which, unlike manufacturing or agriculture, necessitate extensive interaction with the general population. Thus, it is unsurprising that so many firms suffered, with around nine in ten surveyed firms across the four countries reporting that their businesses had (to various degrees) suffered, leading to temporary business closures for 60% of Georgian MSMEs, almost half of Pakistani and Kazakh MSMEs, and a third of Uzbek firms. In general, the smaller the firms the more severely they were impacted.

An interesting result that emerged from the study was that, despite declining revenues and the need to control costs, the vast majority of surveyed firms did not choose to reduce staff, preferring instead to cut working hours and wages. This may be the result of MSMEs generally having leaner staffing structures than larger firms or because they were surveyed at the end of 2020 when they had time to adjust to the various constraints imposed by the pandemic.

In tandem with the imposition of various restrictive measures, all national governments implemented economic stimulus and relief programs to assist firms. The perceptions of the efficacy of these interventions were mixed with the vast majority of surveyed Pakistani MSMEs (87%) stating that government support was inadequate. Conversely, two-thirds of Uzbek MSMEs felt that their government had provided adequate support. Perceptions in Kazakhstan and Georgia were in between with overall 31% of Kazakhstani MSMEs and 48% of Georgian MSMEs feeling that government support was adequate. More medium-sized firms and those engaged in manufacturing (possibly because they were more visible and easier to target) tended to rate government efforts as positive.

The findings show that most MSMEs preferred to rely on their own resources rather than government assistance. Of the minority who did report receiving some sort of outside assistance, government support and that provided by friends and family were the main sources.

Further research is needed to establish why there was such a poor uptake of government support programs. Perhaps not enough government resources were allocated to business relief measures, or they were poorly targeted. It may be the case that small firms were simply not aware of various measures or that they faced bureaucratic obstacles and red tape in attempting to access government support. It is probably a combination of all these factors.

## Recommendations

- 1) Irrespective of the slowdown caused by the Covid-19 pandemic and given the importance of MSMEs to national economies, and in particular to job creation, policymakers need to recognize their contribution and prioritize MSME development. In addition, in formulating economic development plans, policymakers should consider the impact on MSMEs.
- 2) Governments need to closely examine the reasons for the low uptake by MSMEs of government support programs. They need to properly assess the needs of different-sized firms (sole traders and micro enterprises clearly have needs different from more established larger firms), and in particular the needs of different sectors. Policymakers need to assess what worked, what did not, and what could be improved. Better coordination and communication with MSMEs needs to be a priority.
- 3) More attention and resources need to be focused on collecting timely data on MSMEs. This is particularly true for Pakistan where there are no up-to-date statistics on the MSME sector. Without being able to measure MSMEs the government will have difficulties in designing suitable support and development policies and crucially assessing what works.
- 4) Regular quick surveys should be conducted to assess the issues faced by firms and to provide more real-time feedback to governments. This is particularly important in the uncharted territory of recovery from the COVID-19 crisis. To provide cross-country comparisons and to better gauge progress governments should consider utilizing standard enterprise surveys similar to those conducted by the World Bank and the EBRD and consider partnering with monetary financial or other institutions who can quickly assess issues on a regional level.
- 5) Armed with better data, statistics, and feedback mechanisms, government support programs need to be better targeted. Different sectors and firm sizes face different hurdles and therefore governments need to better discriminate in their assistance programs.
- 6) The MSME contribution to Kazakhstan's GDP is low, negatively impacting dynamism and resilience to economic shocks, not to mention providing jobs. While this low share is partially owed to the structure of the Kazakhstani economy, especially the high importance of mining, measures to promote diversification and along with privatization, deregulation, improved access to finance, digitalization, better infrastructure, skills improvement, etc. could help increase the MSME share of the economy.
- 7) Rather than just offering tax relief (which tends to just defer payments but does not address the underlying collapse in demand), MSMEs also want more direct financial assistance – cheap or interest-free loans, loan forbearance, and tax reductions.
- 8) Given that the primary consequence of the pandemic was a fall in demand and loss of income among the general population, governments should consider offering more direct income support. In addition to supporting citizens who have seen incomes plummet, this spending will quickly feed through to firms supporting their sales, and in turn their employees. In general, this is much easier to target and implement and provides less market distortion than funneling money to firms although assistance to firms should also be part of the policy response.

- 9) Governments should not ignore the informal sector. Only working with formal businesses risks ignoring an important part of the economy, and a source of employment (particularly in Pakistan). This also is an argument for more use of population income support measures given the difficulty in targeting unofficial businesses.
- 10) Given the rapid and unprecedented spread of the pandemic, governments have understandably needed to move quickly and in an ad-hoc fashion. However, this has meant that many potential recipients of government aid have been unaware of what assistance is available and how to access it. Governments need to establish clear and comprehensive communications campaigns to ensure that MSMEs are aware of support packages and make it significantly easier to access assistance.
- 11) The survey has shown that firms need to diversify their sales channels. The use of online sales is at a very low level, making it difficult to quickly identify new customers and gaps in the market. There is a clear role for governments to assist with digital transformation by investing in internet and broadband infrastructure, assisting and initially subsidizing internet connections. They should also consider establishing national internet platforms facilitating trade and sales by MSMEs.
- 12) MSMEs and informal businesses typically face great obstacles to accessing finance. In addition to more targeted assistance, policymakers should boost the ability of banks and financial intermediaries to lend to MSMEs by easing collateral and provisioning requirements, providing partial credit guarantees, and creating standard loan application documentation, etc.
- 13) In order to ensure a sustainable recovery, governments need to redouble their efforts to improve the business environment for MSMEs. Despite considerable government efforts, MSMEs in the other countries are still subject to onerous red tape, bureaucracy (and corruption to varying degrees), perhaps with the exception of Georgia. Deregulation and regulatory simplification need to become national economic priorities.
- 14) An obvious benefit of deregulation and improving the environment for MSMEs would be that more firms enter the formal economy, especially if this includes tax simplification.
- 15) Analysis has shown that MSMEs in the four countries barely engage in any import/export activity. While most smaller firms focus on their home markets, this is a missed opportunity. Foreign trade could have played an important COVID-coping mechanism for MSMEs and improved the resilience of firms (exports could help compensate for declining domestic demand), in addition to being important conduits for innovation transfer, and diversification of supply chains.