Supporting Firms in Restructuring and Recovery
March 2021[1]

CONTENTS

FIGURES

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KEY MESSAGES

- Firms and workers continue to be deeply affected by COVID-19, while the reach of policy support has been limited. Only one in four businesses surveyed across 60 countries has received any type of public support, with the share varying from more than 50% in high-income countries to just over 10% for low-income economies.
- While several types of instruments – including access to credit, wage subsidies, and tax support – have been effective in easing liquidity constraints and preventing layoffs, policy targeting must be improved. Twenty percent of firms that did not experience any negative shock due to COVID-19 report receiving public support, compared to 26-29 percent of firms that were affected.
- Technology is helping firms adjust to the shock, but only about one-third of businesses have been able to increase the use of digital technology in response to COVID-19. Support programs should incentivize the adoption of technology (such as fintech, e-commerce, and B2B digital solutions) and build firm capabilities, including managerial practices, that help firms adopt this technology. Policymakers can further enhance the impact of new technologies through regulatory reform for a contestable digital market, digital access between government and business, and increasing public sector use of digital financial services.
- To facilitate a productivity-driven recovery and make the best use of limited fiscal resources, firm support should be targeted to viable firms facing financial distress or insolvency due to COVID-19. Viability is best determined by self-interested stakeholders (i.e., those with a potential claim to the firm and its assets) while policymakers can play the role of a convener. Viability requires considering solvency (the discounted value exceeds obligations to financial institutions, bondholders, and government), vulnerability (whether financial distress is related to COVID-19), firm size and formality status (with support to micro and less formal firms best channeled through social protection mechanisms). All support should be data-driven to the extent possible, while avoiding undue favoritism toward state-owned firms.
- Firm support programs should be state-contingent, tied to observable goalposts in recovery, such as control of the virus and feasibility of operating at full capacity, and feature simple and transparent criteria. Since lack of awareness is a key impediment to accessing policy support, information about support programs, insolvency frameworks and options for restructuring must be widely- and well-communicated.
- Concentration of market power should not be neglected. Smaller firms have been exposed to bankruptcy to a greater extent than larger players, governments' policy responses to the crisis may themselves have been raising other risks to competition, and the preference for remote interactions has further boosted the position of the large platform businesses. Governments should take this opportunity to review the economic rationale of the state-owned enterprises (SOEs) and whether support is not exclusively and unnecessarily granted to dominant firms (SOEs or private). Support should also involve commitments to monitor and strengthen SOE corporate governance.
- To address financial distress and maintain productive resources, insolvency and restructuring frameworks may need to be strengthened, including court-sanctioned debt restructuring processes, Out-of-Court Workouts (OCWs) and simplified insolvencies for SMEs.
- Based on available recent data, some economies are showing historically high rates of new business creation, along with the unprecedented rates of business bankruptcies and closures. To support effective reallocation of resources and building back better, regulatory reforms should

focus on lowering barriers to entry and greater regulatory flexibility while protecting health, safety, and the environment through risk-based solutions.

- For stronger and more sustained recovery, the financial sector's ability to continue lending to the viable corporate sector must be protected. Regulatory and supervisory incentives should be considered, where relevant, to foster early action on non-performing loans (NPLs) and promote effective corporate debt restructuring. If corporate debt is large and growing, focus on measures that reduce dependence on debt finance, such as clearing government arrears, and encouraging equity and quasi-equity stakes. Reform tax laws that incentivize debt over equity.
- To calibrate firm support, strengthen insolvency frameworks, and protect the financial system, authorities should collect and analyze data to monitor the impact of the shock on the private sector, and disclose as much information and data as possible to the public.

1. Introduction

Firms in developing countries are in financial distress and key indicators suggest a rise in firm insolvencies is coming. On average revenue declines were 40% a few months into the crisis and reached 70% around the peak of the crisis, compared to 45% in OECD countries in the early weeks of the shock. Furthermore, there is a growing corporate debt problem in many developing countries. On the eve of the pandemic, corporate debt was already elevated in several emerging market and developing economies (EMDEs). Pandemic-induced negative shocks to earnings have worsened debt service capacity of firms (listed or not), with small businesses being severely impacted (see IMF Global Financial Stability Report and update, Oct 2020, Jan 2021). Recent survey data of more than 100,000 businesses mainly in developing countries shows that 39% of micro and small businesses (those with less than 20 employees) are in arrears or expect to fall into arrears in the next six months (Apedo-Amah et al, 2020). Growth in unemployment has also been a predictor of the growth of insolvency cases in previous crises, and two-thirds of firms have either fired employees, reduced worker hours or wages, or asked workers to take leave. While there are welcome news of vaccines and new treatments for COVID-19, these are unlikely to be available everywhere at once meaning that the economic pain is likely to persist for some time.

Policy response has been relatively swift but reach and effectiveness are still limited. In the months following the onset of the pandemic, at least 1,600 policy measures to support SMEs were rolled out in 135 countries. In high-income countries, fiscal stimulus has exceeded 10% of GDP, with more than 40% of the total going to firm support. In low-income countries, less than 2.5% of GDP has been dedicated to fiscal support and less than a quarter of this has likely gone to firm support. Consequently, only about one of ten firms report receiving public support in countries with GDP per capita below US$2,500 compared to 53% in countries with GDP per capita above US$10,000. And while there is evidence that sectors most affected by the pandemic have been more likely to receive policy support, this relationship is much stronger in upper-middle and high-income countries than in the poorer economies. Targeting has also been a challenge: 20% of firms that did not experience any negative COVID-related shock received public support versus 26-29% of those that did experience a negative COVID-related shock. During the early months of the pandemic, concerns about exclusion errors likely and rightly dominated those about inclusion errors, but more precise targeting will be important as fiscal space tightens.

The rest of this note is structured as follows. The next section presents the main impacts of COVID-19 on businesses. Section 3 revisits the organizing framework of the first *Supporting Firm Resilience* note (Freund and Mora 2020), reaffirming its relevance as the underlying methodology for analysis and guide to policy discussions with client authorities. Section 4 summarizes the policy responses by authorities around the world. Section 5 provides some early evidence on the impact of policies as well as recommendations for improving their targeting and effectiveness. Section 6 maps out the way forward for countries. Section 7 concludes and outlines how the WBG can support.

2. Impact of COVID-19 on Firms

COVID-19 has resulted in a large, sustained drop in firm revenue across the developing world. Data from firm surveys show that 84% of firms in developing countries have reported a reduction in sales relative to the same period in 2019, with an average drop of 49%.[2] Micro and small firms have been affected disproportionately, experiencing a decline in sales of 50% or more, while large firms (those with 100 workers or more) saw sales declines of less than 40%. There are also important differences across sectors with tourism-related activities being the most negatively affected due to the high level of face to face interactions. Businesses owned by women or those with an above-average fraction of women employees experienced larger declines in sales, and especially so in hospitality industries. Two-thirds of foreign-owned firms have experienced decreases in investment, revenues, and profits, highlighting that these challenges are not faced only by domestic firms.

Financial risks driven by defaults and bankruptcies loom large. The IMF has recently reported that global financial vulnerabilities have continued to rise since the start of the pandemic, partly because firms have borrowed to tackle liquidity shortages during the pandemic (IMF, 2020). The share of SMEs that are already in arrears or expect to fall into arrears during the coming six months has declined somewhat from 48% in April -September 2020 to 39% during October 2020 – January 2021 but remains elevated (Apedo-Amah et al, 2020). Firms in harder hit sectors tend to have bigger financial woes. More than half of firms in tourism-related activities (62% of firms in accommodation and 56% in food preparation services) expect to fall into arrears, as compared to 35% and 43% of firms in financial services and ICT (Apedo-Amah et al, 2020). In Sub-Saharan Africa, 10% of the most affected firms do not have enough cash on hand to survive beyond one day (Apedo-Amah et al, 2020). While there are important differences in financial vulnerabilities across countries, differences within countries have dwarfed those. The bottom 10 % of firms in Cote d'Ivoire have enough cash on hand to survive just 14 days whereas the top 10 % can cover as much as 112 days of costs. Likewise, in Kenya, Senegal and Tanzania the bottom 10 % of firms report having zero cash on hand, while the top 10% can cover about a year of costs. More firms are likely to face financial distress due to the current spike of COVID-19 cases that many countries in the northern hemisphere are experiencing, coupled with the projected 4.3% global GDP contraction for 2020 according to the Global Economic Prospects 2021.

The predicted rise in firm insolvencies has not yet fully materialized, but a closer look at global and country-level insolvency data reveals cause for concern. Global insolvencies were originally expected to grow by 17% in 2020. While accurate data is not available from all markets, many economies appear to have not seen high levels of growth of insolvency cases and, indeed, some have seen a reduction in the overall number of cases when comparing 2019 Q2 and Q3 to 2020 Q2 and Q3. It is important to note, however, that even in those countries, reporting a reduction in total cases, such as the US and Canada, worrying signs persist. In the US, for example, filings by foreign companies—which can use Chapter 15 of the Bankruptcy Code to file in the United States if they meet certain requirements— have risen almost 3 times from Q1 2020 to Q2 2020. Chapter 11 filings – which is more heavily used by larger firms— have

[2] Based on 60 countries covered by the World Bank's COVID-19 Business Pulse Surveys and COVID-19 Follow-up Enterprise Surveys.

risen by almost 45% when comparing Q2 and Q3 2019 to the same period in 2020. Similarly, large value insolvencies in Canada were already higher in 2020 than in 2019.

Firms have been holding on to workers, opting instead to reduce hours and wages or grant leave. Two-thirds of businesses made some adjustments to their payroll, but most firms did so by reducing hours, wages, or granting (paid or unpaid) leave to workers. Only 19% of firms fired workers. However, this likelihood has tended to increase somewhat over time in cases where countries are facing protracted shocks. Firms that experienced larger declines in sales were more likely to rely on layoffs, but the response has been relatively inelastic: a firm with 100 workers facing an average 53% reduction in sales was likely to shrink by just 4 employees. Women-owned businesses and those with above-average share of female employees were somewhat more likely to shed workers when faced with a shock of the same magnitude. Hardest-hit sectors made the biggest adjustments: firms in the accommodation sector had the highest probability of granting leave (53%) and cutting wages (34%), while firms in the food services sector had the highest probability of laying off workers (24%). Furthermore, half of foreign-owned firms – and among them especially smaller firms -- report reducing total employment by 10 % on average reflecting reduced hours and furloughs, in addition to layoffs.

Businesses are adjusting by innovating and going digital, but not all firms or countries have benefitted equally. Firms are responding to the shock by increasing the use of digital platforms and social media (34% of businesses), making new investments in digital solutions (17%), and adjusting their product mix (26%, including moving into health-related products). There is early evidence that digital adoption may be helping firms weather the shock: firms that were more likely to adopt digital technology post-COVID experienced an 8 percentage point lower decline in sales than firms of similar size, sector, and the same pre-COVID levels of technology (see Box 1). However, firms in Africa and South Asia have so far been significantly less likely to adopt digital technology than firms in other developing countries, and large businesses have been much more effective at increasing the use of digital than small firms. These findings have implications for how policymakers approach policies and incentive programs to support digital transformation during the recovery phase.

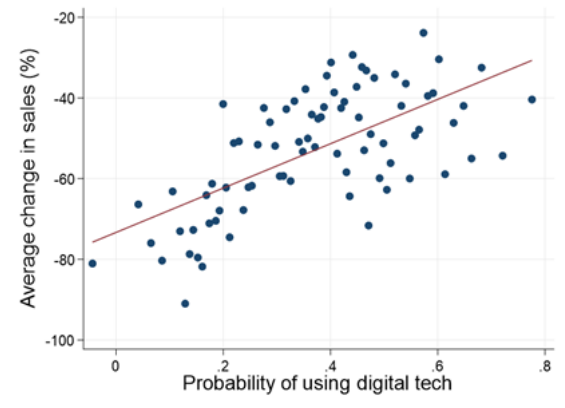
Box 1: Technology adoption in response to COVID-19

The pandemic has triggered an unprecedented increase in investments and use of digital technologies, which are positively associated with better firm performance and larger firm size. Faster-growing firms have a higher likelihood of starting use or increasing the use of digital technologies, even after controlling for basic characteristics of the firm, such as country, size, and sector (Figure 1a). However, the use of digital solutions is much lower among smaller firms (Figure 1b). Although the association between digital adoption and performance does not imply a causal relationship, the strong correlation between adoption and the size of firms may raise concerns regarding an increasing digital divide, across firms and across countries.[3] For example, the fraction of businesses that increased their use of online platforms ranges from 11% in Ghana to 81% in Indonesia. The quick response from several businesses on going digital represents an important opportunity for technology upgrading, but additional efforts are needed to facilitate this process for firms with lower levels of capabilities to avoid leaving some firms and workers behind.

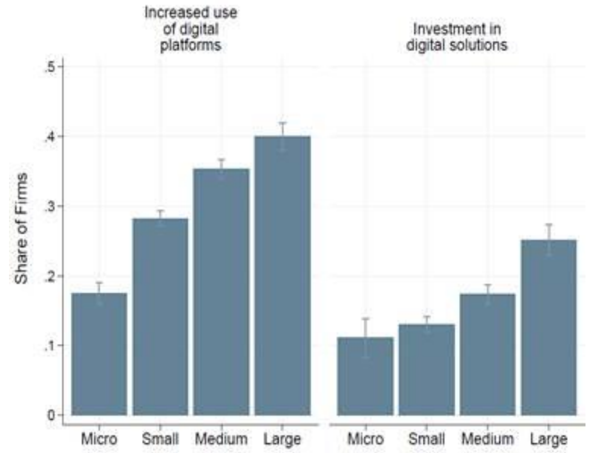
[3] Cirera, Comin, Cruz, and Lee (2020) shows evidence of a significant gap on technology adoption across small and large firms in developing countries pre-COVID 19.

Figure B1.1 Digital adoption in response to COVID-19

a) Average changes in sales are positively associated with the likelihood of starting or increasing the use of digital technologies for businesses



b) Average predicted probability of starting or increasing the use of digital technologies



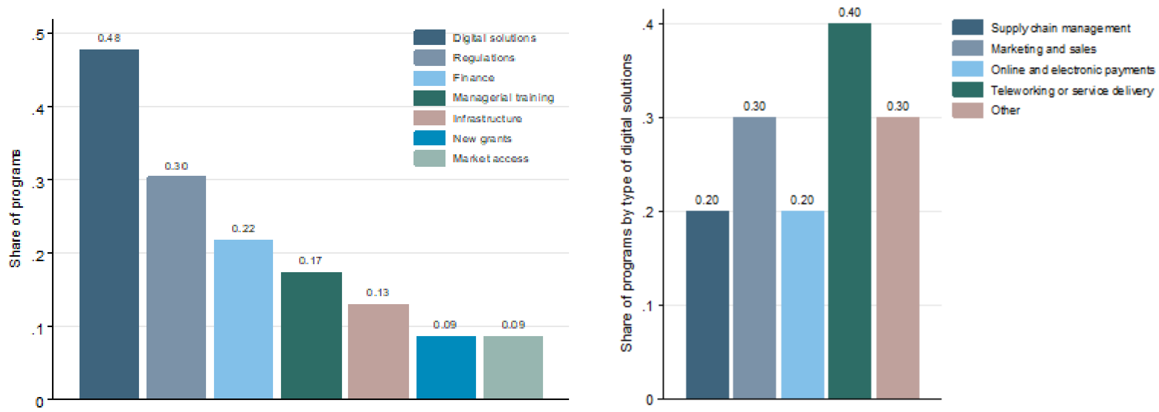
Note: (a) Estimates of the relationship between average change in sales and probability of using digital technology for business based on a sub-sample of countries for which the level of information of technology pre-COVID is available. (b) Average predicted probability for size from a Probit analysis that controls for country, size, subsector, and weeks before and after the peak of the mobility shock based on the full BPS sample. Data on "investment in digital solutions" is not available for micro firms.

Mitigating the risks of a growing the technology/digital divide requires removing existing barriers to adoption**.** Firms in Brazil, Senegal, and Vietnam that were already more prepared with higher level of technologies, particularly digital technologies, pre-COVID, were significantly more likely to accelerate adoption post-COVID. This suggests that the existing barriers may be persistent. Among the factors that likely explain these gaps are issues related with lacking managerial capabilities, lack of access to finance, and limited access to markets or uncertainty – many of which have deteriorated disproportionally for small and female-led businesses, which further exacerbates the barriers to adopt technologies for these SME groups.

Governments and business-supporting organizations are intensifying the use of policy instruments to support digital adoption and upgrading. A survey conducted between July and August 2020 with 23 business supporting public programs in Kenya shows that many of these programs have adjusted the services they provide by increasing the support to digital solutions. About 48% of the programs that already existed before COVID-19 reported that they have started or expanded the offer of training and technical support related with digital solutions.[4] The most common types of support were related with teleworking and service delivery, marketing, and sales. Similarly, management extension support services in Brazil are experiencing a shift of demand towards digital upgrading programs; and new programs are been created, such as Jornada Digital, to tailor SMEs needs in this area. These programs combine the provision of information with technical assistance, and are taking advantage of greater interest among SMEs for technology upgrading. One concern, however, is the narrow focus of managers and entrepreneurs on upgrading sales and marketing functions while neglecting others. Data for the state of Sao Paulo, Brazil, shows that among all firms adopting and using digital technologies, 76% used digital tools for marketing and 56% used digital tools for sales, but only 12% of firms for digitalizing supply chain management or 10% for production planning.

[4] The Kenya Industry and Entrepreneurship (KIEP) project is an example of a US$50 million program supporting technology upgrade implemented by the Ministry of Industry, Trade and Cooperatives (MoITC) of Kenya, with support from the World Bank. The Ministry of ICT, Innovation and Youth Affairs of Kenya also has plans to roll out campaigns to sensitize Small and Medium Enterprises (SMEs) on need to digitize to strengthen their market positions and enable the enterprises conquer new markets.

Figure B1.2- Share of public programs that started or expanded the offer of any of the following services to support businesses in response to the COVID19 pandemic in Kenya



Source: World Bank Entrepreneurship Enabler survey (2020)

3. Pathways of Economic Shock

The *Supporting Firm Resilience* (Freund and Mora, 2020) note identified four distinct channels of impact of COVID-19 on firms. These channels remain relevant as the adverse effects of the shock continue, and empirical evidence collected since the onset of the pandemic reaffirms their individual importance. While supply and demand shocks were most acute initially, going forward heightened uncertainty is depressing investment and a wave of insolvencies could affect financial stability. Policy dialogue around business adjustments to COVID-19 and public support to aid firms in this process should consider which of these channels presents more risk in each country context and how different types of firms are being affected. Policy responses will need to be tailored accordingly.

1. **Supply/lockdown shock**. The reintroduction of lockdown and resurgence in the number COVID-19 cases is extending the duration of the supply shock. This generates a temporary decline in output and productivity driven by (a) restrictions to work at full capacity, (b) decline in labor availability, and (c) limited access to inputs (e.g., 60% of firms report difficulties obtaining inputs). While important, this channel is likely to be the more short-lived, and as soon as cases level off and restrictions are lifted, the effects of this channel should dissipate. It should be possible for policy makers to know in real time if this channel is operating or not, which could be important for policies that are state-contingent[5]. Further, some firms have accelerated the adoption of digital technologies and product innovation in response to COVID-19, which represents a positive supply shock that could also be important in supporting a productivity-driven recovery (although so far, only one-third of firms have been successful in adopting digital technology and one-quarter have innovated into new products in response to COVID-19).

2. **Uncertainty shock.** In the US, uncertainty has doubled following the onset of COVID-19.[6] Yet, developing countries show levels of uncertainty which are three to four times higher than the US

[5] See section 5 for more discussion on this.
[6] Uncertainty is measured using subjective sales uncertainty regarding firms' own future sales growth rates. According to Altig et al (2020), these firm-level growth expectations are highly predictive of realized growth rates, and firm-level subjective uncertainty predicts the magnitudes of

peak in June-July 2020 (Figure 1). Uncertainty is correlated to the size of the shock, as firms and countries that experienced larger drop in revenues tend to have significantly higher level of uncertainty. Firms that experience higher uncertainty tend to lay off more workers and may be more likely to hold off investment or limit innovation. Therefore, uncertainty is not only worsening the situation today, but may also have negative implications for the recovery and medium-to-long term growth. Foreign direct investment (FDI) is expected to have dropped 40% in 2020, and surveys show that 85% of foreign-owned firms in developing countries are either not changing their investment plans or are investing less. Firms are adopting a “wait and see” approach.

3. **Demand shock.** Demand for both final and intermediate goods continues to be weak, however this is highly heterogenous across firms and sectors. The demand shock is likely to dissipate more slowly than the supply-side shock, but while demand for certain products and services may remain sluggish (e.g. travels), for others it could expand significantly. However, it is important to note that while the demand shock is exogenous to the firms, firms can attenuate the shock’s impact by adopting digital technology, coming up with new ways to supply goods and services, or introducing completely new products (see point 1 above). This is confirmed by survey results showing that firms in same sector and country can experience widely varying changes in sales. In the sample for Senegal, for example, there are 10 businesses in wholesale and retail with 5 full-time employees each and no part-time employees, interviewed in the same week, and open at the time of the interview. Their average drop in sales is 62%, but values range from -90 to -13, with a standard deviation of 24, indicating wide variability.

4. **Financial shock.** In order to support liquidity, many countries have so far adopted financial sector measures that have in effect frozen recourses in cases of non-payment. As noted above, risks of financial distress are quickly building up. In a third of the countries surveyed, an average firm reports that it has enough cash on hand to last just over one month. This is especially concerning as insolvency pressures are particularly strong on small firms, for which restructuring may be difficult to achieve (Figure 2). Furthermore, experience from previous crises suggests that non-performing loans (NPLs), which lead to firm insolvencies, can take several quarters, after the onset of economic crisis, to peak. As more debtors default, an increase in insolvency filings typically follow. Yet, the process of NPL build-up is often lengthy. For instance, taking December 2007 as the date where the Global Financial Crisis began, the median lag between the onset of the crisis and the peak NPL levels was approximately 13 quarters for the OECD countries and 11 quarters for non-OECD countries. In turn, these pressures could put strains on the broader financial system, and limit further access to finance for firms, especially smaller and younger ones which already have limited access to finance.

4. Public Policy Responses

Public response to the pandemic has been swift, especially in advanced countries. In high-income countries, authorities deployed fiscal stimulus packages exceeding 10% of GDP on average (Figure 3), with close to half of this amount directed to support firms. Focusing more specifically on support to SMEs, the

future forecast errors and future forecast revisions. See Apedo-Amah et al (2020) for more details on measuring uncertainty in developing countries using World Bank Business Pulse surveys.

World Bank's SME COVID-19 Policy Response Dashboard catalogues some 1,600 policy measures implemented in 135 countries. More than three quarters of these measures are concentrated in three categories: debt finance (37%), employment cost support (22%), and tax support (20%). The type of policy responses varies systematically across countries. High-income countries rely less heavily on debt finance or tax relief (33% and 15% of all measures, respectively), but use employment support measures (34%) more frequently (Figure 4). More direct forms of income transfers, i.e. wage subsidies and direct monetary transfers, are more common among firms in richer countries. The World Bank's efforts to track and monitor various types of policy responses by governments around the world since the onset of the crisis can be found in Annex II.

The combination of fiscal stimulus and regulatory and legal forbearance has likely helped to mitigate and postpone the impact of the economic crisis. According to IMF calculations, US$9 trillion in fiscal support were injected globally by May of 2020. These interventions included spending and revenue measures of over US$3 trillion, as well as loans, equity injections, and guarantees of over US$4 trillion. These large stimulus packages including direct deposits to individuals, corporate debt purchases, providing public guarantees for bank loans or liquidity or capital injections to financial institutions have likely helped many firms to weather the storm since the initial months of the COVID-19 crisis, primarily, though not exclusively, in higher income economies. As noted in Reinhardt (2020), the features of the economic crisis caused by COVID-19 are different from those of the 2008 global financial crisis (GFC) and other economic or financial crises before. Governments are not only granting significant state aid and bailing out systemic market players as they did after the GFC. They are taking additional measures that reflect much more flexibility to adjust to the unusual circumstances of this crisis, including exemptions to competition policy and law. While unusual measures are warranted, the emergency measures during the containment period should not permanently alter the market functioning in the medium-term.

Credit-support measures have been one of the main tools to soften the economic blow of COVID-19. Chief among these were generous loan guarantee schemes and concessional finance mobilized through public banks. Advanced economies such as France and emerging markets such as Peru launched loan guarantee programs worth 12% and 8% of their respective GDP, while Japan and Saudi Arabia mobilized approximately 3% and 0.4% of GDP, respectively, through domestic public banks to support businesses, especially SMEs. These measures were complemented by unprecedented monetary policy actions as well as by several indirect actions such as tax deferrals and regulatory forbearance, which provided for additional liquidity room in firms' balance sheets while incentivizing commercial banks to continue to extend credit to firms. However, evidence from China (Chen et al., 2020) as well as United States' Paycheck Protection Program (PPP) program (Granja et al. (2020); Chetty et al. (2020)) shows that financial support policies during COVID-19 have not been effective in alleviating SMEs' cash constraints or encouraging the reopening of small businesses, potentially due to difficulties in accessing policy-oriented loans and misallocation of credit.

The World Bank COVID-19 Financial Sector Policy Response Database shows that many authorities around the world implemented temporary relief measures in support of borrowers and to ensure the flow of credit to the real economy while safeguarding banks' resiliency (also see Feyen, Gispert, Kliatskova, and Mare (2020)). A recent study of financial sector policy responses to the COVID-19 crisis shows that all 154 of the countries reviewed have introduced at least one policy intervention, with 80 % of the measures being introduced early in the process, by June 1, 2020. After prudential measures, borrower support is the most common action taken by policy makers. Most of the measures seek to directly or indirectly avoid a rise of insolvencies of cash-strapped, but otherwise viable businesses (and households), by providing direct support to borrowers in the form of, inter alia, public guarantees for bank loans, state subsidies, debt repayment moratoria, or encouraging loan restructuring. Some governments also have purchased corporate securities outright in capital markets. Other measures that also impact firms include those aimed at bringing prudent flexibility to financial integrity requirements to help address COVID-19 related challenges (e.g., supporting digital onboarding, simplified due diligence).

To support the flow of credit, including to firms, many authorities have taken prudential measures seeking to support and encourage the use of the flexibility embedded in global prudential standards (e.g. the use of capital and liquidity buffers, the treatment of restructured loans, the treatment of non-performing exposures). However, compared to advanced economies, low- and middle-income EMDEs appear to have relied more heavily on the relaxation of certain prudential regulations that goes beyond the flexibility embedded in the international standards (e.g., lowering minimum risk-adjusted capital requirements, and particular changes in the treatment of non-performing loans), perhaps because they have fewer options at their disposal due to limited policy space, bank-centric financial systems, and less sophisticated regulatory and supervisory frameworks. The negative impact of employing regulatory flexibility beyond the international standards, even if temporary, should be carefully weighed against the short-term benefits to support firms. This is particularly important for some EMDEs which operate in a more constrained environment and have relaxed certain regulatory requirements that may challenge bank resilience in the medium term and may cause a credit crunch which will affect firms and the broader real economy (Reinhart (2020)). One key challenge going forward is the risk of cliff edge effects when some of these forbearance measures will be wound down. Discussions around the "exit" of financial support measures is only starting and remain challenging given the prevailing uncertainties.

While governments' support and firms' reactions have certainly played a role in the relative decrease in business insolvency filings, other more direct legal measures may have had a larger impact. Several countries have put in place short-term insolvency and insolvency-related measures to help ensure firms and consumers have breathing space during the core of the crisis. In June 2020, the World Bank launched the Global Guide on insolvency and insolvency-related reforms under the COVID-19 pandemic (Guide). Our analysis based on the guide has revealed that over 90% of the 62 economies (AE and EMDE) in our sample have enacted insolvency and insolvency-related reforms since the onset of the pandemic. Specifically, 80% of these economies have relaxed debt repayment requirements for debtors; while 43% of countries have made it more difficult for creditors to force debtor firms into insolvency; and 30% have relaxed the obligations upon management of the firm to enter insolvency proceedings when the firm is illiquid or when its assets exceed its liabilities.

Since the start of the pandemic, it appears that the importance of digital payments and fintech have been recognized by governments. Digital payments enable Governments to have better control of the integrity of the overall payment process and has a bearing on the overall efficiency and effectiveness of revenue collection as well as expenditures like public procurement and social benefit transfers. Increasingly, it is also clear that digital payments are a core requirement for digital-economy businesses like ride hailing and ecommerce. A recent McKinsey study of COVID-19 relief programs concluded that financial infrastructure (particularly digital payments and digital ID) were critical to the successful delivery of the twelve COVID relief programs across the seven countries examined in the study. In a recent survey administered jointly by the World Bank and Cambridge University, of the 114 jurisdictions surveyed, 37% of regulators confirmed having taken at least one regulatory step to enable greater use of fintech since the start of the pandemic, with digital payments being the area most widely addressed. Indeed, 60% of respondents reported an increase in the use of digital payments in their respective jurisdictions (the Central Bank of Kenya, for example, reported that more than 1.6million additional customers are using mobile money since the start of the pandemic). Regulators have taken steps, such as those taken in Ghana, Kenya, Lesotho, Liberia, Rwanda, Uganda and Zambia, to facilitate and simplify remote account opening, open the provisions of digital financial services to new providers and increase transaction limits for the use of mobile money.

To complement financial support, governments have also taken complementary investment climate measures to supporting the survival of otherwise viable firms through regulatory flexibility and targeted services to retain investment. Regulators have taken steps, for example, in Albania, Bahrain, India, Malaysia, Saudi Arabia, South Africa, and Vietnam, to temporarily suspend or delay tax and social security filings, waive fees for government transactions such as licenses, registrations or permits, or automatically extend licenses and permits during the relief stage. Investment promotion agencies (IPAs) are in large part shifting their principal focus from FDI attraction to retention by bolstering aftercare services that include identifying and directly contacting at-risk firms according to number of employees, region, or sector; brokering solutions to their specific issues; encouraging repurposing; and advocating for urgent government actions to solve these issues more systematically (to benefit other similar investors).

Despite the expansive roll-out of support measures, access to policy support has been limited, especially for small firms and poor countries. Only 33% of firms globally has received any type of public support during October 2020 – January 2021, although this number has increased from 26% during May-August 2020. Access to policy has also been uneven: since the onset of the crisis, the probability of receiving support for firms in high-income countries (53%) has been nearly four times the likelihood for firms in low-income countries (11%, Figure 6), while almost twice as many large firms (30%) as micro firms (18%) report receiving support (Figure 7). The probability of accessing the support is similar across broadly defined sectors (Figure 7), with a somewhat higher likelihood in accommodation (31%) and food preparation (29%). Finally, as expected, formal firms are more likely to access public support, albeit the difference is not large. Still, 24% and 16% of informal firms report receiving monetary transfers and wage subsidies, respectively. This is consistent with some views that suggest the use of cash transfers to support informal firms, given the difficulties to obtain information necessary for targeting of other support types.

Lack of awareness has been a major challenge, especially in low-income countries. Forty percent of firms across all countries report lack of information as the main reason for not accessing public support, with remaining reasons evenly distributed across ineligibility, difficulty in applying or the time gap between application and receipt. Lack of awareness is similar across different firm size categories, but there is a clear inverse relationship between access to information and per capita incomes: 71% of firms in low-income countries but only 11% of businesses in high-income countries report this as the main constraint (Figure 8).[7] Strikingly, there is little evidence to suggest that awareness of government support programs has increased since the peak of the crisis: approximately 50% of firms report lack of awareness as the main

[7] In high-income countries, 47% of firms cite ineligibility while 40% cite difficulty in applying as the reason for not receiving government support thus far.

reason for being unable to access government support 1 week after the crisis peak, but this remained unchanged even 16 weeks after the peak, albeit with some fluctuations.

Another challenge is that policy support provided hasn't always matched the demands of the private sector. Demand for wage subsidies and tax reductions increases with income level, driven by higher degree of formalization and larger average firm size (Figure 5). The opposite is observed for monetary transfers, which are more demanded by smaller firms. In many instances there is some mismatch between policies demanded and offered: for example, access to credit is the most preferred policy for firms in lower-middle income countries, but tax relief is the main mechanism of support offered in these economies. For upper-middle income countries, there is a mismatch for tax deductions and access to credit, which rank high in firms' preferences but low in terms of policy utilization or access.

5. Targeting and Effectiveness of Policy Support

The main objectives of policy support to firms are to avoid the financial repercussions of mass exit of viable firms facing financial distress, prevent the losses of firm-specific intangible capital, and minimize the friction costs of firms exiting and subsequently re-entering the market.[8] While ideally policymakers would ration support to the more productive firms facing financial distress, productivity can at best be observed with a significant lag. Policymakers should therefore look to ***viability*** as a key determinant, targeting support to viable firms facing financial distress or insolvency due to COVID-19. However, viability is a complex and nuanced concept that requires taking several factors into account. Blanchard et al (2020) define a viable firm as one whose discounted value exceeds the recovery value of its assets (e.g., a 'forced-sale' or liquidation value of the assets). This may be too static a definition of 'viability' and may not answer the question of whether the firm, if restructured, could deliver higher returns to its stakeholders than its current break-up value. The break-up value itself may also be adversely impacted by weak demand conditions. Firms' historical tax returns and EBITDA (earnings before interest, taxes, depreciation, and amortization) can also shed light on viability, but lack of adequate financial information or insufficient analytical capabilities can make determination challenging, especially in a world where there may be persistent changes in demand. The following can serve as useful inputs in determining which firms should be considered 'viable', including with respect to possibly benefitting from public support:

- *Solvency*. As noted above, Blanchard et al (2020) provide helpful definitions to analyze the current financial state of a firm. They define a solvent firm as one whose discounted value exceeds its obligations to financial institutions, bondholders, and government. Most countries opt to define solvency either through a 'cash-flow' or 'balance-sheet' test. Declining profits together with tightening financial market conditions (e.g., 70% of firms globally reported difficulties in accessing finance during October 2020-January 2021 due to rising interest rates and higher repayment risk) will have made some otherwise healthy firms insolvent, making such firms a potential target for public support. In such cases, government arrears to firms – where applicable – should be cleared as much as possible to provide a more accurate estimate of a firm's solvency and should precede or complement other forms of support.

[8] There may be other, strategic reasons for extending support to specific firms or sectors, such as ensuring uninterrupted delivery of key emergency services (e.g., avoiding disruptions to air cargo services and maintaining the supply flow of essential critical products, including food, medicines, PPE, and other key inputs for sensitive supply chains that were vital during the initial phase of the pandemic) – which policymakers must balance against risks of creating market frictions and distortions. Such considerations, however, are beyond the scope of this note,

- *Vulnerability*. A firm is vulnerable if it is facing financial distress or insolvency due to the COVID-19 shock. A number of COVID-19 firm support programs have used a decline in revenue as a criterion for determining eligibility and/or amount of support provided (Box 2). [9] It is important that the consideration of vulnerability is combined with some notion of solvency to avoid channeling scarce fiscal resources either to firms who do not need support or those who are unlikely to survive anyway (see Table 1). For example, support could be prioritized towards firms which were not cash-flow or balance-sheet insolvent prior to December 2019. Support should also be time-bound and could be calibrated to firm needs by capping the amount per beneficiary and varying the limits by sector (Pop and Amador, 2020).

- *Size/formal status*. When fiscal resources are scarce, not all viable but vulnerable firms may be saved. The rationale for using public funds to support firms weakens when the recipients are smaller/less formal: for such firms entry/exit costs tend to be low, intangible capital is largely embedded in the entrepreneur herself, and risks to creditors' balance sheets from firm closure is limited.[10] In cases such as these, support is better provided directly to workers via social protection channels – although the exact cut-off will be a matter of some discretion and will vary by industry and country (it should be noted that even in high-income economies such as Germany and Spain, a firm with just 11 employees will be in the top 20% of the size distribution [see Li and Rama, 2015]).[11] It is also important to consider market dynamics and avoid the anti-competitive effects of channeling support to only one firm or a limited number of firms, notably based on size (e.g., large, dominant firms) or ownership (e.g., SOEs).

- *Long-term considerations*. As discussed in the *Supporting Firm Resilience* note (Freund and Mora, 2020), several types of firms – exporters, young firms and start-ups, innovative firms – may experience financial distress during the crisis while being particularly important for the recovery.[12] It is important that these firms are, at a minimum, not left out of the support programs (e.g., by virtue of concentrating support in certain instruments which are less applicable to these firms – see the discussion in the following paragraphs) and interventions could indeed be biased to some extent towards these firms in order to support a productivity-driven recovery that creates more and better jobs.

- *Who decides?* Typically, in the case of individual firms, viability will ultimately be determined by self-interested stakeholders (i.e., those with a potential claim to the firm and its assets) who believe they stand to gain from continuing to support a particular distressed firm. In countries with deep secondary markets for assets and with established procedures for asset valuation, valuation can be more straightforward. There will also be cases where policymakers may need to weigh into the determination of viability: for example, in cases where a firm's social value may

[9] To minimize the risk that moral hazard becomes a problem in the context of a program that compensate firms based on revenues drop this compensation should be lower than a full compensation or it should be anchored to average revenues drop at level of sector or location and not to the self-reported decline in revenue.
[10] Mechanisms to support informal firms also tend more limited. They are often outside the tax and banking systems, so tax relief may not be an option and financial support may only be available through non-bank financial institutions and microlenders.
[11] Blanchard et al (2020) argue that in instances where support is provided to very large numbers of workers, existing social protection mechanisms such as unemployment offices may struggle with the volume of claims and channeling support to workers via firms' payrolls may be more efficient.
[12] Evidence from firm surveys shows that exporters have generally been less vulnerable to the effects of the crisis (in terms of lower decline in sales and likelihood of falling into arrears) – although the effects are heterogeneous and exporters in East Asia have been somewhat more vulnerable.

differ from its private value. In such cases, where the state has a compelling policy need to play a role in viability-determination, such valuation procedures and the private-sector actors who enable them should be used by the state. In addition, the state can play the role of a convener, bringing multiple stakeholders together and helping establish an appropriate time horizon for determining viability.

***Table 1*: Targeting and required interventions according to different levels of financial distress**

Type of firm	Support needed	Instruments
Viable and not facing financial distress	No targeted support needed to address financial distress, but general firm development policies may still be relevant to achieve longer-term objectives (e.g., innovation, tech adoption, exports, female-led participation, green and circular economy).	Various instruments seeking to enhance the business environment, access to finance support, facilitating access to markets, building firm capabilities. Relaxation of sector-specific regulatory restrictions. Pre-insolvency proceedings may also be used, where available, in anticipation of growing financial distress.
Viable but facing financial distress	Targeted support to solve the liquidity problems	Support through grants, loans, subsidies, tax deferrals. Pre-insolvency procedures may also be needed.
Viable but insolvent	Debt restructuring (possibly followed by targeted support)	Debt restructuring procedures that result in win-win for both the firm and lenders, equity participation. These may include out of court, formal and hybrid insolvency proceedings.
Not viable and insolvent	Liquidation	Improved insolvency procedures to reduce the cost of bankruptcy and protect financial sector balance sheets

Box 2: Approaches to determine vulnerability

A number of COVID-19 firm support programs have used a decline in revenue as a criterion for eligibility or to determine the amount of support provided. For example, a €130 million Danish guarantee scheme for exporter SMEs affected by COVID-19 is accessible to SMEs (and their suppliers) whose exports represent at least 10% of their yearly revenue and who experienced or expect to experience a decline in revenue of at least 30% compared to their revenue before the COVID-19 outbreak in Denmark. In the US, the federal Paycheck-Protection-Program scheme (which offers a loan, 60% to be spent on wages and salaries that turns into a grant if employment is maintained) requires that businesses applying for their second PPP loan show a 25% or greater reduction in revenue, comparing any quarter in 2020 with the same quarter in 2019. At the state level in the US, New Mexico's Small Business Recovery Loan Fund requires a 30% drop in revenues for eligibility.

World Bank operations to support the private sector in response to COVID-19 have also used similar criteria. In Ghana, a US$5 million COVID-19 grants scheme under the Ghana Economic Transformation Project scores potential beneficiaries by the degree of COVID-affectedness (whether a firm is in an area that faced lockdown restrictions as well as a change in sales, employment and exports relative to 2019 – although the score is capped for declines in excess of 50%), pre-COVID performance (whether a firm was an exporter pre-COVID, its output per worker in 2019, and whether it was on a growth trajectory between 2017 and 2019), and use of grant. In Turkey, where the authorities have suspended labor displacements since April 2020 and are supporting employment through wage subsidies, a decline in revenue of 25% or more is an eligibility criteria for performance-based reimbursable support under the US$300 million Rapid Support For Micro And Small Enterprises Project (other eligibility criteria include size, sector, and viability, with special consideration given to young innovative firms).

Effective targeting of policy support requires a balance between pragmatism and precision. A critical aspect in designing effective targeting is that information asymmetries between firms and policymakers are pervasive. Firms have private information on their productivity, business (i.e., profitability) prospects, cost structure, and so on that are typically unobserved by the policy designer, especially in developing countries where capabilities are more limited. The existence of information asymmetries gives rise to informational rents, that is, to the possibility that firms extract private benefits to the detriment of social welfare. Thus, identifying mechanisms to mitigate those asymmetries becomes essential to reduce inclusion errors that provide support to firms that do not need them, as well as exclusion errors that keep desirable beneficiaries out of a support program. Some potential funding allocation mechanisms that may also reduce information gaps are outlined in Table 2.

***Table 2*: Funding allocation mechanisms and key considerations**

Type of funding allocation mechanism	Banking system	Alternative finance mechanisms (development banks, funds)	Specialized processes (e.g., grant assessment committees run by the government or outsourced)	Funneling
Method	Traditional credit assessment approaches	Using investment assessment approaches of venture capital, private equity, etc.	Varied, depends on design but can have elements of quantitative and qualitative assessment, or be an 'entitlement' based automated approach	Tiered, sequenced support based on performance, with better performers "graduating" to more intensive support.[13]
Target	Bankable SMEs with available financial data	Suitable for non-bankable SMEs, option for bankable SMEs	Varied, may be more appropriate for smaller firms, start-ups, innovators	Varied
Scalability	Scalable through banks with SME focus, including through the use of partial credit guarantees and other credit enhancements	Less scalable because more transaction intensive than bank model (relies on people to make assessments, fewer providers)	Depends on intensity, can be outsourced or utilize existing government mechanisms	Depends on intensity, can be outsourced or utilize existing government mechanisms
Limitations	Excludes unbanked firms	Limited scalability	Subject to arbitrariness or outright corruption in contexts with poor governance	Not as effective responding to challenges requiring immediate attention (i.e. need to mitigate liquidity problems that otherwise would lead to outright insolvency); high transaction costs given hands-on approach

[13] For example, information and light touch 'one-to-many' training can be provided initially to many recipients, but more intensive and tailored follow-on support (mentoring, strengthening managerial capabilities, and ultimately market linkages and finance) is limited to firms that show an ongoing commitment to improvement, both by a deployment of their own resources but also their actions, as measured against milestones in an improvement plan. See, for example, Grover and Imbruno (2020) and McKenzie (2020).

In practice, targeting has been more successful at the sector level, and in higher-income economies. Although sectors that experienced larger declines in sales were more likely to receive public support, this relationship is driven primarily by high- and upper-middle-income countries (Figure 10, consistent with [Bennedsen et al for Denmark, 2020](#)). As shown in the previous sections, micro and small firms have been impacted most severely by the shock across a range of performance indicators yet have been the least likely to access policy support. Similarly, although firms that declared having experienced no adverse shock due COVID-19 were less likely to receive public support, 20% of such firms did receive some assistance from the authorities (Figure 11). Some mis-targeting is to be expected given that many policies (rightly) prioritized speed over precision given limited information and urgency to help, and concerns about exclusion errors dominated those about inclusion errors. However, mis-targeting has been more common in low and lower-middle-income countries, and in countries with lower governance scores (Cirera et al, 2021). As fiscal space becomes more limited going forward, it will be important to improve the targeting of public programs, both in terms of eligibility criteria as well as program implementation, and minimize inclusion errors as well as undue market distortions.

Box 3: Emerging evidence on targeting

Emerging evidence on targeting of support policies highlights two main factors associated with mistargeting: i) barriers to access policy support, such as information and application costs, particularly for smaller firms; ii) government capacity and the ability of public agencies to target beneficiaries.

In the United States, funds disbursed through the Coronavirus Aid, Relief, and Economic Security (CARES) Act's PPP did not flow to areas more adversely affected by the economic effects of the pandemic, as measured by declines in hours worked or business shutdowns, but most likely to less hard hit businesses and locations (Granja et. al. 2020). Some of the key challenges to rollout of the PPP funds have been related to the significant heterogeneity across banks in terms of their capacity to disburse the funds (Granja et. al. 2020), the lack of awareness among small firms on the PPP program (Neilson et. al. 2020), as well as bureaucratic hassles and difficulties establishing eligibility (Bartik, 2020). By comparison, the roll-out of a similar program in Italy appears to have been effective in reaching the smaller firms and those in more adversely affected areas, at the most acute phase of the pandemic (Core and De Marco 2020). Their results highlight the importance of the role of information technology and the structure of local banking markets for the allocation of public relief funds during a crisis.

In China, although labor informality limited the extent of support to smaller firms, the regressive tax structure of social insurance contributions, and the greater labor intensity of small firms and sectors affected by COVID-19, still allowed tax breaks to deliver substantial benefits to vulnerable firms (Cui et. al., 2020). In a context where labor informality is combined with high-level of informal (unregistered) firms or if those firms are less labor intensive, those firms would be less likely to be reachable and less likely to benefit from a such instrument.

Effectiveness has varied across types of policies. Early evidence suggests that some policies have been associated with improved performance across a range of firm performance indicators.[14] The likelihood of firing workers for a given change in sales (i.e., the elasticity) was significantly higher for firms which did not receive policy support vs those that did, with the relationship driven mainly by access to wage

[14] Assessing rigorously impact of policies is complex based on cross-section data and the fact that a firm access to policy support cannot be considered exogenous. Given our available information it is not easy to identify an instrument that would work for different types of policies, and therefore the analysis is descriptive and should not be interpreted as association rather than causal impact.

subsidies (Figure 12). Monetary transfers and access to credit which may be relaxing short-term credit-constraints and liquidity problems are correlated with lower drop in sales and higher future expected sales growth, as well as with higher probability of investing in digital solutions.[15] Tax support is associated with smaller reduction in sales and a lower likelihood of falling into arrears, although it has no impact on likelihood of investment in digital solutions.[16] Finally, payment deferral seems to be the least effective of all the policies with only marginal effect on the likelihood of increasing the use of digital platforms.

The following four principles could help policy makers maximize the effectiveness of their interventions and get the biggest bang for the buck.

- **Move towards reactivation and recovery**. Shortly after the onset of the pandemic the focus of the policy was to "freeze the economy" in place with a stronger bias towards maintaining the pre-pandemic equilibrium from collapsing. Currently, albeit gradually, it is important to switch the support packages towards measures that start setting the basis for a new equilibrium and facilitate recovery through reallocation. Two examples may clarify this principle. First, many countries have introduced measures to protect jobs and support the payment of salaries for furloughed workers. While these policies have helped to contain unemployment, as the lockdown eases and economic activities reactivated, it is advisable to move towards policies that provide incentives to firms restart their operation and grow such as wage subsidies (see Box 2). Second, countries need to gradually phase out regulatory forbearance measures and consider introducing mechanisms for restructuring and bankruptcy that allow firms to restart from a clean slate.
- **State-contingent policies**. In a context where firms are facing unprecedented levels of uncertainty public policy can play a crucial role in reducing uncertainty and anchoring expectations of firms around specific milestones. Policy makers can make policy support conditional to specific states of the world, for example at the micro-level make support conditional to the level of foregone revenues, or at the sector-level support will be continued as long as businesses (e.g. restaurants or hotels) are unable to operate at full capacity because of health measures, or announce future support conditional to specific states of the economy.
- **Don't forget the future**. The policy packages introduced today should keep in mind the interests of the future and overcome the strong present-bias that the crisis generates. To the extent that lobbies and coalitions of interests may have shifted during the crisis, there may be an opportunity for new social contracts and reforms that pave the way to a robust recovery and shift the economy into a higher equilibrium. For example, policies and programs that provide incentives to adopt digital technology and innovate are two crucial areas to prioritize (see, for example, Cirera et al (2020) for a discussion of policy instruments to support innovation). Reforms that promote trade, investment, a level playing field and long-run productivity growth should return to be priority areas of focus. In particular, avoiding disproportionate support to SOEs, which are likely to crowd out private investment ang slow growth. At the same time, the level of legal and regulatory forbearance that has helped avoid widespread defaults (Muro, 2021) is likely to end and countries must prepare for the post-forbearance impacts.
- **Importance of gradualism**. While it is important to complement the lifting of the most restrictive health measures with policies focused on recovery and support for reallocation of resources towards firms and activities able to restart and grow, it should be stressed that with firms facing

[15] Access to credit is also positively correlated with higher likelihood of expanding use of digital platforms.
[16] Tax support includes fiscal exemptions or reductions and tax deferrals.

low demand and many countries still imposing significant restrictions to maintain social distance and slow down the contagion, market reallocation is likely not to operate efficiently. In such circumstances, with high unemployment and a slow recovery, reallocation may be slower and transition costs higher. Therefore, policy makers should be ready to either set up adequate social welfare and retraining programs for those losing their jobs or accept a gradual approach towards reallocation.

6. Where Do Countries Go from Here?

With the global economy now approaching the recovery phase, bolstered by positive vaccine developments, the challenge for governments will be to combine protection with reallocation. In a context where firms will still have a hard time obtaining credit, many firms are likely insolvent or nonviable, and government interventions face the reality of limited public resources. Financial support to firms can be delivered through a range of channels as outlined in Table 3.

Table 3 – Pros and Cons of Types of Financial Support to Firms

Type of Financial Support	Pros	Cons
Grants/repayable grants/convertible grants (either non-repayable, or repayable if pre-agreed revenues are achieved)	Non-dilutive/doesn't add to debt, repayable offers upside for government, can be bundled with other instruments, can be carefully targeted for specific activity (e.g., wage subsidies – see Box 4)	Repayable options complex, expensive, needs effective assessment and grant management infrastructure
Indirect (tax incentives for investment or training expenditure)	Non-dilutive/doesn't add to SME debt load, can be designed as credit and provide upfront payment, tax system established mechanism for distribution/management/repayment	Generally requires business to spend then claim back
Loans	Highly flexible, non-dilutive, allocation through banking system so large pools of capital can be accessed, distribution scalable, lending criteria generally transparent and due diligence/selection done by banks	Requires collateral and credit history so favors established lower risk SMEs, can be short term and expensive, banks may favor 'who they know'
Equity	Suitable for riskier and younger firms, can provide longer term finance, is 'smart capital so combines both financing and advice/networking, funds are responsible for due diligence and selection, can be mixed with quasi-equity/quasi debt to suit business	Requires specialized delivery structures (e.g. funds) and management personnel, has resource intensive/non-scalable due diligence, lack of familiarity/hostility from SMEs in giving up equity, poorly developed/no exit markets

Quasi debt/quasi equity (various models often firm specific with repayment tied to revenues)	More flexible than debt/equity, tailored to client needs, collateral requirements not so stringent as lending, 'smart' capital, generally avoids need for 'exit' process	Needs specialized institution/fund to manage, heavy due diligence, relatively new

Box 4: Rationale for wage subsidies
Wage subsidies may not be the appropriate policy in a normal context as they may slow down reallocation, prop up inefficient businesses and distort markets and incentives for firms to become more efficient. However, where governments can afford them, they may be an appropriate response in a world characterized by high-unemployment and weak demand (Blanchard et al, 2020). There are two conceptual reasons that justify the use of wage subsidies under these conditions:

- First, in a context of high unemployment the shadow price of labor is lower than the prevailing wages so there is an incentive for private firms to fire workers. However, this would worsen unemployment in the short run, as it is unlikely that the workers would be able to quickly find a job. In this situation the wage subsidies would aim at reducing the cost of the wages paid by the firms and bring them in line with the shadow price of labor.
- Second, in the context of high unemployment it can be argued that firing workers does not promote reallocation but instead increases pressure on unemployment. In this context, firing workers generates a negative externality as it increases unemployment and makes the probability of finding a job lower for those already unemployed.

Blanchard et al (2020) argue that wage subsidies may be particularly appropriate during economic recovery, in order to tilt firms' incentives towards restarting (particularly in instances where governments pay the cost of unemployment benefits for furloughed workers while firms pay the cost of wages for active workers). Bruhn (2020) offers empirical support for this suggestion, showing that wage subsidies implemented in Mexico during the global financial crisis did not necessarily result in firms retaining workers but helped employment rebound faster in eligible industries vs ineligible industries by facilitating rehiring of workers during the recovery.

The terms of financial support will need to evolve. For viable firms with little debt, loan guarantees should remain the instrument of choice, yet with less generous terms and conditions (i.e. lower coverage rates that those observed during the outbreak phase, pricing aligned with risk). For firms with large financial liabilities, an appropriate mix of equity/quasi-equity financing and debt restructuring should be contemplated (see Box 5). Viable firms could be offered the option to convert guaranteed loans into equity or quasi-equity instruments such as preference shares or subordinated debt. Even with all this support, however, a number of firms will likely not be viable and therefore will need to restructure their debts. When these loans convert into equity and state participation, the governments should define a clear exit strategy and should refrain from intervening in managerial decisions and prevent disruption of business decisions. For instance, governments can obtain non-voting shares and limit their role as "observer" on the managerial boards, to maintain as much as possible the market-based incentives on the firms.

Box 5: Debt and Equity

There are a variety of options for supporting SME funding needs through the COVID recovery stage. Traditional SME lending through the banking sector and microfinance institutions is well established, is generally well understood by SMEs and remains the mainstream platform for bankable SMEs (although still underdeveloped in many countries). Over recent years, alternative equity and variants like quasi-equity/quasi debt/mezzanine have grown in use (albeit from a small base), particularly through hybrid public-private co-investment fund models. These can be designed to support a variety of young and innovative firms. Similarly, hybrid funds that maximize finance for development utilizing institutional investors and other private financing can support investments in firms operating in key industries (Green energy, infrastructure, manufacturing and others) with positive spillover effects on SMEs engaged in these supply chains.

There has been a rise in financial institutions and SME funds that can mobilize institutional investor funding and provide long-term financing to mature viable SMEs in a more tailored manner; other types of debt funds (such as receivable funds) could also mobilize funding for working capital. These are relatively new solutions in EMDEs; and although they do not have the same scalability as bank loans they could be an interesting complement to bank financing, useful for countries with a robust institutional investor base. These programs will likely require mechanisms to align risk-return appetite of investors such as partial credit risk guarantees; they also require a robust fund management industry; legal and regulatory changes might be needed as well. Finally, leasing or capital goods financing is another form of financing supporting SMEs in manufacturing or commercial agriculture and other industries. Trade financing approaches such as factoring may be lower in risk since they are backed by receivables/invoices and can support cross-border (intra-regional) trade where many SMEs operate. These tools however remain nascent in many developing economies but can play an important role in business continuity and growth if appropriately developed.

Policy makers are seeking options for supporting otherwise viable SMEs that cannot raise finance during the crisis, including those that have traditionally relied on debt finance but which may become overly indebted if they rely on traditional instruments. In addition, with many firms beginning to fall into arrears, banks are feeling the pressure of rising NPLs and are restricting new lending, preferring to direct their portfolios towards purchasing government securities. Various specialized financing and de-risking tools that can leverage private resources will be useful to develop both to address these COVID related needs, but also to broaden and deepen the SME finance market. Importantly, these alternatives can relieve pressure on governments from having to extend their borrowing to support channeling liquidity to firms. Some of the tradeoffs and challenges of debt versus equity instruments are summarized below:

Debt:

- Banking
    - Advantages: SMEs generally understand the product, it is non-dilutive, allocation occurs through banking system so large pools of capital can be accessed and distribution scalable, lending criteria generally transparent and due diligence/selection done by banks,
    - Challenges: requires collateral and credit history so favors established lower risk SMEs, can only be available on short terms and at relatively high cost, banks may favor 'who they know', for banks SME lending generally has higher transaction costs than other lending.
    - Summary: remains main vehicle for scale/mass support for bankable SMEs but is still relatively under-developed in many markets.

- Capital markets solutions
    - Advantages: SME lending funds mobilize institutional investors funding, provide longer term financing in a more tailored manner; other types of debt funds (such as receivable funds) mobilize funding for working capital
    - Challenges: relatively new solutions in EMDEs; they require mechanisms to align risk-return appetite of investors such as partial credit risk guarantees; they also require a robust fund

management industry and specific legal and regulatory regimes; not the same scalability of bank loans
    - Summary: can be an interesting complement to bank financing, useful for countries with a robust institutional investor base (*ongoing work of the WB in Morocco, where FCI is assisting the authorities to set up a sovereign strategic fund, which will have an EME debt fund component; in Colombia, where FCI is assisting the National Guarantee Fund to develop a partial credit risk guarantee that can be used in the context of private credit funds and in South Africa, also assisting the authorities in the development of debt funds; and IFC investment in a receivable fund in Peru)*

Equity/hybrid

- Venture capital for SMEs
    - Advantages: suitable for riskier and younger firms, can provide longer term finance, is 'smart finance' so combines both financing and advice/networking, funds are responsible for the due diligence and selection, funds can be flexible with their instruments (mixing equity/quasi-equity/quasi debt) to suit firm needs
    - Challenges: requires specialized delivery structures (e.g. funds or investment companies) and personnel, has resource intensive/non-scalable due diligence, due to perceived high risk of investments can be difficult to attract private capital for early stage investing without some risk-sharing from government with mitigation measures to ensure investments and their management are strictly private sector led, lack of familiarity/hostility from SMEs in giving up equity, poorly developed/no exit markets;
    - Summary: evolving models offer more flexible products for young and innovative SMEs but require different delivery capabilities and higher transaction costs, so scalability is a challenge at the fund level but it can have a catalyst effect by fostering more confidence in the market to support SMEs through demonstration effect. With appropriately designed public-private mechanisms it has been possible to raise private financing and support development of this nascent industry (*examples of WB supported projects using this model can be found in Lebanon, Jordan, Morocco, Tunisia, and Egypt*). Growing evidence of effectiveness, especially for smaller firms and for firms with lower likelihoods of otherwise being funded, when combined with interventions to enhance investment readiness (see, for example, Cusolito et al, 2019).

- Larger companies/firms
    - Advantages: a similar model of co-investment via funds can potentially be expanded to larger firms (including not listed), but likely will require some focus, large amounts of global capital seeking investment opportunities
    - Challenges: requires a robust fund management industry, but potentially less resource intensive than VC funds, reluctance of companies to accept external shareholders would still be an issue even under a model where the fund takes a minority stake, but level of indebtedness could incentive a change

Independently of the specific form of support, the government intervention should be carefully assessed such that risks for distorting market incentives or crowding-out market players can be mitigated. Principles of transparency and accountability are also essential to shape the government interventions particularly to mitigate the risks of favoring politically connected firms, providing access in preferential terms to certain market players or unlevel the playing field (e.g., SOEs or private dominant firms). As public resources are scarce, governments need to consider if support to specific private firms and even SOEs is the best use of limited resources and monitor program implementation. If any form of state ownership is deemed necessary and linked to the support, governments should protect the market-based incentives of private sector activity. Disclosure of information and accountability principles will also mitigate the risks of potential interference of the government in the day-to-day operation and business strategies of the firms. Governments should take this opportunity to review the economic rationale of the SOEs and whether support is not exclusively and unnecessarily granted to dominant firms, be they SOEs or private firms. As with the private firms, support to SOEs with structural issues that were incurring in losses prior to the coronavirus outbreak should be limited to the minimum. Support should also involve commitments to monitor and strengthen SOE corporate governance (Pop and Amador, 2020). More can be found in Annex IV.

In addition to financial support, policymakers should also prioritize reforms to the enabling framework with a focus on addressing insolvencies of corporates and MSMEs. As noted above, several countries have undertaken reforms to 'flatten the curve' of insolvency cases**.** These reforms are described in *Supporting Firm Resilience* (Freund and Mora, 2020) as "Phase 1" reforms designed avoid the insolvency system from being overloaded with cases. They are not, however, designed to respond to the longer-term functioning of insolvency systems as both liquidations and restructurings, resulting from the economic disruption of COVID-19, grow. While some countries may still need to undertake Phase 1 reforms, most will also need additional longer-term reforms. The scope and severity of these reforms, at individual country level, will depend on whether or not firm distress threatens to reach levels that may trigger a systemic financial sector crisis. These reforms may include centralized approaches to deal with systemic insolvencies and critical reforms to implementing institutions such as courts (Menezes and Gropper, 2020).

Well-developed insolvency and restructuring frameworks typically include a sanctioned (usually by court) debt restructuring process as one of the tools to address financial distress. These processes typically have elements of Out-of-Court Workouts (OCWs) and formal insolvency proceedings and are often referred to as "hybrid" or "quasi-judicial" processes. Annex I provides a taxonomy of different types of formal and informal insolvency proceedings. The advantages of the hybrid processes to a pure OCWs is that "standstill" periods can usually be invoked by filing a notice to court to commence a period of negotiation with specific financial creditors who are then subject to stay. In some jurisdictions (e.g. Spain) the commencement of pre-insolvency proceedings is public, in other (e.g. France) it is confidential and cannot be disclosed to public. Recently, with the introduction of the EU Directive on Preventative Restructuring, a number of countries have taken steps to introduce preventative hybrid restructuring procedures or to improve the already existing ones.

The typical features of these processes are the following:

- The restructuring plan is negotiated outside of the formal bankruptcy proceedings;
- There is a possibility to impose a court-ordered stay or a time-limited moratorium on individual enforcement actions;
- The process is accessible to a debtor in the situation of imminent insolvency;
- The agreed upon restructuring plan can be made binding on the dissenting minority creditors, including across classes of creditors ("cross-class cram down");
- There is no court-assessment at the very start of the procedure;
- The process does not affect the directors' ordinary management powers, i.e. the debtor remains in control of the day-to-day operation of the business. Where necessary, a neutral third party – a mediator or a supervisor - can be appointed by the court;
- There are provisions to protect new financing from avoidance actions.

Since the onset of the COVID crisis, several advanced economies have enacted such proceedings, in part as a recognition of the increased volume of cases expected. In October 2020, the Netherlands adopted a new pre-insolvency restructuring process. This new process enables debtors to elect to have their proceeding remain confidential (as an inducement to debtors to seek restructuring assistance while the firm is still savable) and allows for the development of restructuring plans outside of the formal bankruptcy process which, if approved, can bind all creditors and shareholders while preserving employee rights and claims. On January 1, 2021, a new scheme took effect in Germany that will permit debtors to reject burdensome contracts and access a court appointed mediator to assist in debt restructuring negotiations with creditors.

Several countries have taken action to shore up their insolvency systems by introducing new fast-track insolvency (restructuring and liquidation) procedures specifically for MSMEs. Even in normal times, MSMEs tend to be more financially vulnerable than larger firms; as shown in section 2, their vulnerabilities have been magnified during COVID-19 while the majority of insolvency systems, even in developed jurisdictions, are not prepared to handle a wave of MSME bankruptcies. The challenge for medium-sized firms is typically access to more traditional 'corporate' insolvency proceedings that are tailored to the needs of these firms. For individual micro-entrepreneurs, the objective is often to address what amounts to an individual insolvency, including through the discharge of debts, without undue moral hazard. To address this issue, several countries have introduced new fast-track insolvency procedures for MSMEs. Such is the case of the Republic of Korea where a new MSME procedure (the *Summary Rehabilitation Proceeding*) was introduced in 2015 and has led to substantial improvements in case duration. The simplified restructuring procedures are conducted outside the formal insolvency proceedings and are debtor-in-possession processes. Their complexity is further reduced by providing easier access (i.e. it is not necessary to meet the insolvency threshold and there are lesser requirements for documentation), easier plan approval mechanisms, reduced cost of facilitators/insolvency practitioners. Some of the common features of these procedures include: (1) a temporary stay or standstill against creditor actions and a suspension of directors' wrongful trading liability; (2) debtor management remaining in possession; (3) some supervision by a regulated professional (insolvency or restructuring practitioner); (3) fresh financing; (4) minimal or no reliance on formal insolvency procedures/courts. Unlike simplified restructuring procedures, simplified liquidation procedures involve greater court involvement but with lesser procedural complexity compared to the regular liquidation process.

More broadly, evidence shows that the regulatory environment for businesses can influence how well firms and economies overall cope with the crisis. Where business regulations are transparent and efficient and institutions ensure protection of property and contractual rights, it is easier for firms to adapt to new rules, reorient their economic activity to meet new market demands, and for new firms to start up. Countries with lighter regulatory burden and lower barriers to entry generally experienced increases in newly registered firms, higher productivity growth rates, and stronger reallocation of resources towards higher-productivity firms (Motta, Oviedo, and Santini 2010; Arnold, Nicoletti, and Scarpetta 2011).

In assessing the role of a large variety of factors on short, medium, and long-term resilience post-crisis in the European Union, Alessi et al. (2019) find that a favorable business regulatory environment matters particularly for long-term resilience and is associated with stronger economic bounce-backs. Sound labor and product markets, framework conditions that support firm entry and operations, and strong institutions increase resilience towards adverse shocks (Sondermann, 2016). Policy makers should shift their focus towards new areas of opportunity in order to build back better. This entails removing entry barriers, especially in priority sectors, enhancing policy certainty and investor protection to enable retention and expansion; and realigning policy and regulatory environments to facilitate reallocation of resources toward long-run economic transformation, job creation, and inclusion.

Despite the devastating impact of the crisis, it presents an opportunity to build back better in a more a green and sustainable way to accelerate climate change mitigation and adaptation. While not within the scope of this paper, which is more focused on the near-term approach, policymakers' medium to longer term strategy towards resilient recovery should consider how to accelerate a green recovery. This includes green business growth and green job creation, as well as policies to green the financial sector.

Fostering competition-enhancing policies and regulations helps increase business dynamism through greater entry and exit rates of firms. Emergency-situations like the one caused by COVID-19 require extraordinary measures. Single-source procurement, large amounts of state aid and antitrust exemptions may all be justified in times of unprecedented supply and demand shocks. Yet, this does not imply that response and recovery policies are at odds with competition principles. As with other policies, the remedies to deal with this pandemic have alternative designs - with some safeguarding competition more than others. Governments can still consider competition among the criteria for choosing the right intervention. In practice, to preserve a level-playing field, competition authorities can delay enforcement activities, and prioritize merger review. Authorities can still communicate that they will prosecute any ongoing anti-competitive practices, once regular enforcement activity can resume. Competition agencies can give guidance to industries on the activities that are exceptionally permitted. Authorities can actively monitor government interventions and propose gradual adjustments to emergency programs that safeguard contestability and competition. More can be found in Annex IV.

To help reduce uncertainty and address information asymmetries, authorities should pay particular attention to the transparency of support programs. Forbearance measures, targeted support to certain sectors or types of firms, and other interventions should have clear, measurable, and well-communicated criteria, ideally supported by data and diagnostics. Spending on support programs should be monitored, and amounts publicly disclosed (e.g., in annual reports). Particular attention should be paid to transparency when support beneficiaries SOEs or large firms, as well as ensuring that recipients adhere to principles of good corporate governance.

7. Looking Forward – How WBG Supports Countries

The WBG has a range of instruments to support firms that can be adjusted and expanded to address current challenges--mostly through Development Policy Operations (DPOs) and Investment Project Financing (IPFs) guarantees, lines of credit and equity instruments-articulated around the following pillars. Program for Results (PforRs) can also be used where the focus is on implementation.

1) <u>Better targeting of liquidity and support adjustment.</u> Broad-based emergency measures should have been time bound and can be phased out as conditions improve. The Bank and IFC can continue to provide liquidity support to recovering firms through banks, and NBFIs. Targeting programs toward high productivity firms in viable or essential sectors will preserve scarce resources while promoting growth. It will be important to ensure that IFC and WB design joint interventions to facilitate risk

sharing solutions, creates additionality and crowd-in private sector financing and capital. Particularly relevant will be to leverage the formal banking sector, NBFIs and microfinance institutions, with the latter two often not having access to traditional central bank liquidity facilities and needing additional support, including potentially through capital markets instruments ***This could be articulated through WB IPFs designed to provide lines of credit, equity components, and strengthen partial credit guarantees programs; WB DPOs to support regulatory reforms to facilitate these instruments; and through IFC credit lines to banks and NBFIs, local currency financing, guarantees and other financial solutions provided directly to the private sector in a manner that leverages public sector and eventually donors' resources.***

2) Facilitate the development of digital infrastructure, adoption of new technologies, and the creation of new businesses. Supporting the development of e-commerce and B2B solutions can help firms access new markets, increase matching efficiency and lower transaction costs, especially in a world where face-to-face interactions bring higher risk. GovTech plays a critical role to help governments become more effective and responsive to citizens and firms. FinTech solutions could be leveraged to level the playing field for women-owned or led MSMEs in terms of access to financing, offering an unprecedented opportunity to mitigate the impact of COVID-19, especially for those firms without prior access to the financial sector or to a large extent dependent on remittance flows. Support programs to foster the creation and scale of digital businesses are in demand as private investors park their resources in safer developed markets. MFIs, fintech companies, and SOBs can utilize the following to speed MSME loan decisions: (i) simplified loan application processes and remote customer due diligence/ Know Your Customer rules to facilitate emergency cash transfers (G2P) through digital means, (ii) the acceptance of digital payments for essential entities such as hospitals and pharmacies and (ii) the use of alternative data (leveraging artificial intelligence for instance). Additionally, financial institutions could leverage online platforms and capital market solutions for conducting reverse-factoring transactions that could facilitate supply-chain finance to MSMEs and shorten the maturity of the payments involved. ***This could be done with joint WB-IFC interventions using the range of instruments needed to accelerate the necessary reforms in DPOs and implementation through IPFs/PforRs that would facilitate digitalization of financial services, e-commerce development, GovTech solutions for service delivery and accountability, interoperability of payments systems, merchants' acceptance of digital payments. Innovative Fintech solutions can be supported through IFC investments, and helping firms build the necessary management, organizational, and technology skills to conduct business online.***

3) Ensure the financial sector has the capacity to provide the needed liquidity and support without jeopardizing its resilience: Unprecedented regulatory forbearance decisions will continue to need to be designed carefully to avoid increasing financial risk, especially in those systems that are already vulnerable. This calls for adequate reporting and monitoring of forbearance measures to be able to assess asset quality, provisioning, and capital adequacy on a continuous basis, with decisions that are state dependent, transparent and based on rigorous risk assessments. Monitoring of liquidity would be particularly relevant; often, other measures such as restricting the distribution of dividends and recapitalization of specific banks and NBFIs that are viable may be needed. Recovery and resolution planning for banks and strengthening deposit insurance funds may need to be updated, and NPL management frameworks put in place together with comprehensive insolvency and out-of-court processes. ***This could be achieved by a combination of reforms included in WB DPOs, IPFs, PforR to***

recapitalize safety nets, and IFC co-investments to recapitalize institutions and help to resolve distressed assets.

4) Create the enabling framework needed to restructure debt, providing financial support to firms during the recovery phase: The deterioration of the business cycle will have a large impact on the quality of assets and the capacity of firms to continue operating. Many firms will need to restructure their debt profiles and others will require to be promptly resolved to avoid an increasing number of zombie firms. The WBG needs to engage in the initial stages with authorities to strengthen the insolvency and resolution frameworks, including legal frameworks for corporate and consumer debt restructuring, and out-of-court conciliatory measures. The latter will be particularly important to prevent a surge in insolvency filings, value-destroying liquidations, and asset fire-sales, helping to preserve employment and also reduce pressures on bank balance sheets which impair their functioning and stability. In many countries the WBG could facilitate, promote and design systemwide corporate resolution mechanisms or "Recovery Funds". ***This could be implemented by a combination of WB DPOs to create the enabling framework and the design of recovery interventions with different WB instruments (IPFs, PforRs) and IFC financial instruments. Such interventions should be designed with an exit strategy in mind to release public resources and let market forces function post recovery.***

5) Undertake reforms to enable firm entry and expansion. Countries can focus on improving overall ease of doing business to lower regulatory costs and risks to businesses and accelerate digitization of G2B services; risk-based and safe reopening of the economy; and strengthening institutions. Policy makers should shift their focus towards new areas of economic opportunity. This entails removing entry barriers, especially in priority sectors in light of market shifts following the pandemic; enhance policy certainty and investor protection to enable retention and expansion; and realigning policy and regulatory environments to facilitate reallocation of resources toward long-run economic transformation, job creation, and inclusion**. *In many countries, the WBG is using a combination of DPOs, IPFs, PforRs and supplementary ASAs or IFC advisory to design and implement investment climate reforms for economic reopening and recovery. Since the outbreak, for example, the WBG has supported at least 70 countries directly through policy lending and advisory services around regulatory flexibility, improving women's economic opportunities (e.g. Women, Business and the Law reforms), increasing investment retention, and tapping new GVC opportunities.***

6) Preserve incentives for recovery and a level playing field. During the crisis recovery and for building forward, it will be important for all the countries to undertake reforms that reinvigorate competitive pressures to stimulate productivity growth. A first step is to ensure that recovery measures do not create unintended consequences and permanently lock in market structures with lower competitive pressure. It will be important to re-establish transparent and competitive public procurement processes, limit bailouts to companies that already had a good track record, ensure that ongoing state support is granted in a transparent and non-discriminatory way, and refrain that price controls are permanently used to stabilize prices across food and non-food markets. Beyond doing no harm, countries will need to enhance competition policy enforcement and consumer protection, particularly as regards digital platforms, where restrictions on commercial use of data or open access initiatives may be warranted. Competition policy will entail increased vigilance and investigations of potential collusive practices, ending antitrust exemptions that allowed for information sharing among competitors in online and offline markets during the crisis, consideration for remedies and insolvency risks on a case-by-case basis during merger review and proactive approaches to ex ante regulation to preserve the right market incentives (Pop and Amador, 2020). ***Targeted WBG support can be***

achieved through a combination of DPOs/IPFs/PforRs, ASAs or IFC advisory to design and implement pro-competition interventions for economic recovery.

7) Collect data to monitor and analyze COVID-19 impact on firms and effectiveness of policy support. Continued monitoring of how businesses are affected by and responding to the shock, as well as the effectiveness of government support programs and policy changes, will help shape better policy and prioritize the use of scarce fiscal resources. The WBG can support data collection to monitor COVID-19 impacts on firms and policy responses (e.g. COVID-19 Business Pulse and Enterprise Surveys and Insolvency Reform Tracker – an expanded list of WBG efforts to track and monitor various types of policy responses by governments around the world since the onset of the crisis can be found in Annex II). It can also help clients with data analysis and provide technical assistance to countries to strengthen data collection to ensure policy support is targeted as accurately as possible.

Annex I. Spectrum of Insolvency Processes

Formality	Procedure		Advantages	Disadvantages	Level of Distress		Key Considerations for Enabling Environment*
Workouts	Out-of-court workouts	E.g. The London Approach; INSOL Principles)	– No legislative process required (in some cases non-binding guidelines may be adopted by a government agency to encourage standardized multi-creditor behavior) – No court involvement – Confidential, flexible and fast – Cost-effective (no court or insolvency practitioner costs) – Option to select creditors to negotiate with	– Coordination problems and risk of creditor holdout – Risk of creditor actions during the negotiation period (insolvency filing or individual debt enforcement actions) – Risk of avoidance actions in subsequent insolvency (unless insolvency law impedes revocation of good-faith informal workouts) – No scrutiny of management's behavior pre-restructuring	Financial difficulty	Imminent insolvency	✓ Negotiation culture among creditors and debtors ✓ Availability of financial information (refer to WB-ICR Principle B1**) ✓ Existence of contract rules that allow modification of debts and establish good faith requirements for the parties to the contract ✓ "Shadow of law" (availability of recourse to debt enforcement, liquidation and/or reorganization proceedings)
	Enhanced workouts	E.g. Republic of Korea Financial Institutions' Agreement for Promotion of Company Restructuring; Thailand's CDRAC; Istanbul Approach)	– No legislative process required (but in some cases corporate restructuring laws may be passed to enhance the effectiveness of the system) – No court involvement (but often another coordinating institution involved, e.g. financial supervisor) – Cooperation reinforced by fiscal and regulatory incentives (e.g. tax exemptions, regulatory forbearance, modified labor standards) to restructure and/or penalties for failure to meet deadlines – Possible to bind dissenting creditors that are part of the inter-creditor accord	– Fiscal and regulatory incentives can distort incentives of market participants and prop-up non-viable businesses – Often involve fiscal costs – Restructurings only cover certain creditors as part of the inter-creditor accord– trade creditors, tax claims, labor claims normally excluded – Debtor not a party to the inter-creditor accord and therefore does not have a say on the workout process – Limited effectiveness for borrowers with only one financial creditor (often micro and small enterprises)	Financial difficulty	Imminent insolvency	✓ A strong, proactive coordinating agency (usually a central bank/financial supervisor) (refer to WB-ICR Principle B4.1) ✓ Cooperative FIs (inter-creditor accords should cover all or almost all FIs) ✓ "Shadow of law" (availability of recourse to debt enforcement, liquidation and/or reorganization proceedings)
	Hybrid workouts	E.g. US Chapter 11 pre-packaged bankruptcies; UK scheme of arrangement; Singapore's scheme of arrangement (2017); Dutch confirmation of extra-judicial restructuring plan procedure (2021); French conciliation procedure	– Combines speed, flexibility and informality of purely contractual restructurings with the benefit of access to formal processes in court to preserve the going concern business value – Reduced stigma and publicity while negotiations are ongoing	– Due to informality, may lead to inefficient and/or unfair outcomes for minority creditors – The court may find that pre-bankruptcy disclosure was inadequate and refuse approval of the restructuring plan (see, for e.g. Section 1125(a) of the US Bankruptcy Code)	Financial difficulty	Imminent insolvency	✓ Adequate expertise and capacity of courts ✓ Availability of financial information (refer to WB-ICR Principle B1) ✓ Enabling legislative framework (refer to WB-ICR Principles B3 and B4) ✓ Availability of recourse to debt enforcement, liquidation and/or reorganization proceedings

* It should be noted that country approaches to the design of insolvency and restructuring processes vary. It is important that countries, when adopting these processes, consider the unique context of their legal and commercial systems.

** The World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes. Available at: www.worldbank.org/insolvency

	Preventative hybrid workouts	E.g. Germany's pre-insolvency scheme ("StaRUG"); French safeguard procedure	– Provides for court-imposed stay – Includes statutory protection of new finance – Can bind dissenting creditors ("cram-down" feature) – May provide for court and insolvency practitioner oversight and assistance (e.g. judicial resolution of disputes) while debtor continues to control its assets and business operations (debtor-in-possession)	– Same as above – Can be costly as usually an insolvency practitioner must be appointed – Usually public (which can be associated with stigma)	Financial difficulty	Imminent insolvency	✓ Adequate expertise and capacity of courts (refer to WB-ICR Principles D1-D6) ✓ Availability of qualified insolvency practitioners (refer to WB-ICR Principles D7-D8) ✓ Enabling legislative framework ✓ Availability of recourse to debt enforcement, liquidation and/or reorganization proceedings
Formal insolvency procedures	Judical reorganization	E.g. France's judicial reorganization procedure - *redressement judiciaire*; US Chapter 11 judicial reorganization procedure; UK administration procedure	– Provides access to all formal mechanisms to preserve the going concern value of business (stay, challenge of fraudulent or preferential transactions, continuation of essential contracts, etc.) – Protects new finance – Plan can bind dissenting creditors – Allows amendment of contracts – Provides for substantial court and insolvency practitioner oversight – Some aspects may be simplified for micro and small enterprises	– Usually costly and lengthy – Can be disruptive to business operations – Sometimes delays inevitable liquidation – Publicity, stigma – The process is driven by court and insolvency practitioners (debtor removed from management in some systems)	Imminent insolvency	Insolvency	✓ Adequate expertise and capacity of courts (refer to WB-ICR Principles D1-D6) ✓ Availability of qualified insolvency practitioners (refer to WB-ICR Principles D7-D8) ✓ Insolvency legislation enabling and detailing the formal reorganization procedure (refer to WB-ICR Principles, Part C)
	Liquidation	E.g. UK liquidation procedure; Republic of Korea bankruptcy proceeding	– Enables orderly exit of non-viable business from the market and distribution of the proceeds to creditors – In some cases, sale of business as going concern can be achieved, thereby preserving its continuity – Some aspects may be simplified for micro and small enterprises	– Low creditor recovery (quick diminution in value) – Can be lengthy – Auction process can be non-transparent – Bailiffs/sheriffs might not have adequate training or protections for the seizure and sale process – Movable property might not be traceable	Insolvency		✓ Adequate expertise and capacity of courts (refer to WB-ICR Principles D1-D6) ✓ Availability of qualified liquidators (refer to WB-ICR Principles D7-D8) ✓ Insolvency legislation enabling and detailing the liquidation procedure (refer to WB-ICR Principles, Part C)

Definitions

Out-of-court workout – a privately negotiated restructuring between the debtor and all or some of its creditors
Enhanced workout – a workout with the involvement of an administrative authority but with no provision for a court to play a role
Hybrid workout – a procedure that involves private negotiation of a restructuring agreement and provides for a court role short of supervision of the full procedure
Preventative hybrid workout – hybrid procedure aimed at restructuring, while under court protection, of a debtor's business that is in financial distress but not yet in a technical state of insolvency
Judicial reorganization – a court-supervised restructuring process aimed at restoring the financial well-being and viability of a debtor's business
Liquidation – a court-supervised process by which assets are sold and disposed for distribution to creditors, in accordance with a ranking of claims established by law

ANNEX II: Overview of World Bank Policy Trackers related to Firm Support

Name of tracker	Scope (type of firms, sectors, etc.)	Measures tracked	Unit (number, $, %)	Sample size (no. of countries)	Main results
SME COVID-19 Policy Response Dashboard	Measures to support private sector firms, especially SMEs, in all sectors of the economy.	Measures tracked are classified in eight categories: Business advice, Business climate, Business costs, Debt finance, Demand, Employment support, Tax, Other finance	Number of measures. Details on amounts or number of beneficiary firms are spotty and only available in a few cases	1,600 measures in 135 countries	The database helps understand which support measures have been most commonly used, distinguishing by country income levels and region. Income levels, administrative capabilities, fiscal space, size of the informal sector, among other factors, may affect the number and type of measures adopted.
State support and aid tracker; including related SOE tracker	Approved subsidies and state aid measures to support firms of all sizes, types (SME, large companies, SOEs) and all industries in response to Covid-19; the associated SOE tracker also includes measures to support companies with state participation or private companies where support would imply transformation in the ownership structure.	State guarantees (for loans or trade credit insurance), tax advantages, wage subsidies, grants, loans and repayable advances, subsidized and subordinated loans, suspension/rebates for input costs, direct purchase of goods, equity, packages of multiple measures. SOE tracker includes additional data on capital injections, equity transactions (purchase of shares and M&A), loans, government guarantees, grants, PPP, creation of SOEs, subsidies and tax deferrals.	Number of measures, targeted sector, type of measure, description, value in original currency and USD, recipient firms, measure objective, government participation (%), type of measures, and presence of sovereign wealth funds (SWF)	611 measures in 124 countries SOE tracker: 174 measures in 75 countries	At least USD 8.4 trillion in state aid committed as of November 20 2020; around 5% of state aid measures that specifically target SOEs; around 32% target MSMEs/SMEs, 11% target large enterprises and 45% all enterprises; around 40% of schemes target specific sectors, of which 30% target air transport (12% of total schemes), 16.5% agriculture (7% of total) and 15% tourism (6% of total); 25 countries across regions (EAP, ECA, LAC, MENA, North America, SSA) implemented state aid measures directed at SOEs. Capital injections are the most common form of intervention when targeting SOEs (30%) overall. However, the instruments used varies depending on the presence of SWF and the level of state participation.
Financial Policy Response Compendium	Financial sector firms and their borrowers and clients	Support to borrowers through financial sector; central bank support (liquidity), prudential, payments, conduct, integrity, insolvency	Number of measures	Over 3400 measures in 156 countries	Compendium report (link here) 52% of measures in support of banking sector globally (mostly prudential and support for borrowers), 25% liquidity measures. Moratoria represent 10% of Banking sector measures; 9% for relaxation on treatment of NPL.

[Insolvency tracker]()	Economies	Insolvency and insolvency related measures	Number of measures	62 economies	Over 90% of economies introduced insolvency or insolvency related measures. The most common type of measures were mandatory contract modification measures, addressing either the prospects of repayment or the effects of non-payment. These measures were introduced by 82% of the economies in the tracker.
[Competition policy tracker]()	Competition policy actions implemented by governments, incl. competition authorities and other regulatory bodies across all continents	Cooperation and collaboration among competitors, price controls (fixed or maximum prices), actions against price gouging, temporary relief of competition laws and/or regulation, undue regulatory barriers, expedited public procurement, simplified merger review procedures and penalties for anticompetitive conduct	Number of measures, type of measure, sectoral/horizontal approach	146 measures across 64 countries (+EU)	Around 60% of measures are implemented in high income countries, 42% in ECA and 20% in EAP; 40% of measures allow cooperation and collaboration among competitors, 26% concern price controls and 23% involve actions against price gouging; 76% of measures target specific sectors/product groups, importantly Hygiene and medical products (32% of total), Food (20% of total), Air transport and Utilities (6% of total each)
[Industry-specific policy tracker]()	Government measures to support specific sectors and industries affected due to COVID-19 pandemic.	Business climate, business costs, business upgrading, debt finance, employment support, green/climate, investment/capital, other finance, production, regulations, support to demand, tax	No. of measures implemented by country, region, income level, sector and subsector	238 measures for 95 countries	More than 238 industry-specific measures have been implemented across 95 countries mostly in the form of debt support, investment and tax allowances, and reduction of business costs (e.g. fees rebates).
[FDI Entry and Screening Tracker]()	Investment policy measures related to the entry of foreign investment in all sectors of the economy adopted in the context of Covid-19 across the globe.	Barriers to investment entry including: screening mechanisms, restrictions on hiring foreign workers, restrictions on land ownership, restrictions on foreign capital ownership Measure facilitating the entry of investment: Opening a new sector to FDI, increasing foreign equity ceiling, streamlining foreign worker permits, streamlining land ownership	Number of measures	64 measures in 41 countries	Provide an accurate and regularly updated in-depth database on countries' responses to the Covid-19 pandemic as it relates to FDI flows. The database appears to support the hypothesis that countries are enhancing protectionism to combat the effects of Covid-19; with 71% of the measures being barriers to investment entry. Out of those restrictive measures 80% are screening measures, and OECD countries were the most active countries in restricting FDI (74% of the restrictive measures). [Many observations can be made from this dataset that can be found here]()

ANNEX III – Sector Specific Considerations (Tourism)

Tourism. As a people-based and travel-reliant sector, tourism is one of the sectors hit hardest by the COVID-19 pandemic. There was a 73.9 % decline in international arrivals in 2020 compared to 2019 (UNWTO, 2021). Up to 120 million jobs may be at risk, more than half held by women and youth.

SMEs make up more than 80 % of the travel and tourism sector. In the face of complete cessation of demand, SMEs need support to address immediate liquidity challenges to limit firm closures and prevent widespread layoffs. Tourism SMEs also need regulatory flexibility to ease the pressure on cash outflows. Because tourism relies on an ecosystem of SMEs including attraction sites, wildlife, parks, restaurants, artisans, entertainers, airlines, taxis, marketing, baggage handlers, airport concession suppliers and others, helping to prevent breaks in the SME supply chain are critical to the whole sector.

Measures put in place by governments to save SMEs in tourism are similar to those in other sectors but in general have had to last longer. These include short to medium term direct financial support, wage assistance schemes to reduce layoffs, and cost reductions (tax, tourism authority levies, fees etc.) and medium to long term low-interest loans, debt financing, product redevelopment, and restructuring.

While immediate responses have taken a "one-size-fits-all" approach, longer term approaches need to be more strategic, allow for the protection of critical assets in the supply chain, facilitate digital uptake, a transition to greener operations and enable labor mobility.

- Direct support should be tailored to the type of firms, the amount of resources available and the administrative capacity of each country. Measures should be transparent, and time-bound.
- Assistance to firms can include: clearing public arrears and expedite payments, with a focus on SME suppliers; mutualizing losses of small businesses by issuing tax credits, providing direct transfers, extending guarantees for receivables, and/or lending on a concessional basis; introducing borrower relief measures such as reprofiling debt service repayment schedules; and allowing for the time-bound and transparent deferred recognition of NPLs on bank balance sheets.
- Special assistance may also be needed for micro firms in the tourism sector such as tour-guiding and operation companies which typically lack the ability to access finance due to informality or lack of collateral. These firms in particular can benefit from support for digitization, digital marketing and sustainability improvements.
- Support may also need to be channeled to firms that have higher potential to: lead recovery through stimulating demand, tap into larger financial and organizational capital (which may be difficult to replace), and those with greater capacity to support smaller and other less resilient firms in the supply chain.
- Finally, governments will also need to invest in reopening strategies including promotions especially those focused on building traveler confidence and on sectors with demonstrated pent up demand, product development, sustainability and health assurances, and insurance products to help attract back old and new domestic travelers. Public investments should be guided towards sustaining key assets and supply linkages in destinations and positioning them for greater resilience. During the restructuring phase it will be necessary to support firms in changing business models by mobilizing innovation and technology e.g. virtual tourism experiences, ecommerce etc.

Good practice examples of tourism sector support include:

- COVID Support Hub (Ireland). Fáilte Ireland, the National Tourism Development Authority of the country, has a COVID Support Hub that highlights learning resources for individuals and businesses to increase their competitiveness and navigate the recovery period. The hub also includes advisory resources on key topics such as operational cost management.
- Tourism Transitions Program (New Zealand). New Zealand's Ministry of Business, Innovation, and Employment has begun a Tourism Transitions Program to deliver advice and support to businesses interested in pivoting to the domestic or regional (Australian) market.
- Support measures (Croatia). Croatia implemented a set of measures to support tourism businesses including postponing payment of fees, tourism taxes, and increasing their liquidity. Besides tourism specific measures, general economy interventions support the sector by including tourism in the scope of the Export Guarantee Fund with the aim of enabling the issuance of guarantees for loans to banks for additional liquidity.

Many policies have been driven by an overwhelming desire to "return to normal" as soon as possible. Yet for many tourism destinations, the future may look quite different. There may be a shift toward domestic and regional markets. There is also expected to be a shift toward local supply chains, and greener and more circular business models that advance sustainability in the sector. This is an opportunity to accelerate change towards localization, digitalization, and sustainability that will build sector resilience in time for the next crisis.

ANNEX IV – The Rise of the State

COVID-19 has been disruptive for all economies - large firms and SMEs have been facing severe financial distress and with high levels of uncertainty ahead, some firms are exiting the market or being merged. The unprecedented magnitude and length of the COVID shock is changing the business landscape and is triggering government measures worldwide.

To avoid market disruption, ensure the provision of key goods and services, and protect jobs, worldwide governments are providing policy responses through multiple channels of support including direct loans, state guarantees, debt relief measures, among others. As of early February 2021:

- Subsidies and state aid tracker includes more than 650 approved measures directed at private firms and SOEs across 125 countries (EAP, ECA, LAC, MENA, North America and SSA). It indicates that state aid has taken multiple forms, such as grants (25% of measures), subsidized loans (14%), state guarantees for loans (13%), tax advantages (9.3%), wage subsidies (4.3%), multiple measures (20.4%), among others. Around 5% of state aid schemes across 25 countries specifically target SOEs, many in air transport.
- Further, SOE policy measure tracker shows that more than 175 measures implemented across more than 75 economies have been targeted towards companies where the government has any level of ownership, surpassing USD 889 billion in January 2021. The instruments and conditions provided are not always the same: Capital injections (30%) and purchase of shares (13%) are the most common instruments of intervention for majority owned SOEs, while loans are provided to minority SOEs. In 11% of the cases identified, SOEs with less than 25% (not even blocking minority) received more than USD 24 billion in support. One in every 3 SOE-measures identified come with ownership strings attached increasing the participation of the state (e.g., Lufthansa loan connected to increased state participation up to 20%). Instruments also vary depending on the presence of SWF. For instance, capital injections and mergers among SOEs are more likely to occur in countries with SWF.[17] The tracker also reveals that SOE support is targeting mostly companies in commercial and contestable sectors: 47% in aviation, 11% in manufacturing (automotive, pharmaceutical, and PEP.
- The industry-specific policy tracker reveals that more than 251 industry-specific measures have been implemented across 97 countries mostly in the form of debt support, investment and tax allowances, and reduction of business costs (e.g. fees rebates).
- Finally, the competition policy tracker includes 124 competition policy measures across 64 countries put in place by governments to provide relief and exemptions from competition rules. Around 40% of measures allow cooperation and collaboration among competitors, 26% concern price controls and 23% involve actions against price gouging. Most measures (76%) target specific sectors or product groups. For example, competition measures in hygiene and medical products (32% of total), food (20% of total), air transport and utilities (6% of total each) are most common. These measures would require monitoring to avoid long-lasting market distortions.

Many of these emergency policy interventions have as objective the provision of undisrupted public services or goods. However, these policy interventions can have unintended consequences in the market dynamics in the short and medium-term, especially in scenarios where certain market players benefit from the government support on a preferential basis. For instance, a detailed analysis on the measures implemented in the aviation industry highlighted that state-owned airlines received 6.8 dollars vis-à-vis 3.2 dollars allocated to private companies of every 10 dollars provided by governments to support the

[17] The SOE definition in the tracker includes all companies with any level of government participation and is not limited only to controlled firms (e.g. 50%+ government participation).

aviation industry as of June 2020 (Martinez et al 2020). This points out the risks of SOEs benefiting from government support that might not be available under the same conditions for private firms with impactful effects on competition (e.g. exit of highly productive firms, higher concentration) and potential delays on the process of recovery (Pop and Coelho 2020).

- **Some government interventions state a clear policy objective and rationale for the provision of the support specially when targeted to SOEs, although it is not always the case**. Some governments have argued the need of SOE-specific interventions as the instrument to protect jobs, guarantee service continuity of essential services, and ensure the provision of key goods under the potential disruption of GVCs. However, there is evidence of the expansion of the state as market player in commercial sectors (e.g. automotive, steel manufacturing, accommodations services). There is also evidence of business consolidation strategies among SOEs, in addition to those involving private players, that could lead to more concentrated industries after COVID. For instance, in Indonesia the government is merging 8 SOEs in the accommodation sector with the state-run airline to create a large holding company with the objective of offering lower prices than private competitors and boost tourism. Although related to a policy objective, governments should assess the costs and benefits of the measures, identify the appropriate target and instrument of support, and protect market-based incentives for private activity.
- **As public resources are scarce, governments need to consider if support to specific SOEs is the best use of limited resources.** Governments should take this opportunity to review the economic rationale of the SOEs and whether support is not exclusively and unnecessarily granted to dominant SOE, especially in countries with a large SOE footprint. Support to SOEs with structural issues that were incurring in losses prior to the coronavirus outbreak should be limited to the minimum. Support should also involve commitments on measures to monitor and strengthen SOE corporate governance.
- **Criteria for the state to intervene through direct or indirect measures need to be defined and exit strategies would require to be in place**. The purchase of shares and increased state participation should be considered as a last resort and if deemed needed, it requires the design of a clear exit strategy. Similarly, capital injections or full-scale nationalizations should avoid potential market distortions associated with state participation in commercial sectors. Objective criteria and clear conditions should be included to ensure that state support translate into pro-competitive business environments. For instance, governments can impose additional measures to protect contestability of the markets and promote other policy objectives. Other measures such as environmental standards can also be justified in exchange for state support. However, it is recommended that measures are carefully designed to respond to a specific objective and do not distort market conditions even further.
- **Independently of the specific form of support, the government intervention should be carefully assessed through the competition lens such that risks for distorting market incentives or crowding-out market players can be mitigated**. Principles of transparency and accountability are also essential to shape the government interventions particularly to minimize the potential interference of the government in the day-to-day operation and business strategies of the firms, including SOEs (Pop and Amador, 2020). Any support provided should be transparently assigned, recorded, and disclosed. Asymmetric conditions for accessing support for SOEs vis-à-vis private companies should be avoided and governments should prioritize the assistance on economic and transparent variables (e.g. employment), whereas ownership structure should not be a decisive

variable (e.g. SOE vis-à-vis private company). Transparency and accountability mechanisms are determinant to avoid specific support is disguised in the form of capital injections, reduced fees to SOEs, or grants to favor specific companies that could create undue advantages for some companies in the industry.

FIGURES

Figure 1: Uncertainty in developing countries vs US

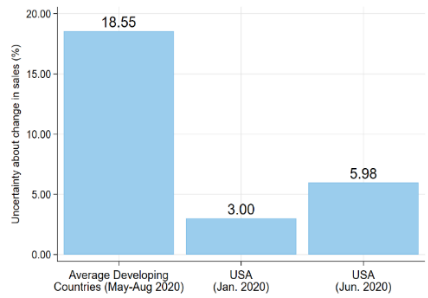


Figure 2: Businesses in arrears

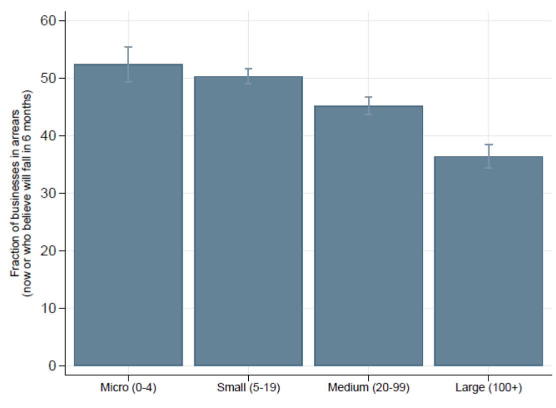
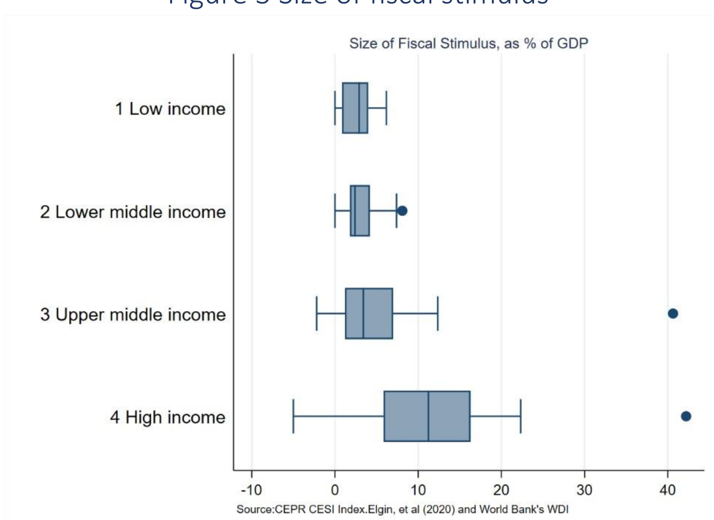
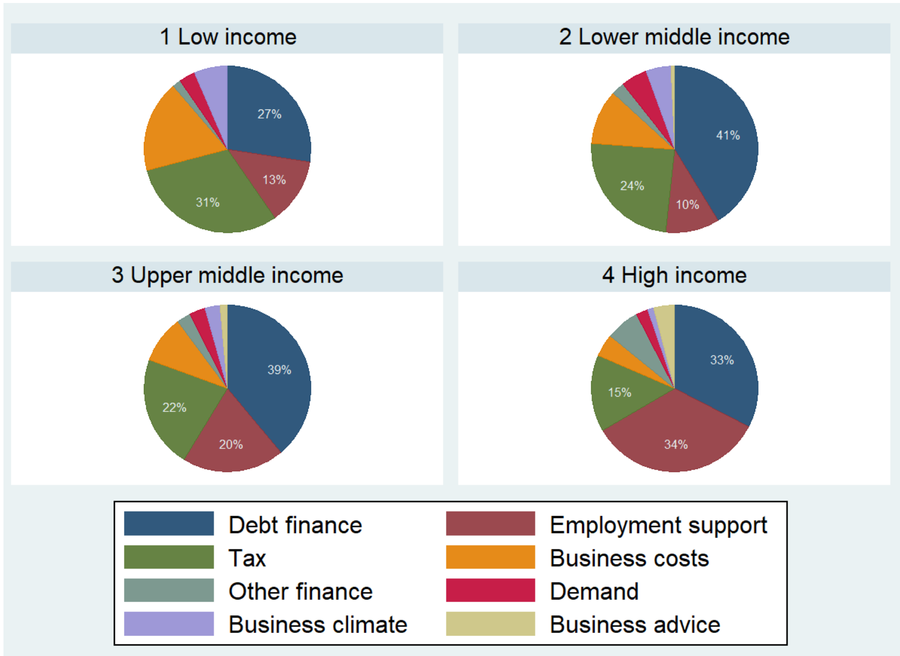


Figure 3 Size of fiscal stimulus



Country income groups are defined according to the World Bank's World Development Indicators definition.

Figure 4 Policy responses by country income groups



Note: Country income groups are defined according to the World Bank's World Development Indicators definition.

Source: World Bank Group, Map of SME-Support Measures in Response to COVID-19

Figure 5 Preferred policies by size and formality status

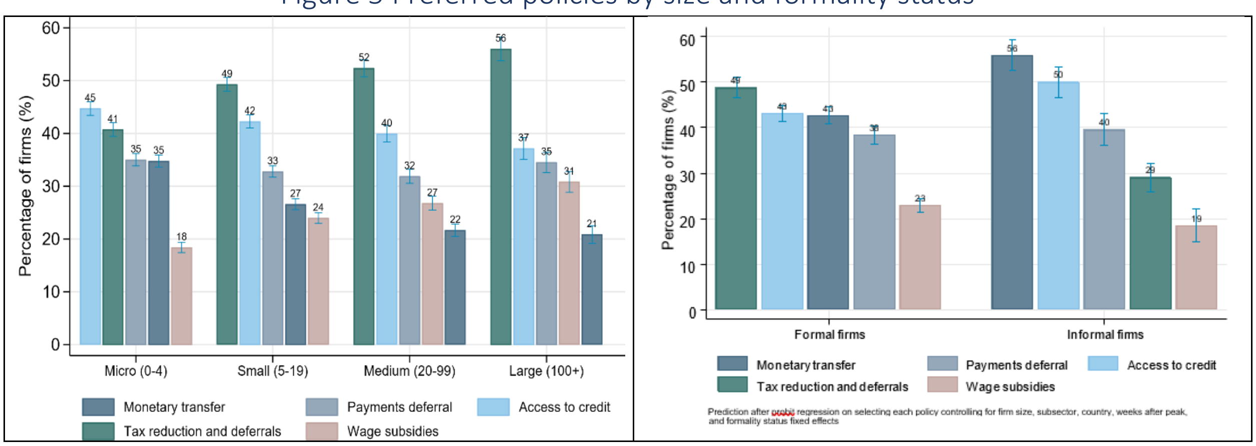


Figure 6 Access to public support by countries’ income groups

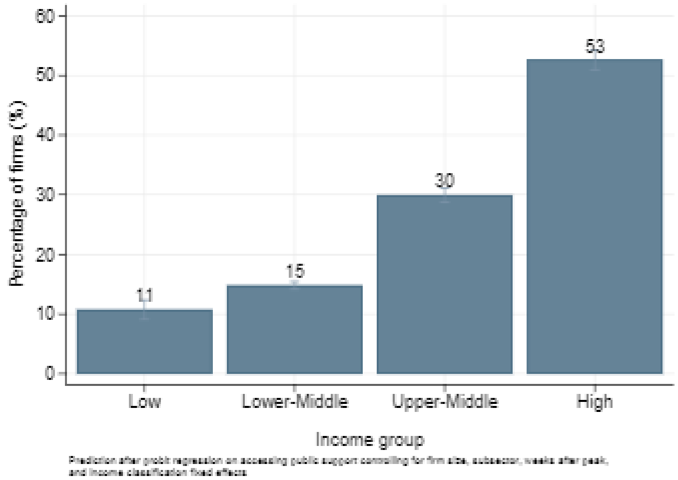


Figure 7 Received policies by size and sector

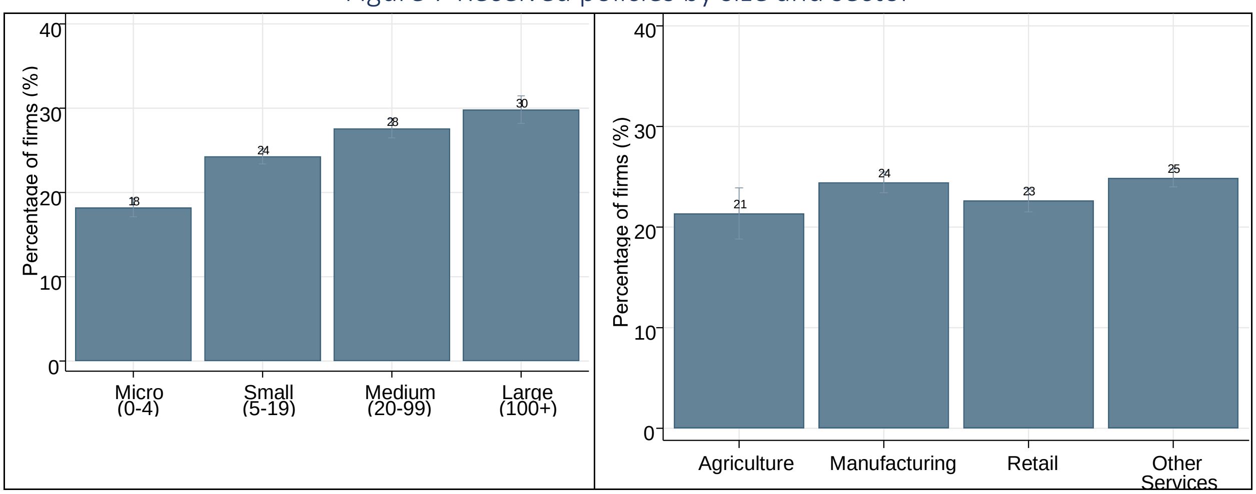


Figure 8 Reasons for not receiving policy support

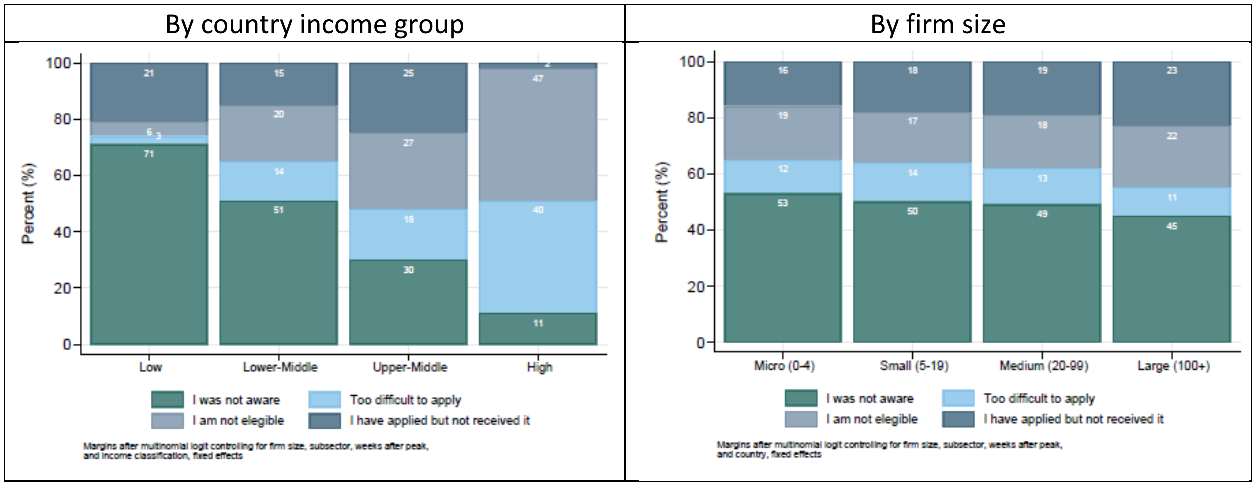
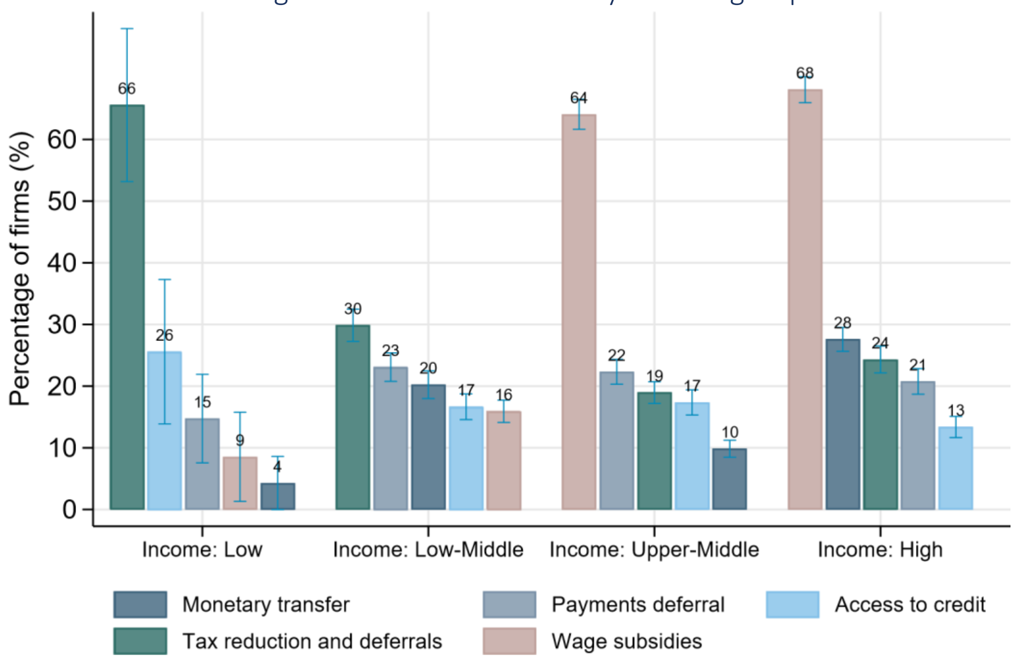
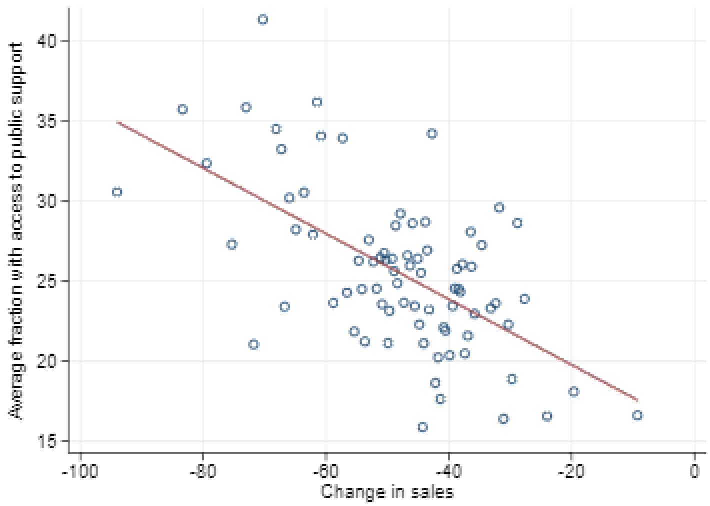


Figure 9 Received Policies by income group



Prediction of a probit regression of policy received on firm size, subsector, number of weeks from the peak of the mobility, restriction and income classification fixed effects

Figure 10 Access to public support and change in sales



Note: For each sector in each country we compute the fraction of businesses with access to public support and the average change in sales. The figure is the binned scatterplot of this relationship after removing country fixed effects.

Figure 11 Access to public support by type of shock received

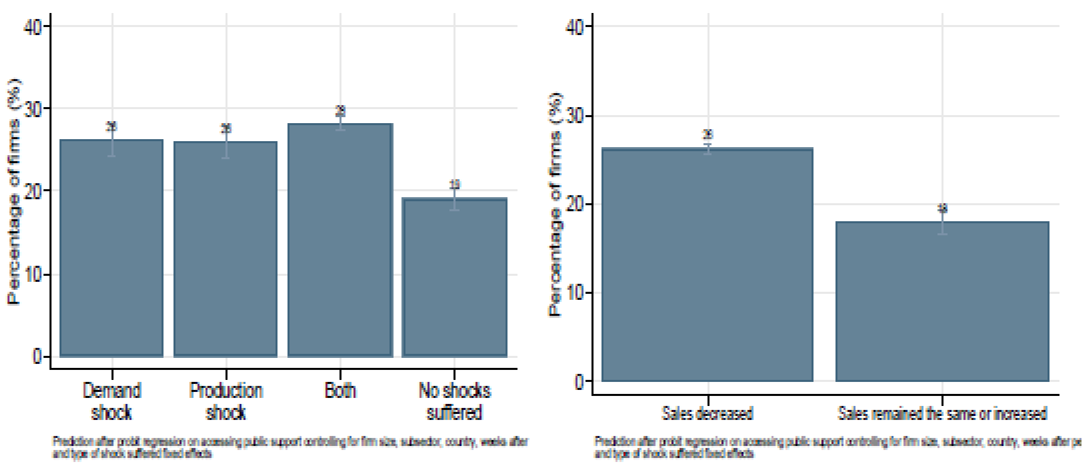
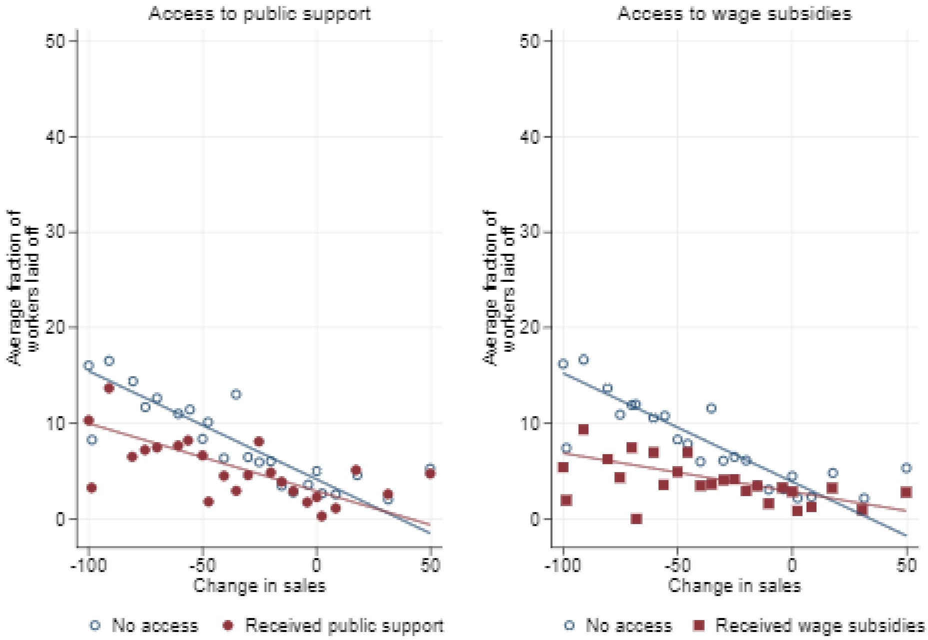


Figure 12 Share of workers fired and access to policy support



Note: Binned scatterplots. Computation use weights equal to the inverse of the number of observations in each country.

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