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## **EXECUTIVE SUMMARY**

# **Small Businesses: Impact of Disasters and Building Resilience**

*Analysing the vulnerability of Micro, Small, and Medium Enterprises to natural hazards and their capacity to act as drivers of community recovery*

**United Nations Development Programme (UNDP)**

**Crisis Prevention and Recovery**

**Final Draft – ISSUE NOT FOR PUBLICATION**

The impact of disasters on Micro, Small and Medium Enterprises (MSMEs) and the consequences this impact has on the economic and social recovery of the affected communities is one of the least explored areas in disaster risk. This gap hinders the understanding of the way community resilience can be achieved, including the restoration of the social and economic fabrics after disasters.

This study finds that MSMEs are disproportionately affected by disasters, compared to bigger firms with access to a broader set of coping strategies. However, the study also finds that MSMEs have an inherent flexibility due to the lower levels of capital needed to operate and looser work relations (especially in the case of informal MSMEs), which could be exploited after disasters to support a faster and more equitable recovery of the local community. The role of MSMEs in disaster recovery thus depends on their own ability to withstand disasters and having the right incentives in place for them to actively participate in livelihood recovery.

The study suggests that resilience of MSMEs should start by tackling the socio-economic drivers of risk in the pre-disaster stage, and should be further built by the provision of swift and adequate support to MSMEs shortly after disasters. Through better understanding of the impact of disasters on MSMEs, the study concludes that MSMEs' vulnerability to natural hazards can be reversed by promoting enabling pre- and post-disaster environments for MSMEs to use entrepreneurship as a driver of local economic and social recovery.

### *MSMEs and Disasters*

MSMEs contribute to the well-being and the livelihoods system of their community by providing and demanding employment, goods and services. These are needed even more in times of crises, in order to restore the economic fabric of disaster-affected communities. MSMEs also support the creation of social capital in communities, which is a crucial element in restoring the social fabric ruptured by disasters. With local businesses reopening and providing spaces for social bonding, MSMEs can contribute to motivating a relocated population to return home, as well as helping to attract new investment in recovering areas. A strong MSMEs sector also promotes a country's resilience to shocks by broadening and diversifying the domestic economy. By reducing the dependency on few large firms or specific sectors, MSMEs protect a broad base of the labor force from sector-specific shocks and fluctuations in international markets (Dalberg, 2011).

MSMEs are considered to be more vulnerable to natural hazards than larger firms, given the more limited range of risk-management mechanisms they can access. Furthermore, MSMEs in developing countries have additional characteristics that can exacerbate their vulnerability such as informality, which: keeps them out of the reach of government Disaster Risk Management (DRM) programmes and other DRM strategies (e.g. insurance); constrains the ability of MSMEs to diversify their supply and customer base; and implies a lack of compliance with norms and regulations that can increase disaster risk for them and for their employees (e.g. operations in informal settlements, lack of social protection for their employees). Women and young workers tend to be overrepresented in the informal economy (ILO, 2002; Perry et al., 2007), increasing their vulnerability compared to other groups.

Evidence shows that the majority of MSMEs are worse off after disasters. Loss of assets, supplies, customers and staff can compromise livelihood strategies of MSMEs owners. Having fewer coping strategies make it difficult for MSMEs to handle the consequences of disasters, compared to larger firms. Evidence on MSMEs' failure after disasters is limited and varies widely from context to context, though the impacts of disasters on the financial viability of MSMEs point at increasing vulnerability after the event, and decreasing ability to cope with shocks.

Despite the panorama of high vulnerability and low coping capacity, evidence shows that the trend can be reversed by helping MSMEs access rapid post-disaster assistance and network support. Fewer assets and employees translate into simple production/operating systems that can be swiftly reinstated with appropriate support. From this perspective, even greater flexibility could be expected from informal MSMEs, particularly the self-employed, if provided with swift and adequate support.

### *Impact of Disasters on MSMEs*

MSMEs are affected differently by disasters. These differences are determined by the type of hazard, risk exposure or context-specific vulnerabilities (exogenous variables), as well as from the characteristics of MSMEs, which increase or decrease vulnerability to natural hazards (endogenous variables). Analysing the differential impact of disasters on MSMEs can shed light on what form adequate support to MSMEs might take.

Exogenous variables such as the type of risk exposure determine the level of damage (which can be catastrophic in the case of intensive risk) and the potential for adaptation and better coping (recurrent extensive risk). Disruptions such as physical damage can cause severe financial stress, while lack of basic service provision can compromise swift reopening and exacerbate medium- and long-term disruptions such as population dislocation. The latter can severely hinder MSMEs operations due to a reduction in staff supply and customer base. Lastly, the legal and regulatory frameworks can influence financial and spatial vulnerabilities, particularly so for informal MSMEs operating in unsafe premises and out of the reach of DRM programmes and tools (e.g. insurance).

Endogenous variables can help explain individual business shocks on MSMEs belonging to the same context, exposed to the same level and type of risk, and facing similar disruptions. For instance, evidence shows that MSMEs in different industries can be affected differently by disasters. Despite heavy initial disruptions, MSMEs in the retail sector, particularly informal entrepreneurs, can recover faster compared to those in other sectors and serve as a buffer during times of crisis. MSMEs engaged in manufacture can lose critical assets and staff, which can generate long closure periods and compromise business continuity. After a short-term collapse, MSMEs in tourism tend to bounce back unless recovery strategies for the sector exclude them on the basis of value-chain upgrade or resettlement policies (informal entrepreneurs are particularly at risk). The construction sector can temporarily benefit from reconstruction efforts though projects usually involve large, unaffected construction firms. Lastly, environment-dependent MSMEs can be considered one of the worse off sectors, given the severe disruption disasters pose to the availability of natural resources and the time it takes for ecosystems to recover.

Other endogenous variables that make a difference in terms of impact of disasters on MSMEs include business size, level of informality, location, previous experience of business owners with disasters, pre-disaster business performance, and ownership of premises. Evidence is inconclusive in relation to variables such as age of the firm or gender of firm owners, though if gender-biased vulnerability is present in a society, it is likely to be found among MSMEs.

Most small businesses, whether formal or informal, operating in developed or developing countries, tend to rely on personal savings and networks to cope with disasters. In the case of developed countries where special recovery funds and insurance are widely available and accessed, MSMEs tend to prioritize or complement formal coping mechanisms with individual informal ones. In developing countries, informal coping strategies are often not chosen but imposed by the absence and/or insufficiency of formal mechanisms that guarantee business owners' own survival, as well as that of their business.

## *Post-Disaster Response and Recovery Support*

Achieving effective post-disaster recovery is often influenced by actions taken immediately after disaster; this is particularly so in the case of MSMEs, whose business continuity is threatened by prolonged closure periods and population dislocation. However, post-disaster response and recovery usually has a stronger focus on infrastructure restoration and other elements of household recovery than on economic resilience, leaving business continuity and livelihood restoration as marginal programme components.

Effective post-disaster recovery involving MSMEs as engines of local socio-economic recovery requires public investment to focus on the right mix of 'hard' infrastructure restoration and 'soft' socio-economic policies. Adequate 'hard' policies can include restoration of basic services that can enable MSMEs to continue operations while preventing population dislocation. Housing should be seen as an essential component of livelihood recovery, determining and even serving as primary input (e.g. home-based MSMEs) of productive processes (Pribadi, 2005). Hence, emergency response involving relocation can include temporary operating locations such as those accommodating displaced households (Zhang et al., 2004). During the recovery phase, unconnected housing and livelihood recovery programmes that can negatively affect the restoration of MSME operations should be avoided.

Large-scale projects are the most efficient way of restoring damaged infrastructure but they are likely to exclude local businesses and workers if not carefully designed. Labor-intensive infrastructure projects that explicitly prioritize local contracting can better serve the recovery of MSMEs by involving them directly in recovery processes and stimulating local-level employment and production, while minimizing the redistributive effect of disasters in favor of larger (usually outside) businesses (Lyons et al., 2010).

'Soft' livelihood recovery programmes can include emergency employment, cash and in-kind aid, and microfinance. 'Cash-for-Work' and other emergency support programmes can be useful safety nets to help communities restore the necessary basic infrastructure, local demand, and personal capital needed for MSMEs to operate. Grants can be a more direct way of providing MSMEs with the necessary capital for business continuity and, when given promptly after disasters, can be more effective than emergency employment in supporting the recovery of MSMEs. However, cash is effective as long as markets function; hence the importance of well-designed in-kind support programmes that facilitate MSMEs' access to productive inputs when markets are heavily disrupted by disasters (e.g. MSMEs in manufacture exposed to intensive risk). If designed well, microcredit programmes linked to sustainable income-generating activities can be an option to support the transition between disaster response and medium-term economic recovery.

Central and local governments' roles can facilitate recovery strategies for MSMEs. Financial, technical and political support roles could be better allocated to central-level institutions that generally have greater capacity and decision-making power than disaster-affected local governments (UN, 2011). The main advantages of central governments' coordination of recovery priorities lie in the robust budgets they could leverage from their own or donated resources, and the potential to coordinate different stakeholders (the international community, private sector, regional/local government offices) to simultaneously address the different components of integral post-disaster recovery. Central governments also have the role of ensuring that the business environment, if not totally stable, remains predictable for MSMEs and other members of the community, allowing optimal decision making with regard to the recovery processes (Chamlee-Right and Storr, 2008).

By building on pre-disaster partnership and knowledge, local-level institutions can mobilize adequate response to affected MSMEs and minimize disruptions in their operations. Local governments are also better placed to identify the role MSMEs can play in disaster response. Practical areas for local governments to make a difference in the recovery of MSMEs are the provision of alternative workspaces (e.g. as part of the temporary resettlement programmes), and the coordination of debris removal and other activities that need local labor and that can facilitate the return of the affected population (De Ruiter, 2011). Local governments also have the potential to effectively engage in longer-term planning processes with post-disaster communities and build on pre-disaster partnerships to ensure local MSMEs are part of new development strategies.

Other stakeholders such as development partners, non-governmental organizations (NGOs) and business associations (BAs) are instrumental in helping governments after disasters. Donors can help governments finance response, recovery and reconstruction strategies. However, this support can have mixed effects in the recovery of MSMEs due to the favoring of large infrastructure projects and the upgrade of certain industries (tourism is a recurrent example), both of which can translate into the exclusion of local MSMEs. NGOs' traditional focus on 'soft' socio-economic initiatives concentrating on livelihood recovery, as opposed to major infrastructure projects has been found to complement donor-funded 'hard' recovery programmes (Regnier et al., 2008). NGOs are well placed to support government efforts in transitioning from emergency response to long-term economic and social recovery by establishing links between different stakeholders. NGOs can also support MSME recovery to the extent that they provide the necessary technical and financial inputs for MSMEs to resume operations and avoid replacing private sector activities with aid. NGOs should also complement government efforts rather than replace them. Business Associations (Bas) can ensure that disaster response meets the needs of MSMEs thanks to their matchless private sector knowledge and can facilitate the intervention of bigger firms in the framework of Corporate Social Responsibility (CSR).

### ***Policy Approaches***

Livelihood strategies in the post-disaster stage appear to face two main issues: they can be relatively ignored by recovery programmes or they can be addressed in a way that does not support local community recovery. In both cases, the potential for MSMEs to be drivers of local socio-economic recovery is undermined. These issues are intimately related to pre-disaster conditions of disaster-affected areas. Poor and vulnerable communities that have been ignored by public policy are likely to see their livelihood restoration as a marginal component of disaster recovery. Large-scale economic recovery projects can equally ignore local livelihood strategies and bring external initiatives with little or negative impact to communities.

Therefore, resilience of MSMEs should start by tackling socio-economic drivers of risk in pre-disaster stage. This can be done through ensuring an adequate investment climate for MSMEs to thrive and build resilience to shocks, and through interventions that can support resilience building more directly.

Ensuring an adequate investment climate requires policy makers to be aware of the importance and role that MSMEs have in local economic dynamics, which can facilitate the design of relocation and recovery programmes that support livelihood recovery. Legal and regulatory frameworks that effectively address issues such as insecurity of tenure, informality, land use planning and building codes, can in turn encourage MSMEs' investments in DRM and market diversification.

Direct interventions for building resilience of MSMEs before disasters can draw on the support of BAs and community groups to design and communicate DRM strategies, as well as help MSMEs be less

dependent on local markets by diversifying their supply and customer base. Having social protection systems in place can help decrease the possibility of individual shocks, while having in place systems that can provide swift support after disasters.

Enterprise recovery programmes that respond to context-specific needs of different industries, through cash in-kind and technical support, can help reverse the 'inherent' vulnerability of MSMEs to natural hazards by maximizing the flexibility that fewer assets and employees give to MSMEs compared to larger firms. Microfinance products tailored to the needs of MSMEs can ensure that recovery is effective and sustainable.