

COVID-19's Impacts on SMEs and Policy Recommendations in Response

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Economic, regulatory, and taxation policies can play roles in supporting the growth of new and existing small and medium-sized enterprises (SMEs). The coronavirus (COVID-19) pandemic has harmed the global economy at virtually all levels, necessitating government action to mitigate these effects. This paper examines the issues that SMEs face under current economic conditions and describes the policies and strategies that government officials can employ to provide relief to SMEs.

The effects of COVID-19 have cascaded throughout the global economy, impacting both public finance and private enterprise. The Organization for Economic Cooperation and Development (OECD) defines SMEs as “non-subsidiary, independent firms which employ fewer than a given number of employees.” In the United States, enterprises with fewer than 500 employees qualify as SMEs. SMEs are prevalent in the transport manufacturing, construction, air transport, wholesale and retail trade, air transport, accommodation and food services, real estate, professional services (e.g. medicine, law) and other personal services, hospitality, and tourism, which have been negatively affected by the shutdowns, social distancing guidelines, and related measures to contain COVID-19. SMEs could be more vulnerable to these negative effects than larger enterprises.

SMEs have been affected on both the supply side and the demand side of the economy, creating a vicious cycle. On the supply side, illnesses, quarantines, and a lack of childcare have reduced the amount of labor resources available to SMEs. At the pandemic's outset, the supply chain was disrupted, causing shortages of raw materials, parts, and goods needed by SMEs to produce their goods or services. Compared to larger enterprises, SMEs often have access to fewer suppliers. If an SME were to lose access to a supplier, it could be more difficult to locate a new supplier compared to a larger enterprise.

On the demand side, consumer spending greatly decreased, resulting in a sudden and drastic decrease in revenue for SMEs. A decrease in revenue can hinder an SME's ability to meet its obligations and incur debt to maintain liquidity. These economic effects have continued for close to a year, causing further harm to SMEs. As businesses of all sizes continue to experience the effects of low demand, their needs for labor will decrease, causing an increase in unemployment. An increase in unemployment could depress demand (and consumer spending) even more, which then impacts SMEs. Last, SMEs are more likely to experience the negative demand that has been associated with social distancing guidelines and fear of contracting COVID-19.

The pandemic's effects on the global financial markets could make it more difficult for SMEs to secure the credit that they may need in order to restore the liquidity that was lost due, further compounding the harm. Generally, SMEs have fewer cash reserves than larger enterprises. In the US, less than 50% of SMEs have enough cash on hand to cover 15 days of expenses with no revenue being received during that period, with "healthy" SMEs being those having less than two months of reserves to cover expenses. The reduction of revenue due to decreased demand, coupled with tight credit markets, could make many SMEs insolvent quickly. Noting the numerous ways in which SMEs have been negatively impacted by the pandemic, public officials have had to grapple with the question of what can be done on the part of government to mitigate the effects that the pandemic has had on private enterprise.

Though the pandemic has affected businesses of all sizes, policies to provide relief to SMEs could function best if they are tailored to take the characteristics of SMEs into consideration. Government loans to SMEs are a prime example. Government loans to SMEs can provide the liquidity that these enterprises need to stay afloat while the economy is still depressed. Accordingly, governments should issue loans to SMEs that are in sectors most affected by the pandemic and located in geographical areas most impacted by shutdowns. This targeting could change over time as shutdown orders could change from area to area. Governmental authorities should utilize taxation policies to assist SMEs as well.

Governments can provide cash flow support to SMEs by allowing businesses to deduct more losses through higher loss carry-back amounts than various tax codes currently provide. Allowing for increased loss carry-backs could allow SME taxpayers that have operated at a loss in prior years to derive a greater immediate tax benefit through this deduction. In addition, tax policy could be altered to allow the shareholders of pass-through SMEs, such as limited liability companies (LLCs), to take these deductions on their personal income tax returns. Loss carry-forward provisions will not provide such an immediate benefit to an SME unless the entity generates a profit for tax purposes in a subsequent tax year, which requires at least one year of time for the deduction to be taken and the tax return to be filed. These measures, among others, can provide nearly immediate benefits to SMEs that have been harmed as a result of the pandemic. The most effective government policies geared toward assisting SMEs will be those that are tailored according to the characteristics of SMEs and the economic dynamics that these enterprises face.

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National Law Review, Volumess XI, Number 20

Source URL: <https://natlawreview.com/article/covid-19-s-impacts-smes-and-policy-recommendations-response>