

Impacts of the COVID-19 Pandemic on Chinese SMEs and Countermeasures

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ABSTRACT

Small and medium-sized enterprises (SMEs) in China have contributed a lot to China's economic growth. Yet they are more vulnerable to the Covid-19 pandemic. This paper analyses the impacts of Covid-19 on SMEs and offers countermeasures. Based on the author's observations of 182 SMEs in the surrounding community, 49 SMEs were shut down and more than 10 were unprofitable during the year 2020 and 2021. The author also studied the prosperity index such as Purchasing Managers' Index (PMI) and found that small businesses suffered a lot more than large ones from the pandemic. From an indirect perspective, the author found that SMEs confronted higher operation costs and severer financing stresses during the pandemic. The author suggests that the governments, the SMEs, and the society should all take some measures to resolve the issues.

Keywords: Covid-19, Pandemic, SMEs, China.

1. INTRODUCTION

Over the past two years, the author's great interests in the survival and development of Chinese SMEs have been aroused through the continuous observation and research of convenience stores, hairdressers, restaurants, laundries, fitness centers, educational institutions, and other small and medium-sized enterprises (mainly in the service sector) around the communities. These enterprises are either growing or weakening or even dying out in the common influence of their internal factors and the external environment. Despite their small size, SMEs contribute significantly to China's social economy due to their large numbers (over 90% of all enterprises). SMEs collectively contribute 80% of China's employment, 70% of technological innovation, 60% of GDP, and 50% of tax revenue [1]. However, observations show that the survival status of SMEs does not match their contribution. By reason of the small size, weak ability to take risks, single products, simple services and tight cash flow, the survival and development of SMEs are more vulnerable to the external environment, especially the alternating brunt of the COVID-19 in China and abroad, which can have a huge and far-reaching impact on Chinese SMEs [2]. Therefore, this paper mainly analyses the current situation of SMEs during the COVID-19 pandemic, and explores effective ways to support the development of SMEs so that they

can promote China's social economy. The above work can contribute to a deeper understanding of SMEs, helping the enterprises to get through the hard times and grow sustainably, enabling workers in the field to earn a better living, and ultimately benefiting the social stability and economic improvement.

2. CURRENT STATUS OF CHINESE SMES UNDER COVID-19

2.1 Investigation and observation of SMEs in the surrounding communities

Since the COVID-19 pandemic, the author has been constantly observing and researching various types of SMEs in the surrounding communities, including catering, fast hotels, beauty salons, foot massage parlors, education and training institutions, supermarkets, gyms, healthcare institutions, logistics companies, and community convenience service shops, etc. And the enterprises in the accommodation and catering industry and service sector are mainly focused. The survival of these enterprises constitutes a microcosm of the current situation of SMEs in China.

In the past two years, the number of normally operating SMEs around the community has shown a year-on-year downward trend, from 182 in early 2020 to 166 in early 2022. The overall decline does not appear to

be significant, but the number of SMEs that have actually gone bankrupt and closed down in the community in these two years is far greater than the overall decline, considering that new businesses are set up in the original locations soon after the previous enterprises cease operations and close down. According to a rough count, the number of enterprises shut down in the community is 17 in 2020 and 32 in 2021. There are also more than 10 enterprises whose revenues can not cover their overall costs facing a constant state of loss, with their survival under severe pressure. Many reasons can lead to a poorly run business, for example, some beauty salons and training institutions have unfortunately been eliminated due to the fierce competition, some education centers burned money to cultivate the market and eventually have their capital chains broken, and some stationery shops, photo studios, and other community convenience service providers lived with high costs but marginally profitable products that ultimately cannot make ends meet.

The communication with the business owners proves that the production and operation of these enterprises (also including those still operating normally) have almost invariably been greatly affected by the COVID-

19 pandemic. These impacts are manifested in the following aspects: firstly, the fluctuation and discontinuous decline in consumption caused by the pandemic have greatly reduced market demand for SMEs' products and services; secondly, in order to comply with the pandemic prevention and control policy, the activities of some SMEs have been affected to a certain extent, and even normal operation cannot be guaranteed; thirdly, the operating costs of some enterprises have increased significantly, including the prices of raw materials, logistics costs, and housing rents, etc.

Overall, the pandemic factor has become the most widespread factor affecting the development of SMEs, leading directly or indirectly to the plight of many SMEs, or even their bankruptcy and closure.

2.2 Research and analysis of relevant indices

To get a more comprehensive and accurate picture of the performance of China's SMEs and their relationship with the COVID-19 pandemic, the boom indicators of China's large, medium and small enterprises and the changes in China's SME Development Index (SMEDI) over the past decade are focused on [3].

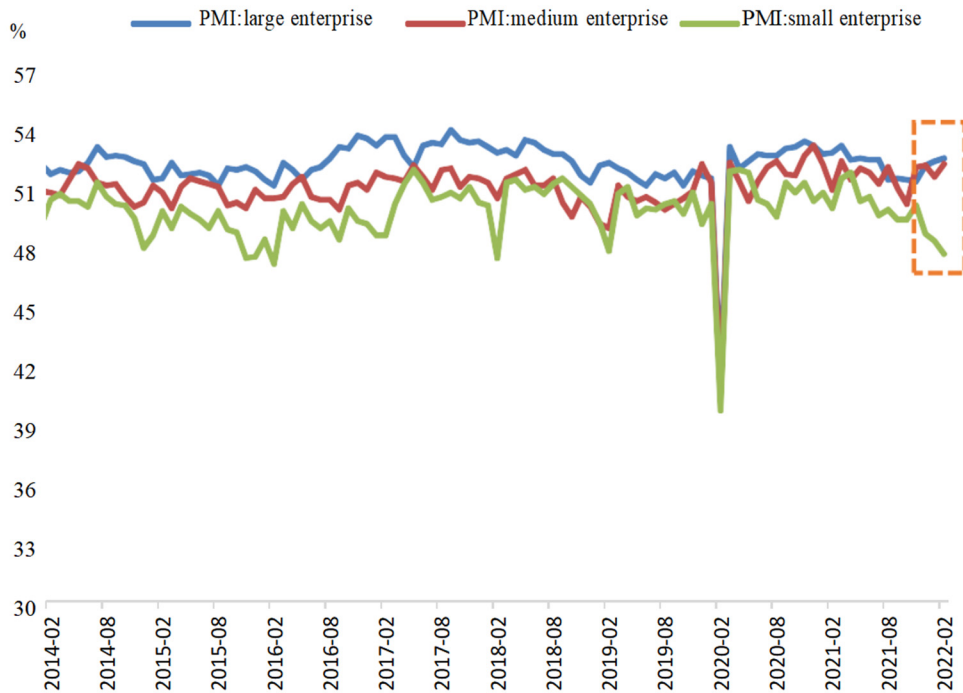


Figure 1 Comparison of prosperity indicators for small, medium and large enterprises (Data Source: Wind).

The purchasing managers' indices (PMI, reflecting business prosperity, Figure 1) of small, medium and large enterprises [4] show that, at the beginning of the outbreak in 2020, the operations of small, medium and large enterprises were severely affected by the pandemic, but they were quickly returned to normal levels in April 2020 after the pandemic was effectively controlled. Since then, the prosperity indicators of small enterprises have been

consistently lower than those of medium and large enterprises. In particular, from the beginning of 2022, the PMI for small enterprises fell further as the number of pandemics circulating in China increased. The PMI for small enterprises dropped to 45.1% in February, the second lowest since 2018 (just above February 2020 during the pandemic outbreak), with the level of prosperity falling back to a low zone. In contrast, the PMI

for medium and large enterprises was trending back up over the same period, and all were above 50%. As it can be seen, the pandemic hit smaller enterprises harder than medium and large ones.



Figure 2 China's SME Development Index (SMEDI):2013-2022 (Data Source: Wind) [3].

Figure 2 describes the changes in China's SME Development Index (SMEDI, a comprehensive index reflecting the economic performance of SMEs) from 2013 to 2022. 2017-2019 saw a generally stable SMEDI in China, with annual averages of 92.9, 93.1, and 92.7, respectively. The overall development of SMEs in China was good during these three years, and although there were external factors such as the trade dispute between China and the US and the global economic top-down,

they did not have a considerable impact on the healthy and stable development of Chinese SMEs. However, with the outbreak of the COVID-19 pandemic in January 2020, the survival and development of SMEs were dealt a huge blow. As seen in Figure 2, the average SMEDI value dropped sharply to 85.6 in 2020, falling below 90 for the first time in history, especially during the period from February to April 2020 when the average SMEDI value was only 80.5, the lowest value ever recorded. After the pandemic was effectively controlled in China, people's production and livelihoods gradually returned to normal, investment and consumption behaviour also resumed, and with the introduction and implementation of government policies to support fiscal, financial, and production resumption, the survival rate of SMEs also began to be improved. After May 2020, the SMEDI tended to pick up, rising to an average of 86.9 in 2021, but there was still a significant gap between this figure and that before the pandemic.

In terms of sectoral impact (Figure 3), the pandemic had a significant impact on SMEs in most industries. Among them, the manufacturing sector was the least affected, as the government introduced a number of policies to boost the manufacturing sector, and the development index of such SMEs even exceeded the pre-pandemic level; the accommodation and catering sector was the most affected, followed by the service sector, mainly due to the pandemic prevention and control as well as reduced consumer demand. This is also largely consistent with the fact observed in the community.

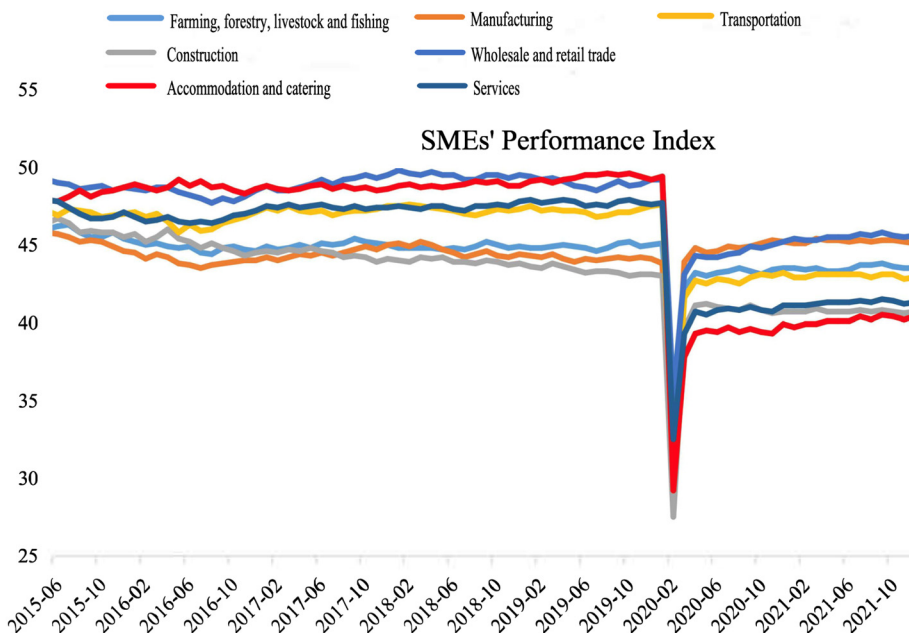


Figure 3 Analysis of the impact of the pandemic on SMEs indifferent industry (Data Source: Wind).

In summary, the influence of the COVID-19 pandemic on the survival and development of Chinese

SMEs is ongoing and profound, and it will take some time for companies to fully recover from this impact.

3. IMPACTS OF THE COVID-19 PANDEMIC ON SMES

3.1 Direct impact of the pandemic on SMEs

The pandemic directly impacted the orders and income of SMEs [5]. For one thing, due to the pandemic prevention and control measures, some manufacturing and service industries had prominent problems with work stoppages and restrictions. This has especially affected consumption in the catering, tourism, recreation, and domestic industries. For another, the decline in residents' income caused by the pandemic led to a decrease in their willingness and ability to consume, and a corresponding reduction in orders and income for SMEs. In the small enterprise operating data published by the China Federation of Logistics and Purchasing (CFLP) (Figure 4), the small business orders on hand sub-index continued to fall to 37.6% (February 2022), the lowest level since 2015, and is still on a downward trend.

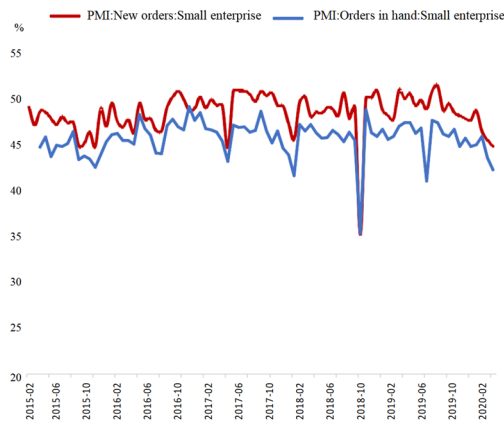


Figure 4 Smaller firms' orders fall back from pre-pandemic levels (Data Source: CFLP).

3.2 Indirect impact of the pandemic on SMEs

3.2.1 Business difficulties caused by the surge in raw material prices

Following the outbreak of the COVID-19 pandemic in early 2020, on the one side, in order to hedge against the impact of the pandemic, countries around the world released huge amounts of liquidity, pushing up commodity prices; on the other side, due to the impact of work stoppages and restrictions brought about by the pandemic, the supply and demand fundamentals of some commodities changed significantly and the gap between supply and demand widened, leading to notable price increases [6]. As a result, some international commodity prices have risen rapidly since the second half of 2020. In particular, from April 2021 to February 2022, the daily average value of the CRB (Commodity Research Bureau) Index rose by more than 40% year-on-year. As SMEs are mostly in the downstream of production, with a high proportion of raw material costs and weak profitability,

the rapid rise in raw material prices has led some enterprises to fall into the predicament of "not being able to start work or start work at a loss".

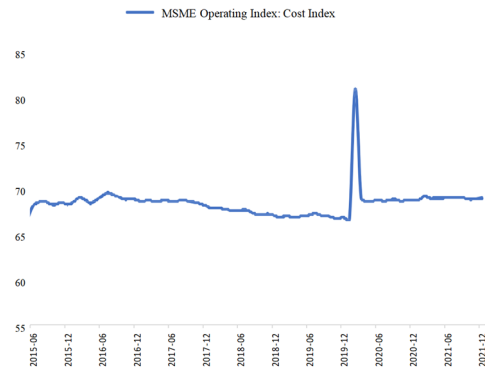


Figure 5 MSMEs' operating costs are higher than before the outbreak (Data Source: Wind).

3.2.2 An increasing pressure on the capital chain of SMEs

Due to the weakness of SMEs in the early stages of development, the high risk of uncertainty, and low credit levels, the problem of financing for SMEs has always existed as a worldwide problem [7], and SMEs in China are no exception. In response to the pandemic, China's monetary policy eased considerably in the first half of 2020, with cumulative new loans of \$12.1 trillion in the first half of the year, up 25.0% year-on-year. However, instead of easing, the pressure on SME financing has become more pronounced due to the heightened risk aversion caused by the contagion and the further increase in uncertainty risks for SMEs, with the loan demand index for small enterprises consistently higher than the level in the pre-pandemic norm (Figure 6). In addition, since 2021, high raw material prices and upstream suppliers' demands for cash transactions have increased the liquidity pressure on downstream SMEs, while SMEs have also found it more difficult to make repayments. The combination of the above factors has caused heavy pressure on SMEs' capital chains, and many SMEs have gone bankrupt due to their capital chains [8].

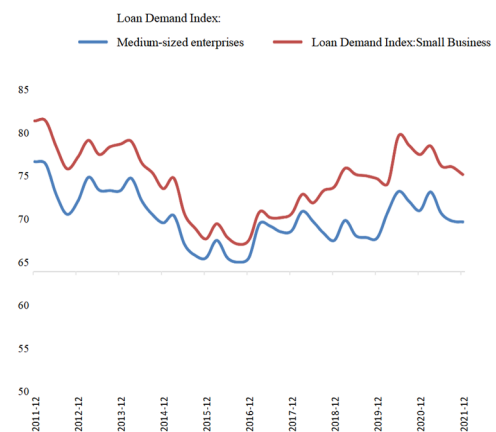


Figure 6 Demand for small business loans is higher than in the norm (Data Source: Wind).

4. SUGGESTIONS TO SUPPORT THE DEVELOPMENT OF SMES

At present, there are more than 150 million market entities in China, the vast majority of which are SMEs. As a major channel to stabilize employment, an important link to ensure the stability of the industrial chain, and an essential force to stimulate innovation, Chinese economy, to a certain extent, will only be prosperous if SMEs are well developed. In the future, there is still a need to continue to hedge against the negative impact of the pandemic on SMEs from both the government and enterprises, and to further consolidate the recovery of SMEs.

4.1 At the government level

Firstly, there is a need to smooth the cycle of the domestic industry chain, boost consumer confidence, and stabilize the indigenous market. For one thing, increasing investment in livelihood areas can alleviate consumers' worries, improve the nation's consumption capacity and create more market space for SMEs. For another, full play should be given to the pulling power of government procurement policies, and more assistance should be focused on SMEs in key industries affected by the pandemic, such as accommodation, catering, and transportation, so as to minimize the influence of the pandemic on SMEs in these areas through precise and scientific pandemic prevention, and to ensure that more SMEs can survive the winter of the pandemic.

Secondly, it is essential to release policy dividends, improve policy effectiveness, and strengthen the synergy between industrial and financial policies. Initially, financial resources should play a leading role in reducing the operating costs of SMEs by lowering the burden of taxes and fees such as social insurance premiums, promoting subsidies for operating costs such as water, electricity and gas, lowering the rates of financing guarantees, and increasing financial support for the development of inclusive finance. At the same time, the power of monetary finance in supporting needs to be fully exploited, the capital market can promote the innovative development of SMEs by guiding all kinds of financial institutions to continue to increase the investment of loans and equity investment in SMEs, especially the expansion of financial support for SMEs in key areas and difficult industries, and the promotion of the financial system to reduce fees and concessions. In addition, it is vital to strengthen the supply and price stability of bulk raw materials, guarantee the necessary profit space for downstream SMEs, and improve their ability to resist risks.

4.2 At the SMEs level

First, it is important to strengthen technological innovation, improve service quality and efficiency, and

enhance the core competitiveness of enterprises. SMEs are always in a highly market-oriented and competitive environment, facing the devastating burden of the pandemic. Only those with competitive advantages have a chance to survive, which is the "law of nature" that SMEs must face.

Second, there is a need to adapt to the online economy and accelerate the promotion of digital empowerment. While technology has empowered social and economic development, it has also changed the path of business development to a certain extent. Especially under the impact of the pandemic, SMEs must accelerate their digital and technological transformation, find ways to integrate their production and operations with the latest technological developments and the most effective business models, and figure out the business model that can best resist and adapt to the impact of the pandemic. In addition, SMEs should also dig deeper into the value of their own data resources to guide financial institutions to reduce their reliance on collateral (pledges) and improve the accessibility of credit financing for SMEs.

Third, SMEs should stabilize the supply chain, hedge against the risk of price fluctuations of bulk raw materials, and ensure production and operation. With the support of national policies, manufacturing SMEs can consider establishing long-term cooperation models with upstream and downstream enterprises in the industrial chain to stabilize supply and demand relationships and jointly share the pressure of rising costs.

4.3 At the Social level

Firstly, greater attention should be paid to the development of SMEs in China. Despite the enormous contribution of SMEs to social and economic development, the survival and development of SMEs in the context of the pandemic has not received widespread social attention, and research literature on this issue is very limited. There is a need for Chinese society to increase awareness of the importance and contribution of SMEs, direct more people and organizations to pay sustained attention to SME development issues, and create a more favorable business environment for SME development.

Secondly, society should respect SMEs' own characteristics and support their development according to respective conditions. SMEs are in the early stages of the enterprise life cycle and have their own unique operation rules. They differ greatly from large and mature enterprises in terms of management modes, policy needs, financing channels, and development paths. Policies to support SMEs cannot be copied from those for large and medium-sized enterprises, but must be based on a deeper understanding of the characteristics of SME development. Only in this case, measures that are truly appropriate for

the development of SMEs can be introduced to help Chinese SMEs to grow more effectively and steadily.

5. CONCLUSION

This paper studied the impacts of the Covid-19 pandemic on Chinese SMEs. The author observed 182 SMEs in the surrounding community and found that 49 were shut down and more than 10 were in financial distress during the pandemic. According to the PMI and SMEDI indices, small companies suffered more than large and medium ones, especially those in accommodation, hotel, and other services industries.

Orders and income to SMEs suffered direct impacts due to limited manufacturing capabilities and reduced consumption. And from an indirect perspective, soaring prices of raw materials and energy, and much more difficulties to get financing made more SMEs harder to survive.

To resolve these issues, the author proposed several suggestions. The governments should do more to facilitate investments, improve market confidence, and coordinate fiscal and monetary policies. The SMEs should focus more on technology innovation and try to improve market competence. They can also undertake transformation to the digital economy and do some online operations. For those SMEs in the manufacturing industries, they can try to cooperate with other SMEs in their supply chains in order to share the costs pressure. And for broader society, people need to care more about SMEs and do more research on them so as to help them face the impacts of the Covid-19 pandemic.

Although this paper did some work on the negative impacts of the pandemic on SMEs, there are still lots of work needing to be done in further studies. For example, congressional analysis can be done to study different impacts of different factors like supplies and demands, costs and prices, etc.

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