43% of MSMEs may end this fiscal with pre-Covid margins

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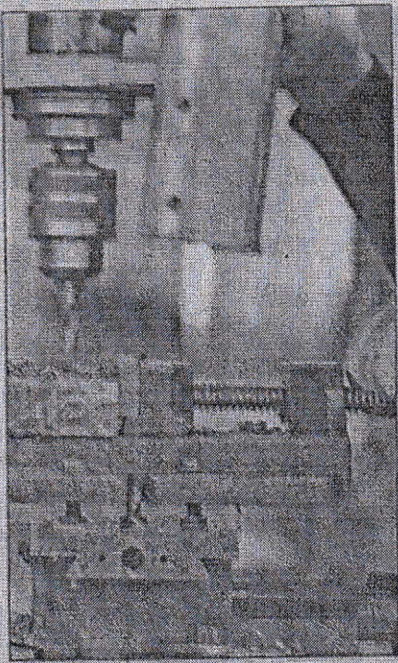

NEARLY HALF OF the small businesses will not be able to claw back their margins to the pre-pandemic levels even though almost all of them will be able to match the fiscal 2020 revenue levels this fiscal due to the inability to completely pass on high commodity prices and the rupee's fall, as per a report.

According to the Crisil report on Wednesday, while almost all small businesses are likely to close this fiscal at the FY20 top-line levels, as much as 43% of them will close the fiscal with pre-pandemic margins because of their inability to completely pass on the high prices in some commodities as well as an unfavourable exchange rate. The report is based on 69 sectors and 147 clusters or two-thirds of the MSME universe, which logged an aggregate revenue of ₹56 trillion, representing 20-25% of the GDP.

According to Pushan Sharma, a director at the agency, the overall MSME sector is expected to bounce back to 1.27 times the pre-pandemic level in terms of revenue this fiscal.

While their operating margin is expected to touch the pre-pandemic level this fiscal for 43% of MSMEs by value will buck the trend.

Around 30% of this 43% who are from sectors like chemicals, milk & dairy, and packaged foods, will not reach the pre-pandemic margin level due to high prices of commodities such as crude oil and milk. The remaining 13% from sectors like pharma (bulk drugs) and gems & jewellery will fall short of the mark due to rupee depreciation.

While the rupee fell to 82.3 a dollar in October against 70.9 per dollar in the pre-pandemic era, crude prices have been averaging at $104/barrel between April and October compared to $61/barrel pre-pandemic. Crude and crude derivatives are used as inputs for many SME sectors, including chemicals, dyes and pigments and construction roads.

An increase in fodder prices, unavailability of green fodder, and loss of milk production as the insemination rate was affected in FY21 due to lockdown led to an 11% increase in milk prices in fiscal 2022. Also, the LSD disease outbreak this fiscal is expected to further increase milk prices by 7%.

Sectors, such as chemicals and road construction, are expected to witness operating margin contraction to the tune of 250-300 bps and 200-250 bps, respectively, this fiscal compared to the pre-pandemic levels due to higher crude prices.

Agriculture-based sectors like milk & dairy and packaged foods are expected to see their margin contracting by 50-100 bps due to rising milk prices.

Sectors like air freight & courier services and travel agents, which were badly hit due to the pandemic, are yet to reach the pre-pandemic level in terms of revenue.

According to Elizabeth Master, an associate director of the agency, the commodity cycle is turning, with steel and crude prices estimated to decline 9-10% next fiscal. The easing of the Ukraine war, correction in coking coal prices, and weak global demand are expected to bend steel prices while easing of geopolitical tension leading to the opening up of supply chains globally will lead to a fall in crude prices.

Thus, the easing commodity cycle, coupled with rising revenue, will help take operating margins to pre-pandemic level for most of the sectors next fiscal, she said.