WHITESHIELD PARTNERS
STRATEGY & PUBLIC POLICY ADVISORY

POLICY INSIGHTS

# COVID-19 CRISIS RESPONSE:

# LIFE SUPPORT FOR SMES

## SIX ACTIONS TO GET IT RIGHT

APRIL 2020

A business without revenues will not last very long.

How can government leaders avoid the negative scenario for their small and medium sized enterprises?

Whiteshield Partners
Strategy & Public Policy Advisory



The analysis and drafting of the 'COVID-19 Life support for SMEs: Six actions to get it right' was conducted by Whiteshield Partners based on a proprietary methodology integrating information from international organisations and interviews with the Advisory Board members.



The report is available at
http://www.whiteshieldpartners.com/insights/COVID19SMEsresponse

Suggested Citation: Whiteshield Partners, Policy Insights, 'COVID-19 Life support for SMEs: Six actions to get it right', 2020.

This Policy Insights was developed by Anthony O’Sullivan, Partner and Director, Whiteshield Partners.

## COVID-19 LIFE SUPPORT FOR SMES: SIX ACTIONS TO GET IT RIGHT

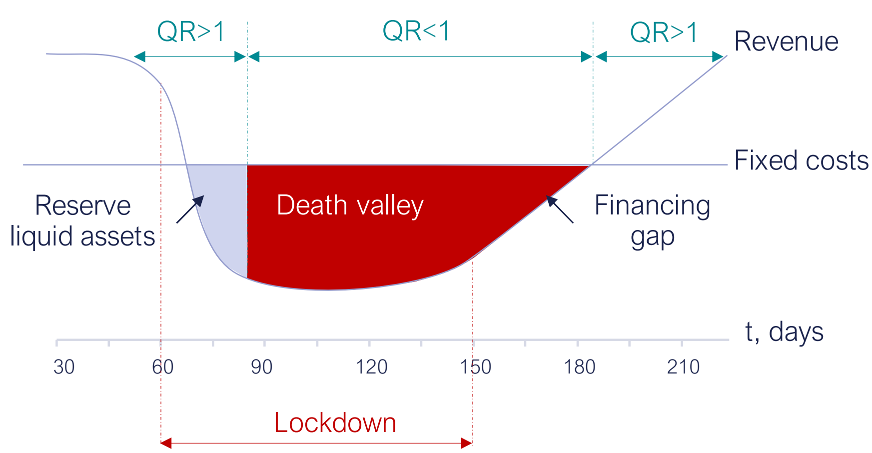
### *SMEs face a 'death valley' of liquidity as a result of the COVID-19 pandemic*

COVID-19 is disrupting all businesses around the world with a particular impact on small and medium-sized enterprises (SMEs) which represent on average 70% of employment and between 50 and 60% of economic value-added in OECD countries[1]. On the supply side, many smaller businesses have temporarily shut down, their supply chains disrupted and their workers disabled by sickness or lockdown constraints. Moreover, overall demand is weaker due to lower incomes, higher unemployment, depreciating short term assets, and reduced consumer mobility. The sectors most directly affected are travel, entertainment, construction, as well as non-essential retail products and services. With revenues at or near zero, SMEs in non-essential sectors have limited resources to cover wages and other short-term liabilities to stay alive until the economy emerges from lockdown.

While the largest firms and multinationals can rely on their war chests and direct support from financial institutions to weather out the crisis, this is much less the case of SMEs which are looking at a "COVID-19 death valley" in liquidity (Figure 1).

*Figure 1: The COVID-19 death valley of liquidity for SMEs*

$$\text{QUICK RATIO: } \frac{\text{cash + marketable securities + accounts receivable}}{\text{current liabilities}}$$




*Note: current liabilities typically include salaries, accounts payable, taxes, short term debt, and accrued expenses.*
*Source: Whiteshield Partners*

The quick ratio – also referred to as the acid test – measures whether a firm has the working capital to cover short term liabilities. When the quick ratio drops below one, a firm is at risk of running into default.

The average small business typically carries 20-30 days of cash reserves before its quick ratio falls below one, and it is no longer able to cover its short-term liabilities without additional revenues or debt.[2]

[1] OECD SME and Entrepreneurship Outlook 2019, OECD 2019.

[2] J.P. Morgan Institute, "Cash is King: Flows, Balances and Buffer Days: Evidence from 600,000 small businesses," September 2016.

### *Policymakers can keep SMEs alive through six actions*

Governments around the world have generally reacted positively in providing financial relief to firms and citizens impacted by COVID-19 under a lockdown and life support scenario.

However, a further analysis of the policies implemented to date highlights a general lack of coherence, coordination and sequencing in policy responses.

We have six recommendations to get right for SMEs:

*1. Stop the bleeding: Ensure fast financial relief*

Many governments have announced impressive measures of financial support but not given enough thought as to how it will be delivered to make the difference. As we highlighted in Figure 1, the difference between life and "Death Valley" for an SME can be just a matter of days. Yet too many measures involve complex application procedures, long processing times, delays in reimbursement or depend on the voluntary compliance of third parties such as commercial banks. Canada has an effective response to loans disbursements: small business loans of up to CAD 100 000 can be obtained online in as little 48 hours from the time of approval. The Netherlands limits reimbursement delays by providing up to 80% of wage cost relief in advance.

*2. Specifically target jobs*

Loans are not enough. Specific incentives must also assist in maintaining employment levels. Most European countries have dedicated funds allocated to compensate for shorter working hours or temporary "technical" unemployment – inspired by the German Kuzarbeit system known to have been effective in saving jobs during the 2008-2009 financial crisis. In this case firms are typically reimbursed 70-100% of salary costs.

*3. Support the most vulnerable enterprise segments*

Macroeconomic measures or policies to support the broader economy will be insufficient in a crisis context. Targeted steps to increase cash availability are necessary to support the smaller firms which face a real threat of bankruptcy with the decline of activity. The increasingly important segment of the self-employed must not be forgotten. For instance, the Netherlands provides the self-employed with non-reimbursable income support for three months through a fast track procedure.

*4. Enable innovation as a crisis response*

A crisis provides an opportunity for firms to innovate, especially in the early on before panic takes over. Singapore, Korea and Ireland have been exemplary in helping their firms "go digital" in the early stages of the Covid-19 crisis through coaching and consulting services. Enabling firm innovation is one the least costly and most sustainable responses to a crisis as successful firms emerge a stronger and more competitive players.

*5. Leave nothing off the table: Use the full arsenal of defensive and offensive measures*

Countries hesitate to deploy their entire arsenal of policy options, including different forms of tax relief, subsidised loans, credit guarantees, direct grants, relief in procurement penalties, monetary policy and innovation support. Supporting small businesses with offensive measures to innovate in times of crisis is particularly important to reduce the taxpayer burden and better prepare for tomorrow. Training and redeployment of workers is another underutilised measure. New Zealand and Portugal have allocated funds for rapid training of workers from the hardest-hit sectors (e.g. tourism) to areas with additional labour needs (e.g. food retail and agribusiness).

*6. Act first and ask questions later: Balance short term trust with fraud containment in the longer run*

The critical need for financial relief in a crisis such as COVID-19 is such that there is no time for complex vetting procedures in the short term. Small companies and the self-employed in sectors directed hurt by the crisis (such as tourism) need rapid relief to escape the death valley. However, these early relief policies must also be limited in scope and time.

Longer-term loans and more substantial schemes must incorporate the right vetting mechanisms to ensure that they reach the enterprise segments that need them the most – and not to firms that may abuse public sector support.

### *Three levels of SME support in response to COVID-19: light stimulus, strong stimulus and life support*

SME support in response to COVID-19 includes an array of defensive and offensive measures which vary in the level of intensity based on the crisis faced (see Table 1).

*Table 1: Defensive and Offensive measures to support SMEs according to different policy stages*

| Policy area | Policy description | Examples |
|---|---|---|
| Policy stage: Light stimulus (D3) | | |
| Offensive | | |
| Innovation | Coach firms to innovate in times of crisis | **Singapore**: Enhanced funding to Enterprise Singapore to help companies go digital SME<br>**Ireland**: Enterprise Ireland expanded consultancy services for finance reviews and approaches to innovate, diversify markets and supply chains SME<br>**Korea**: Coaching and technical assistance provided to businesses moving online SME |
| Defensive | | |
| Finance | Subsidised Loans | **Austria**: 100 million euros of subsidised loans for hotels with more than 15% loss in revenues Sectoral<br>**Colombia**: subsidised credit line for the tourism and aviation sector |
| Tax | Deferred tax payment | **Colombia**: postponed the payment of the VAT and income taxes for the tourism and aviation sectors Sectoral |
| Policy stage: Strong stimulus (D2) | | |
| Offensive | | |
| Training | Redeployment training | **New Zealand** and **Portugal** allocated funds for rapid training of workers in the hardest-hit sectors (e.g. tourism) to areas with additional labour needs (e.g. food retail and agribusiness) General |
| Defensive | | |
| Labour | Subsidised temporarily reduced working hours | **Germany**: Kuzarbeit system in which firms access funds from the government to compensate reduced earnings from shorter working hours General<br>**Netherlands**: Workers compensated by the government for temporary work time reduction General<br>**Denmark**: a temporary reduction in working hours compensated with unemployment benefits General |
| | Temporary layoffs partial reimbursement | **France**: Temporary layoffs 70% reimbursed by the government (initial scheme) General |
| Finance | Grants - wage costs | **Netherlands:** Temporary compensation of wage costs up to 90% for companies with value-added reduction of more than 20%. Possible 80% in advance General |
| | Grants | **Australia**: A cash-flow boost for employers by up to AUD 25 000, totalling AUD 6.7 billion (conditional on turnover < AUD 50 million and employing staff) SME |
| | Credit guarantees | Expansion of credit guarantee schemes in several countries including **Netherlands, France, Sweden, Spain, Germany** SME |
| | Subsidised loans | **Canada**: Small Business Loan of up to CAD 100 000 can be obtained online in as little 48 hours from time of approval SME<br>**USA**: Disaster Loan Assistance programme of the Small Business Administration (SBA) with loans up to USD 2 million at low-interest rate SME<br>**Denmark**: Government guarantees 70% of the value of any new bank loans given to SMEs who have seen operating profits fall by more than 50% SME |

| Policy area | Policy description | Examples |
|---|---|---|
| | Working capital support | **USA:** Commercial Paper Funding Facility opened to underwrite short-term loans that companies can use to pay for operations SME<br>**Canada**: Working capital loan to bridge cash flow gaps and support everyday operations SME |
| | Working capital support | **Netherlands**: low-interest loans for working capital support Self-employed |
| Tax | Deferred tax payment | **Sweden:** different payment of payroll taxes, VAT and corporate taxes SME<br>**Australia**: deferred tax payment made possible until July 2020 SME<br>**Denmark:** DKK 125 million credit facility allowing firms to defer VAT and tax payments SME<br>**China**: deferred tax payment SME |
| | Asset write off | **Australia**: asset write off threshold temporarily increased from AUD 30 thousand to AUD 150 thousand SME |
| | Payroll taxes | **USA**: reduction in payroll taxes SME |
| | Temporary reduction or cancellation of social contributions | **Belgium**: Reduction or cancellation of social contributions for self-employed conditional on proving a decrease in revenue due to the outbreak Self-employed |
| Monetary | Bank buffer release | **Netherlands:** Dutch Central Bank announced it will relax requirements of capital buffers for commercial banks, to support EUR 200 billion in extra credits General<br>**Denmark**: the release of the so-called 'countercyclical capital buffer' banks have kept on their books since the 2007 financial crisis. This will provide them with an extra 200 billion DKK in liquidity, which they can either use to lend to businesses or to withstand losses on existing loans General |
| | Lower central bank lending rate | **USA:** Federal Reserve reduced interest rates down to 0.25% (down 1.5 percentage points) in two waves General<br>**Canada**: central bank rate lowered from 1.75% to 0.75% in two waves General |
| Trade | Reduced fees to improve trade flows | **China**: Reduced port and logistics fees General |
| Procurement | No late penalties | **Belgium**: Suspension of penalties for suppliers failing to fulfil government contracts General |
| Policy stage: Lockdown and life support (D1) | | |
| Defensive | | |
| Labour | Temporary layoffs full reimbursement | **France**: Temporary layoffs 100% reimbursed by the government (initial scheme) General |
| Finance | Grant | **USA:** As part of a massive USD 2 trillion package, USD 367 million allocated for no-interest loans of up to 10 million to pay for salaries and other expenses. Loans forgiven if staff kept in employment SME |
| | | **Netherlands**: provide non-reimbursable income support for 3 months through fast track procedure Self-employed |
| Monetary | Further lower central bank lending rate | **USA:** Federal Reserve reduced interest rates down to 0.25% (down 1.5 percentage points) in two waves General<br>**Canada**: central bank rate lowered from 1.75% to 0.75% in two waves General |

*Source: Whiteshield Partners; OECD*

Under a light stimulus scenario (D3), the emphasis should be on sector-specific measures (e.g. tax deferral, subsidised loans) to support SMEs in sectors directly affected by the pandemic. Broader offensive measures are also required, to help smaller firms adapt and innovate in the event of a more severe lockdown.

Extended measures under a strong stimulus scenario (D2) include a broad array of policies. These policies include low-interest loans, expanded credit guarantee schemes, more flexible labour arrangements (including subsidised part-time work and temporary layoffs), expanded tax deferrals (covering trade duties, VAT, payroll taxes), deferrals in procurement penalties and lower interest rates from the Central Bank.

Finally, the most extreme lockdown and life support policy scenario (D1) can further include direct government grants to the most vulnerable SMEs and self-employed, 100% reimbursement of temporary layoffs or part-time work as well as further measures to lower the Central Bank lending rate. It is in this most extreme scenario that the six above recommendations are most relevant and applicable.

These three scenarios for SME support in response to COVID-19 are part of a broader set of scenarios that were modelled by Whiteshield Partners under a staged response to a pandemic. The scenarios, which are consistent with the DEFCON (defence readiness condition) alert levels used by the US Armed Forces and with the WHO phases of pandemic alert, can be adapted to different economies and types of pandemic.

Mitigating the potential negative social and economic consequences of COVID-19, which are significant, requires carefully crafted and well-sequenced policies targeted at SMEs. It is important to tap into the full policy arsenal, including offensive means of worker redeployment and support in business model innovation. Finally, the most effective policy responses will provide immediate relief while at the same time, building the longer-term resilience of SMEs, which are the backbone of our economies.