

MSMEs Contribution to Local and National Economy

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Key Points:

1. *MSMEs are important to the local and national economy as they contribute to GDP, taxes & duties, and employment & jobs.*
2. *MSMEs support in alleviating poverty and propelling sustainable growth in developing countries.*
3. *MSMEs need support to overcome the obstacles that curb their growth viz. access to finance, infrastructure, labour, skills and training.*

MSMEs are the backbone of economy of a country in terms of sustainable growth, employment generation, increasing trade, development of entrepreneurial skills and contribution to export earnings. Generally, all the businesses start either as small business or as a small enterprise initiated by individual(s). The development of MSMEs is seen as the way to accelerate the achievement of wider socio-economic goals, including poverty alleviation.¹ MSMEs generally operate close to a locality, thus offering employment opportunity to the local people who would acquire the required skills and knowledge. It also provides desirable sustainability and innovation in the economy as a whole. A large number of people transact with the MSMEs directly and indirectly.

Empirical studies have shown that MSMEs contribute over 55% of GDP and over 65% of total employment in high-income countries. MSMEs and informal enterprises account for over 60% of GDP and over 70% of total employment in low income countries, while they contribute about 70% of GDP and 95% of total employment in middle income countries. In this briefing note, we try to deconstruct the role of MSMEs and their contribution to local and national economy through a conceptual framework.

Estimating Number of Micro, Small and Medium Enterprises

World Bank² defines MSMEs as below:

Type	Number of employees	Annual Turnover (in US\$ '000s)	Assets (in US\$ '000s)
Micro	0-10	100	10
Small	10-49	3,000	3,000
Medium	50-299	15,000	15,000

A 2010 IFC study estimates around 455 million MSMEs worldwide; of which 9% are formal MSMEs (typically registered businesses with 5-250 employees). 80% of MSMEs are in emerging markets.³ Of the formal MSMEs, about 70% are formal micro-enterprises employing fewer than 10 employees and with assets below US\$10,000.

Region-wise estimated⁴ breakup of micro, small and medium enterprise is as below:

Region	Number of MSMEs (in Millions)
East Asia	185
South Asia	80
Sub-Saharan Africa	40
Latin America	50
Central Asia and Eastern Europe	20
Middle East and North Africa	20
High Income OECD	60
TOTAL	455

455 million MSMEs across the world are actively contributing to the local and national economic development however; their contribution is often under-recognised.

Contribution of Micro, Small and Medium Enterprises to Local and National economy

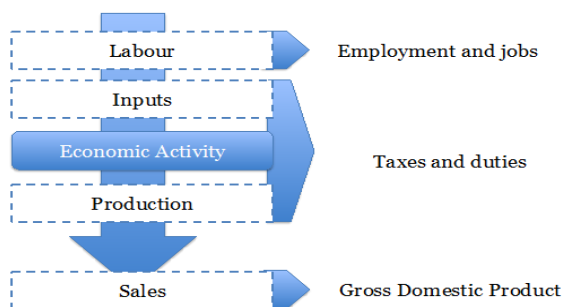
Broadly, the impact of MSMEs' growth on local and domestic economy can be classified into contribution to gross domestic product; taxes and duties; and employment and jobs creation. In the section below, we detail the potential of the growth and its impact.

¹Cook and Nixon, 2000

²http://siteresources.worldbank.org/DEC/Resources/84797-1114437274304/SME_globe.pdf

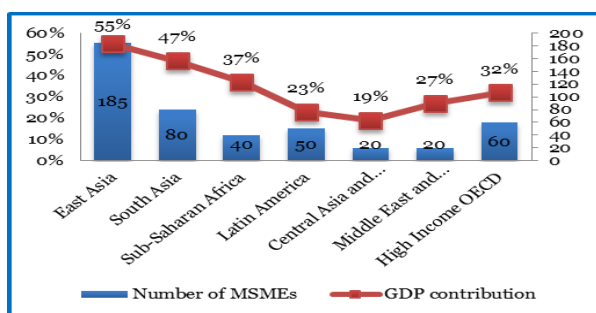
³Scaling-Up SME Access to Financial Services in the Developing World, IFC

⁴Two trillion and counting - Assessing the credit gap for micro, small, and medium-size enterprises in the developing world, IFC and McKinsey 2010



Contribution to Gross Domestic Product

MSMEs contribute directly to the overall economic development of an economy. They play a considerable role in GDP growth on account of increased output, value add and profits. Even without considering the multiplier effect of economic activity and production by MSMEs, the contribution to GDP by MSMEs in economies across various regions⁵ cannot be overlooked.



An example of how MSMEs contribute to GDP is a case of a dairy processing unit from India. The unit buys over 25,000 litres of milk everyday from local villagers to produce cheese and whey products after processing it. Exporting these dairy products brings significant revenue – the net profit ranges between 20-25% and the unit contributes over US\$1.1 million annually to GDP. Typically, MSMEs that make profits and a positive rate of return on additional capital contribute directly to GDP to about the amount of the profits and return on additional capital.

Additionally, there is a significant multiplier effect in the wider economy due to increased economic activity of employees and suppliers of MSMEs.

Taxes and Duties

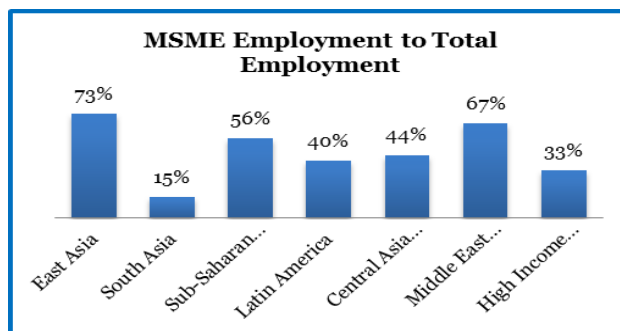
MSMEs contribute immensely to government revenues through the taxes and duties they pay. MSMEs pay direct taxes on their revenues and profits as well as indirect taxes such as value-added taxes, sales tax, apart from duties such as excise, cess and levies. It is estimated⁶ that MSMEs contribute to about US\$14 trillion in taxes.

Region	Contribution to Tax (% of GDP)
East Asia	11.00%
South Asia	14.10%
Sub-Saharan Africa	14.80%
Latin America	6.90%
Central Asia and Eastern Europe	4.75%
Middle East and North Africa	8.10%
High Income OECD	16.00%

Employment and Jobs Creation

MSMEs usually deploy more labour-intensive production processes than large enterprises, so proportionally require more employees. Consequently, they contribute significantly to the provision of productive employment opportunities, the generation of income and the reduction of poverty.

It is estimated that MSMEs employ over 2.2 billion people globally that is around 50% of the total employed workforce. The region-wise classification of MSME employment as proportion of total employment is as follows:



In developing countries, the MSME segment plays a major role in alleviating poverty and propelling sustainable growth. They contribute towards a more equitable distribution of income due to the nature of business. MSMEs help in efficient allocation of resources by implementing labour-intensive production processes, particularly in countries where labour is abundant and capital is scarce.

The pressing need is recognising of the potential and impact of MSMEs on local and national economies and supporting them to overcome the obstacles that curb their growth and success such as access to finance, infrastructure, labour, skills and training. In the other notes in this series, we highlight the core challenges faced by the MSMEs including lack of access to finance and how financial institutions can play a role in bridging the divide.

⁵References were drawn from Ayyagari, Beck and Demirguc-Kunt, "Small and Medium Enterprises across the Globe: A New Database", World Bank 2003

⁶MicroSave estimates based on World Bank data on GDP for each country and taxation policies