A Struggling Recovery for the Private Sector in North Macedonia

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As the COVID-19 pandemic has continued to take its toll on human life, businesses in North Macedonia have continued to struggle despite a return to some normalcy. This note examines the state of the private sector in North Macedonia by comparing the performance of businesses during the period of adjustment to the pandemic in April 2021 with the initial impact in September 2020 and the baseline before the crisis, drawing on a standard round of the Enterprise Survey in 2019 and two follow-up surveys in 2020 and 2021. While the second round of the follow-up survey revealed signs of some early-stage recovery, on average firm sales were still worse off than at the outbreak of the pandemic. Small and medium enterprises (SMEs) have been facing difficulties obtaining financing and were more likely to be overdue on their financial obligations than in fall 2020. A quicker and stronger recovery could be promoted through sound policies that aim at increasing access to financing, enhancing digitalization, and improving firm management and human capital, as well as the effective implementation of insolvency procedures.

The COVID-19 pandemic has affected the economic well-being of individuals and firms alike. To assess the impact on firms, the World Bank has been examining the performance of firms before and during the pandemic. In October 2019, the World Bank completed a standard round of the Enterprise Survey in North Macedonia, comprised of a representative sample of 360 nonagricultural, privately owned firms that employ 5 or more workers. A year later, following the outbreak of the coronavirus, the same businesses were re-interviewed for a first-round follow-up to assess the impact of COVID-19 on their performance. Firms faced a sharp drop in sales due to containment measures and a related decline in demand. More than one-third of jobs in the sectors surveyed have been supported through the state-funded job retention program; unfortunately, some 13 percent of jobs were lost (Jolevski and Madzarevic-Sujster 2021). To examine the recovery process, a similar survey was administered again on the same sample of firms in May 2021. While there are some signs of a recovery taking place, many indicators remain below the pre-pandemic levels.

Sales Are Recovering, but Are Still Below Pre-crisis Levels

While the recovery from the COVID-19 crisis was underway in spring 2021, many businesses continued to deal with declining sale revenues. The fall 2020 analysis showed that the initial shock of the pandemic resulted in an average sales decline of about 30 percent between September 2019 and September 2020. The first round of the survey showed a somewhat indiscriminate impact across sectors, sizes, and regions, with the foreign-owned firms being least affected. In April 2021, businesses continued to suffer, with an average year-on-year decline of about 7 percent, despite April 2020 being one of the months with the most severe restrictions to mobility and operations. However, for some, such as firms based in Skopje, those that are foreign owned, or those engaged in provision of services, the recovery has been underway, while sales have continued to decline for manufacturing firms and those in the western part of the country (Figure 1).

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Firm Closures Accelerated

The persistent decline in sales has resulted in a greater share of businesses ceasing operations for good, as many liabilities remained overdue (Bosio et al. 2020). While the COVID-19 pandemic exhibits some signs of a Schumpeterian cleansing of unproductive firms—and in particular small firms lacking innovation, the reallocation of resources requires further examination to determine whether this process is welfare enhancing (Muzi et al. 2021). Since the onset of the COVID-19 pandemic, at least 2.5 percent, but no more than 16.1 percent, of businesses have permanently closed (Figure 2). In September 2020, permanent closure of firms was less than 1 percent. Business closures were more prevalent among the manufacturing sectors and non-exporting firms (Figure 3).

Government Assistance Has Remained Important to Protect Jobs

The decline in sales and closures of firms have had a direct impact on the labor market. Net employment levels for firms that were successfully interviewed in all three surveys—the standard Enterprise Survey, and both COVID follow-up surveys—exhibited a net decline in...
employment of about 7 percent since October 2020, indicating that businesses continue to struggle (Figure 4). Of the firms that received government assistance, 91 percent received some form of wage subsidies. Nearly half of the businesses surveyed made use of the government-funded job retention program, subsidizing about 68,700 jobs since the start of the pandemic—an increase of about 37 percent since September 2020. When businesses were asked what form of assistance is most useful to them, the most popular response, reported by nearly 35 percent of firms, was wage subsidies followed by tax exemptions, chosen by 25 percent of firms.

Financing Remains a Constraint

The prolonged nature of the COVID-19 pandemic affected firm finances. By October 2020, nearly 70 percent of businesses had experienced cash flow or liquidity shortages. That share fell to about 43 percent by May 2021. The reduction of liquidity among leveraged businesses can pose a risk to their ability to meet financial obligations. The most affected firms are SMEs. Twenty percent of small enterprises and 10 percent of medium enterprises were overdue on their financial obligations as of spring 2021 (Figure 5). Access to new credit since the start of the pandemic also became more difficult for SMEs. More than 17 percent of small enterprises and 15 percent of medium enterprises that applied for a loan were rejected in their most recent application. Emerging evidence suggests that firms with better access to finance have been significantly less likely to experience a decline in sales during the pandemic (Amin and Viganola 2021), especially if they were financially constrained even before the crisis (Bosio, Djankov, and Jolevski 2020). On the other hand, only about 4 percent of large firms in North Macedonia were overdue on their financial obligations or had a loan application rejected.

Some 37 percent of firms continued to delay payments to their suppliers. While the share of firms that had delayed payments to suppliers fell since September 2020, this practice remains the avenue with which businesses are coping with liquidity shortages. Seventeen percent of firms have delayed payments to landlords, while a majority of firms remained current on their financial and tax obligations (Figure 6).
Businesses Are More Optimistic about the Return to (New) Normalcy than in Fall 2020

Despite the prolonged COVID-19 pandemic, businesses are more optimistic about a return to normalcy. For 80 percent of firms, employment is at normal levels, up from 71 percent in September 2020. However, the share of firms at the normal level of sales declined from 40 percent to 32 percent between the two surveys. Despite the decrease of firms at the normal level of sales, the expected recovery times have shortened for both labor and sales, with only 24 percent of firms expecting that it would take six or more months to get back to normal levels of sales, and only 5 percent of firms expecting the same six-month period to return to normal levels of workforce (Figure 7).

Foreign-owned Businesses Drive the Recovery of the Private Sector in North Macedonia

A year after the pandemic outbreak, foreign-owned businesses continue to perform relatively better than domestic firms (Figure 8). Eighty-five percent of foreign-owned businesses have returned to a normal level of sales, compared to only 30 percent of
Sales by foreign-owned businesses have grown 5 percent compared to April 2020 at the height of the pandemic. Sales declined by about 7 percent for domestically owned business, however, during the same period.

While the impact on sales results from changes in demand for the products and the markets in which these firms operate, it seems that overall, sales have remained depressed for exporting firms (those with 10 percent or more of sales derived from exports) (Figure 9). More than two-thirds of foreign-owned businesses stem from exports, while for domestically owned businesses sales from exports make up only about 16 percent of the total. Foreign ownership is generally accompanied by higher technological readiness, digitalization, and related management practices. These factors matter more for recovering sales than the firm’s export orientation. While nearly two-thirds of foreign-owned firms enjoyed an increase in demand for their products or services, this was the case for less than one-third of domestically owned firms. In addition, as shown in Figure 3 comparing the exit rates of exporters and non-exporters, the crisis exposed higher vulnerabilities of firms focused solely on the domestic market.

The performance of firms directly affects labor markets. Given the relatively better performance of foreign-owned firms, it is no surprise that full-time employment rose in foreign-owned firms compared to the period before the crisis. The negative impact of the crisis on employment was also less for exporting firms than non-exporting firms (Figure 9).
Emerging Policy Recommendations

When it comes to access to finance for SMEs, structural issues that existed before the crisis are now amplified (World Bank 2020). Collateral requirements continue to be an issue. This market gap in lending could be partially alleviated by a partial credit guarantee scheme slated to be put in place at the Development Bank of the Republic of North Macedonia, guaranteeing repayment of a certain percentage of the loan in case of default. However, improving firm financial management, accounting standards, managerial skills, and ability to obtain international certifications would also make firms more bankable and ease their access to financing.

On the supply side, some steps that might help SMEs now that overall crisis support has subsided include targeting financial products offered by the Development Bank to start-ups and micro and small enterprises, the Development Bank’s collaboration with savings houses and factoring companies to find affordable financing, establishing a centralized collateral registry for security interests in movable property, and removing obstacles to bank acceptance of movable collateral.

The crisis also increased interenterprise arrears. Making enforcement and insolvency procedures more effective could help reduce liquidity constraints on firms. These steps could also remove ailing insolvent companies from the market faster to prevent further deterioration of the local market.

Incentives for skills upgrading, digitalization, innovation, and development of local suppliers remain important for strengthening domestic firms, which were more affected than foreign-owned firms operating in North Macedonia. With policy priorities now focusing tightly on attracting higher-value added segments of specific value chains, it will be important to adapt incentives and state aid accordingly. The government might consider incentives that target developing human capital and innovation support in the short term while longer-term education reforms to address this issue take root.

Since 2013, there has been a slight improvement in terms of local spillovers from foreign direct investment and upstream linkages with domestic firms. However, foreign firms continue to purchase only around 10 percent of their inputs from domestic suppliers and continue to operate more independently of domestic production networks. A supplier development program to address market and coordination failures may facilitate links and upgrade firm capabilities.

As time passes, the clarity between the permanent and temporary impact of the pandemic on the private sector increases. Forthcoming data will help explain these dynamics further and can inform steps to speed and spread the recovery process.

Notes

1 The analysis of the exit of firms should be interpreted as a range. The lower-bound estimates are those for which in the survey the respondents were reached, and they indicated that they have permanently closed. The upper-bound estimates are based on the assumptions that those firms that could not be reached—despite trying to contact them twice in a six-month period—have closed their business. For detailed definitions, see Muzi et al. (2021).

References