

COVID-19 and Ugandan SMEs: Impacts and Speed of Recovery

Authors: Livia Alfonsi, Oriana Bandiera, Vittorio Bassi, Robin Burgess, Imran Rasul, Ottavia Veroux and Anna Vitali

We document the impact of the COVID-19 shock and related economic restrictions on small and medium enterprises in Uganda using information on 3,961 firms interviewed twice since the onset of the pandemic in the country (i.e., March 2020). The surveys collected information on firms' survival and performance right before, during, and after the first nationwide total lockdown (i.e., April-May 2020) and in the following year until May 2021, allowing for an analysis on both short-term and longer-term impacts. The data shows that whereas most of the firms had re-opened by July-August 2020 (right after the lockdown was lifted), they mostly did so at a reduced capacity and the recovery has been slow: one year after the start of the pandemic, revenues and profits are still 19% and 36% lower than in the pre-lockdown period. Part of the negative effects of the COVID-19 induced restrictions was transmitted to workers, translating to lower employment rate and lower average wages (respectively 66% and 76% of their pre-lockdown level as of May 2021).

Background

In response to the global spread of COVID-19, at the end of March 2020, the Government of Uganda announced a school closure, a national-wide lockdown on all non-essential businesses, the ban of all movements intra and infra districts, and a stringent night curfew. The measures, initially planned for two weeks, were then extended several times: while the total lockdown was lifted at the end of May, schools remained closed and the curfew in place throughout 2020 and 2021. A one month second total lockdown - less strict than the previous and out of the scope of this report - was instituted in July 2021 in response to a second wave of COVID-19 infections.

Developing economies suffer from a lack of market dynamism and competitive firm selection. As a result, low-growth potential businesses can survive absent significant negative shocks. The COVID-19 shock is an important shock to examine in this context. On the one hand, the COVID-19 related economic crisis may winnow out underperforming firms and allow more productive firms to expand their businesses, thus leading to overall efficiency gains. On the other hand, given the unique nature of the shock, the pandemic may enhance the exit (or hamper the growth) of more productive businesses, with persistent negative impacts on future firm and market dynamics.

This study combined existing panel data on 3,961 Ugandan firms with two new phone surveys, with the objective of answering the following research questions: (i) How did the COVID-19 shock affect firm survival

and performance? (ii) What pre-crisis firm-level characteristics predict firm survival in an expansionary cycle vs. during the COVID-19 crisis? (iii) How did COVID-19 affect the competitive structure of markets? In this note, we present evidence to answer our first research questions.

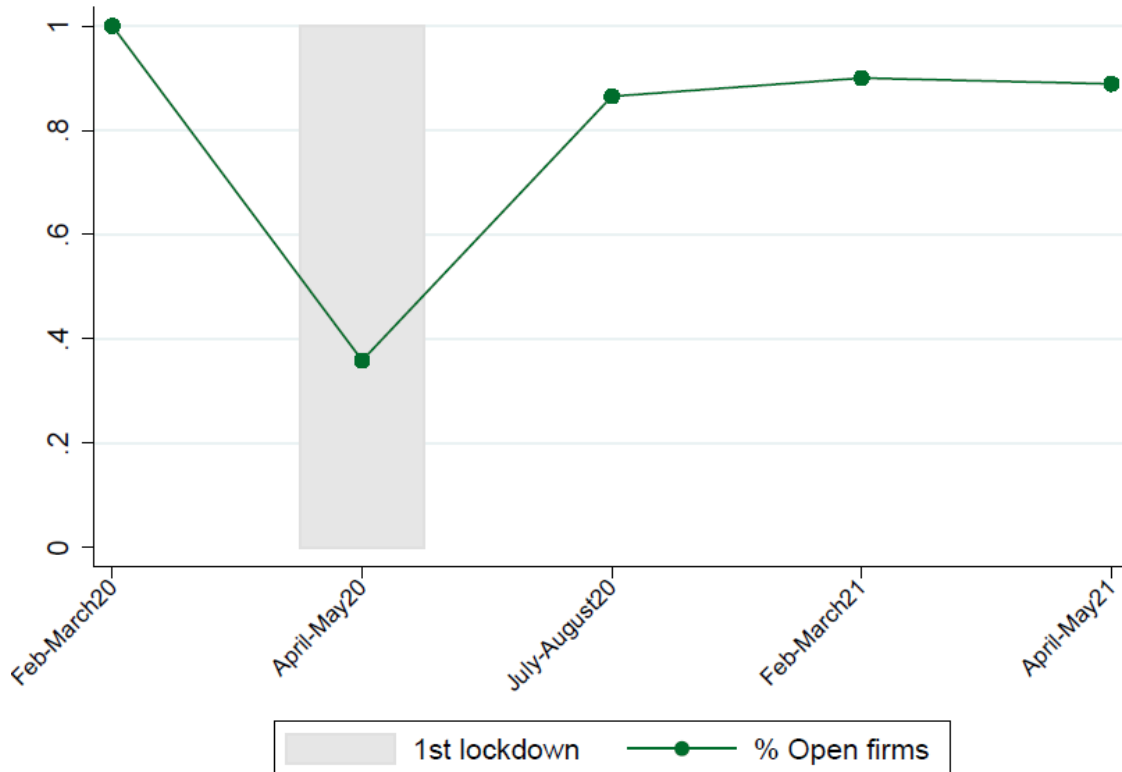
Data and Methodology

The sample includes 3,961 firms located in all regions of Uganda and operating in one of the following sectors: hairdressing, tailoring, welding, motor-mechanics, catering, electrical wiring, construction, plumbing. Firms were initially recruited as part of an earlier study (Alfonsi et al. 2020) and tracked yearly between 2013 and 2017. Eventually, the firms were interviewed two more times in November 2020 and May 2021; the latter two surveys took place over the phone for the restrictions dictated by the COVID-19 crisis. We interviewed firm owners with the aim of collecting information on firm characteristics, operations, and performance in the months prior to the survey. This allowed us to measure firm outcomes: (i) immediately before the crisis; (ii) following the onset of the crisis up until the time of the survey. Specifically, during the first survey round we asked owners to recall outcomes over a six-month period around the first total lockdown in Uganda, namely February-March (immediately before the total lockdown), April-May (during the total lockdown), and July-August 2020 (immediately after the total lockdown). In the second survey round, we collected similar data for the periods November-December 2020, February-March, and April-May 2021, as the Ugandan economy recovered from the lockdown. Furthermore, the questionnaires contained sections about expectations, use of savings and credit, and use (and demand for) public policies.

Results

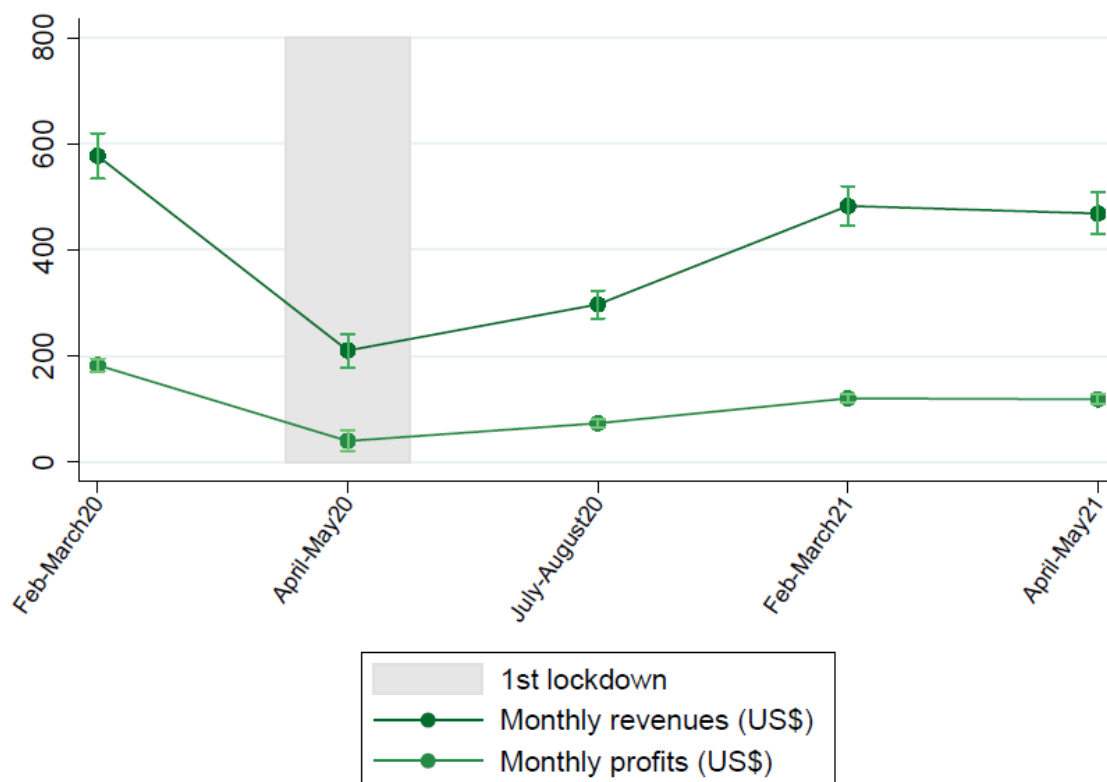
Although only 36% of the firms in the sample stayed open during the first lockdown, immediately after the restrictions were lifted the share of open firms raised to 87%. As the economy recovered, the share of operating firms remained fairly constant: one year after the lockdown, 89% of firms were still open (Figure 1). Nevertheless, the majority of these firms declared to be operating at reduced capacity because of reduced hours of operation (60%), workforce (39%), or machines usage (20%). This suggests that, although the pandemic had a modest effect on firms' closures, it significantly reduced their operations such that after one year most businesses have not yet fully recovered.

Figure 1: Firm Closures



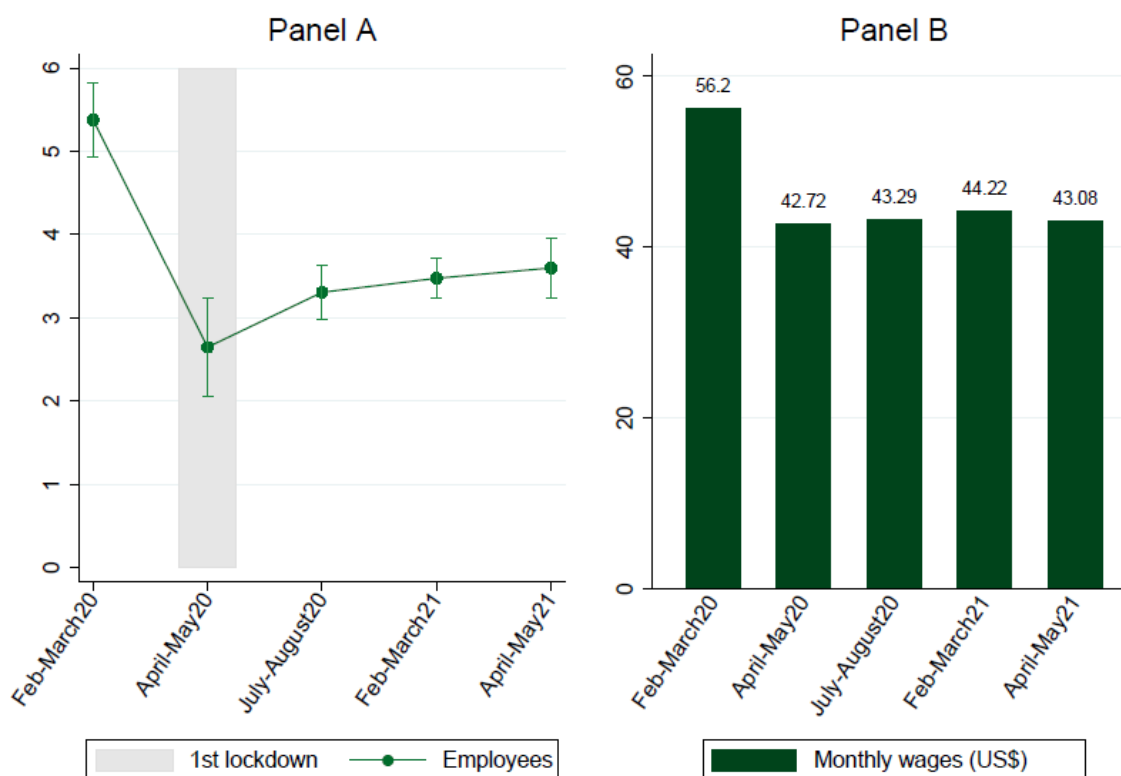
This finding is confirmed by the trend in revenues and profits. Figure 2 shows firms' monthly revenues and profits between February 2020 and May 2021. Even for firms that managed to stay open, both revenues and profits suffered a significant drop during the first lockdown. With respect to the pre-lockdown levels, revenues decreased by 48.5% and profits by 60% in the months immediately after the lockdown was lifted (July-August 2020). One year after the onset of the crisis, revenues were still 19% lower and profits 36% lower than their pre-lockdown levels. Thus, although most businesses reopened, firm owners suffered sizeable income losses. This shows that the lockdown had persistent effects on firm performance and the recovery has been slow.

Figure 2: Average monthly revenues and profits



The general trend in the number of employees follows the one described above for revenues and profits, with a substantial drop during the first lockdown and a partial recovery in the following year. Panel A of Figure 3 shows the average number of employees across the different periods: in July-August 2020, operating firms had on average 61% of the employees relative to the pre-lockdown period. Employment hardly recovered as the crisis evolved: in April-May 2021, firms only employed around 66% of their pre-lockdown workforce. This is despite a drop in wages by 24% (Panel B), suggesting that firms had to resort to workers' layoffs in order to deal with the sizeable decrease in revenues. The effects of COVID-19 on firms were therefore passed on to workers as well, translating into lower employment and wages. Interestingly, we also find that firms tried to decrease labour costs by hiring less skilled and cheaper workers: new employees hired between January and May 2021 were mostly unskilled (40% had no experience nor a VTI degree), while 79% of workers who were fired since the beginning of the crisis had substantial experience within the firm.

Figure 3: Average number of employees (Panel A) and average monthly wages (Panel B)



To better understand the drivers behind these trends in performance, we asked firm owners to identify the main challenges they faced in the 6 months preceding each survey round. We report their answers in Figure 4: at both points in time owners mostly report problems with low demand – either because of customers’ lack of income or difficulties in mobility – and subsequent lack of liquidity to pay rent and inputs.

Firms’ demand for policy reflects their need for liquidity. When asked which is the most needed policy for their business, more than half of the owners replies interest rate subsidies, tax cuts and unconditional cash transfers (Figure 5).

Figure 4: Low demand has consistently been the main challenge related to the pandemic

Between <period>, what is the main challenge that the business faced due to the consequences of the COVID-19 outbreak and related restrictions?

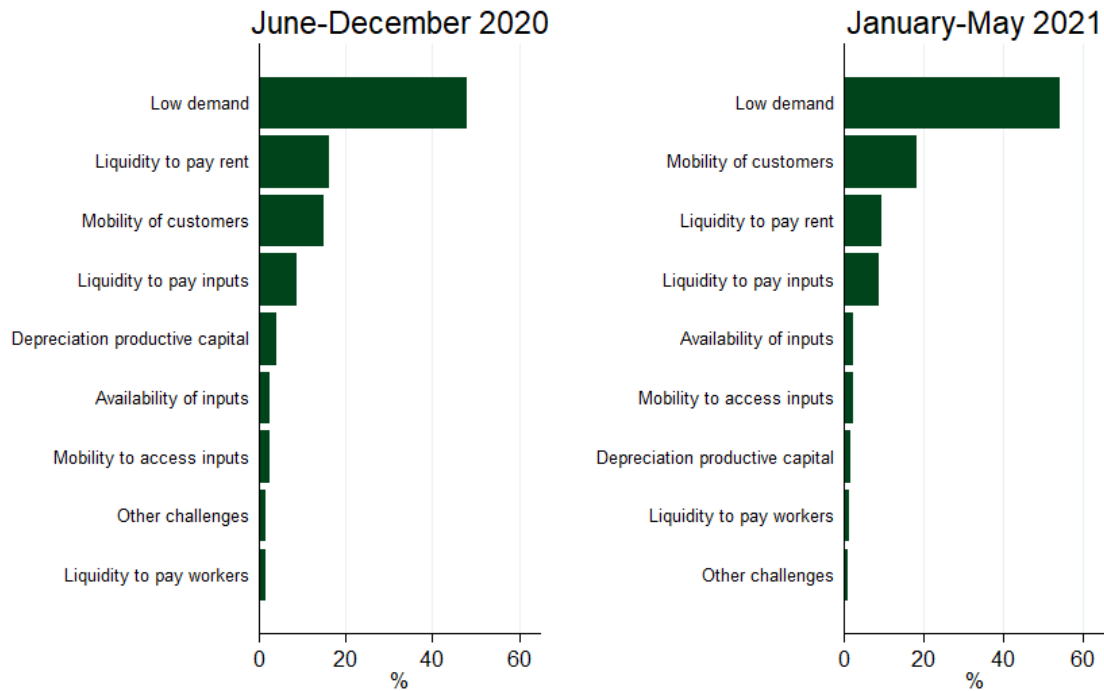
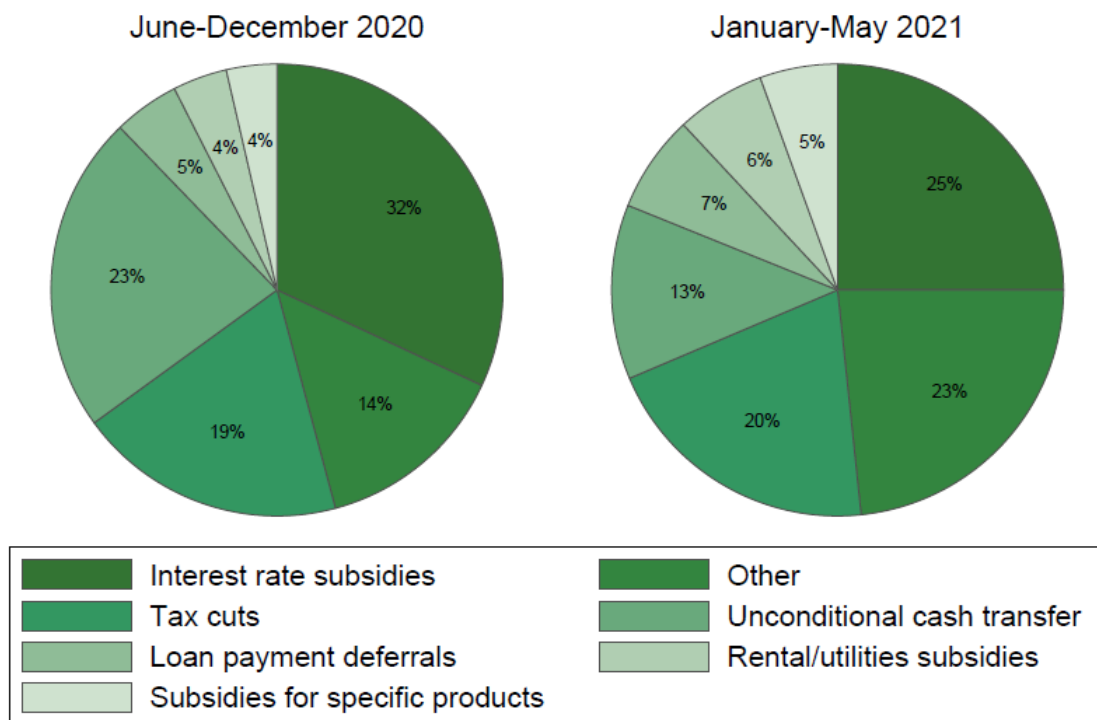


Figure 5: The need for liquidity

What would be the most needed policy to support your business over the COVID-19 crisis?



Policy Implications

From a policy perspective, our results are important for designing programs that encourage the recovery from the large economic shock caused by the pandemic.

Our findings suggest that while permanent firm closures were limited, the recovery has been slow: one year after the pandemic started, demand is still low, and profits, wages as well as employment are substantially below pre-pandemic levels. At the same time, firm owners are experiencing significant difficulties in meeting their liquidity needs to keep firms open.

These results suggest two main directions for policy intervention. First, policy actions that can boost the spending power and ease the mobility of customers will be important to make sure that demand is sustained during the recovery period. Second, policies that can facilitate liquidity access for firms – such as interest rate subsidies, tax cuts/deferrals, and unconditional cash transfers – will be critical to ensure that firms can remain open and keep paying their employees in the path to recovery.

Next Steps

Looking ahead, we will use our firm panel to study which firm characteristics predict survival and performance pre- and post-Covid, with a particular focus on the role of managerial quality and capital stock. This analysis will shed light on the impact of the shock on firm selection and market structure. On the one hand, it is possible that the Covid shock led to a more efficient reallocation of resources from least to most productive businesses. On the other hand, if the impact of the Covid shock was stronger among the most productive firms, the economy may be left with a mass of inefficient firms unable to generate growth in the long run, with significant consequences both for aggregate productivity and employment. Understanding this is critical to formulate guidelines for industrial policy along the path to recovery, and so is something that we plan to study next.

This note is based on research conducted as a part of PEDL [ERG 7871](#).