SME sector impact on Economic Development

in France, Italy and India

Seminar Paper



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Abstract

***SME sector’s impact on Economic Development in France, Italy and India***

The SME sector has seen rapid growth over the last decade especially in developing countries like India. With major financial de-regulation and an increased number of programs for the upliftment of the sector all across the globe, this sector is one of the fasted growing sectors. Inferential statistics have been used for France and Italy, whereas for India descriptive statistics are used. For the regression poverty headcount ratio and gross national income per capita are used to measure the impact of SMEs on economic development. Data was used from both Eurostat and the World Bank databases for the regression for the time period 2000 to 2018. For India, the main data source was the various annual MSME reports issued by the government of India from 2012 to 2017. France and Italy have less maintained the percentage share of total employment by small-medium sized enterprises with respect to total enterprises at around 60% and 98% respectively. The share of the total number of enterprises is also maintained over the last two decades. Through the regression analysis, we found out that these two factors don’t do much to explain the GNI per capita and the poverty headcount ratio of the country. This might be attributed to incomplete or unreliable data. India has been the fastest-growing developing nation. More than 94% of the total MSME sector is informal and unregistered and thus are excluded from various studies. This gives a serious underestimation of the strength of the sector in India. The sector accounts for 30% of the total GDP as of 2020. The major challenge faced by the sector in India is the high financial gap. This is likely to change in the wake of Atmanirbhar Bharat and thus is expected to increase the otherwise stagnant sector to new heights.

Keywords

Small-medium sized Enterprises (SMEs); Employment; GNI (Gross National Income); Poverty Headcount Ratio; Financial gap; Informal and Unorganized Sector; Eurostat; World Bank database

Introduction

Small and medium enterprises (SMEs) are considered the backbone of any economy. The SME sector contributes hugely to local employment and socio-economic development. This sector has contributed significantly to higher growth of employment, output, promotion of exports, and strengthened entrepreneurship in developed nations. SMEs are mostly dependent on the human workforce and less on capital. In India the industries that fall under SMEs are Service and Textile Industry, Agri-based and Food Processing Industry, Rural Engineering, and Biotechnology, Mineral-Based Industry, Polymer and Chemical Based Industry, Forest-Based Industry, Handicraft, and Fiber industries. There is a necessity to create, need, and apply innovation (Curran and Blackburn 1994). It has been found that in the previous century, 60 % of the innovations were in the SME sector but many of them were not successful due to lack of professionalism and inability to collaborate with other enterprises (Rothwell 1986; Noteboom 1991). This has been kind of a black box to SME development.

The key challenges faced by SMEs in developing countries like India are:

• Access to Finance: Bank Credit remains the major source of external finance to SMEs. Banks fund complex, illiquid positions that imply long-term lending to borrowers. This long-term lending especially to new and small businesses poses a threat of credit default. This difficulty arises due to informational asymmetries between borrowers and lenders. The informational asymmetries are pertinent to the SME sector cause of 1) High preference for secrecy and independence of firm’s owner’s-managers. 2) High dependence of a firm’s performance on human capital.

As per Economic Survey 2017-18 India: Large businesses corner 82.6% of the credit, MSMEs get a paltry 17.4 %.

• Access to Markets: SMEs’ sales are mostly connected to the local network. To widen their marketing network and to withstand the onslaught of competition from large enterprises within and outside, SMEs need to respond promptly to the evolving marketing needs and innovations. This is mainly because MSMEs in India are broadly unaware of technology solutions and tools available to cater to their marketing needs.

• Access to Infrastructure: Industries form the backbone for national development and are one of the important components for the growth of the economy and growth of the SME sector at a healthy rate is crucial for the overall growth of the industry. However, lack of proper infrastructural facilities can cause serious damages to an enterprise's value chain process. Each SMEs should have a basic infrastructure that includes workspace, power and water supply, waste management, and new tools for product development.

There is no universal definition of SMEs. Countries have used various criteria for defining SMEs like the turnover of the company determines the size of an enterprise, whereas some countries distinguish on basis of the number of employees.

This is the categorization of SMEs in India, France, and Italy as per their government. Here Turnover means total business sales in a financial year.

|  |  |  |
| --- | --- | --- |
|  | Number of Employees | Turnover |
| India | ------------------------------ | M : Rs 5cr S : 5cr to 75cr Med: 75 cr to 250cr |
| France | M :0-9 S:10-49 Med: 50-249 | -------------------------------------------------------------- |
| Italy | M :0-9 S:10-49 Med: 50-249 | --------------------------------------------------------------- |

M: Micro, S: Small, Med: Medium sized enterprises

Objective

SME sector contributes to a huge extent in a nation's economy. Small-scale businesses and industries provide employment in both urban and rural areas. This in-turn leads to increase in income levels of people which leads to reduction in poverty, improvement of quality of life and curtail migration from rural to urban areas. Another major advantage that SMEs have and other big enterprises do not is that they do not require heavy investment, as a result they can be easy setup in villages and small towns which can lead to secondary growth of the region.

The main objective of this paper is to see the impact of the SME sector on a nation’s economic development. We have chosen the countries of France, Italy and India to do so. We use inferential statistics for the countries France and Italy and descriptive statistics for India. Using regressions, we determine the ability of the growth rate of SME sector in terms of number and employment to explain the corresponding shifts in the poverty and per capita income. In India, we infer how has the sector fared over the last few years in respect to employment, size by market share and GDP contribution.

Hypothesis

**Objective 1: Impact on GNI per capita for France**

Hypothesis 1: Impact on GNI per capita for France

H0: GNI per capita is not significantly explained by growth rate of total number of SMEs in France.

H1: GNI per capita is significantly explained by growth rate of total number of SMEs in France.

Hypothesis 2: Impact on GNI per capita for France

H0: GNI per capita is not significantly explained by growth rate of total labor force share of SMEs in France.

H1: GNI per capita is significantly explained by growth rate of total number of SMEs in France.

**Objective 2: Impact on GNI per capita for Italy**

Hypothesis 1: Impact on GNI per capita for Italy

H0: GNI per capita is not significantly explained by growth rate of total number of SMEs in Italy.

H1: GNI per capita is significantly explained by growth rate of total labor force share of SMEs in Italy.

Hypothesis 2: Impact on GNI per capita for Italy

H0: GNI per capita is not significantly explained by growth rate of total labor force share of SMEs in Italy.

H1: GNI per capita is significantly explained by growth rate of total labor force share of SMEs in Italy.

**Objective 3: Impact on Poverty Headcount Ratio for France**

Hypothesis 1: Impact on Poverty Headcount Ratio for France

H0: Poverty Headcount Ratio is not significantly explained by growth rate of total number of SMEs in France.

H1: Poverty Headcount Ratio is significantly explained by growth rate of total number of SMEs in France.

Hypothesis 2: Impact on Poverty Headcount Ratio for France

H0: Poverty Headcount Ratio is not significantly explained by growth rate of total employee share of SMEs in France.

H1: Poverty Headcount Ratio is significantly explained by growth rate of total employee share of SMEs in France.

**Objective 4: Impact on Poverty Headcount Ratio for Italy**

Hypothesis 1: Impact on Poverty Headcount Ratio for Italy

H0: Poverty Headcount Ratio is not significantly explained by growth rate of total number of SMEs in Italy.

H1: Poverty Headcount Ratio is significantly explained by growth rate of total number of SMEs in Italy.

Hypothesis 2: Impact on Poverty Headcount Ratio for Italy

H0: Poverty Headcount Ratio is not significantly explained by growth rate of total employee share of SMEs in Italy.

H1: Poverty Headcount Ratio is significantly explained by growth rate of total employee share of SMEs in Italy.

Literature Review

The success of SMEs can be understood from a quantitative perspective: quality, financial results, output volume, number of customers (Anggadwita & Mustafid, 2014), market share, profitability, competitiveness, sales dynamics, cost and liquidity etc. and also from a qualitative perspective: achievement of goals, leadership style, employee behavior (Anggta & Batra, 2016; Zimon, 2018).customer satisfaction (Alpkan, Yilmaz, & Kaya, [2007](https://www.tandfonline.com/doi/full/10.1080/1331677X.2019.1636699)), product and process innovation, organizational and marketing innovation  etc. SMEs have an immense leverage impact as the backbone of the economy, which is why it is important that unique concepts for smaller businesses are created. A digital transformation strategy provides prospects for growth and sustainable productivity, regardless of a company's size. (Matt and Rauch, 2020).

The value of studying the success of SMEs stems from many salient aspects. Second, both gross domestic product (GDP) and unemployment are greatly affected by SMEs. As we have said above, both in the EU and internationally, small and medium-sized enterprises (SMEs) are responsible for a large share of GDP and reducing unemployment; this is basically not true only in the case of centralized economic structures (Kunt and Beck, 2003). Between 2008 and 2017, the number of SMEs in the EU-28 grew by 13.8 percent. 88.3 percent of all EU-28 enterprises exporting products were SMEs. Just 30 percent of all SME exports are accounted for by the rest of the world. In 2016, 80% of all exporting small and medium-sized enterprises were engaged in intra-EU trade, while less than half of exporting small and medium-sized enterprises (SMEs) were sold to markets outside the EU-28 and slightly more than a quarter of exporting SMEs were sold to both markets (Brusselsnetwork, 2018). The share of investment companies tends to be proportional to the size category: the highest values are shown by large companies, while the smallest are shown by micro companies. However, the share of investment companies in the groups of micro and small enterprises should not be undervalued (Audretsch et al., (2014)). Entrepreneurial practices are encouraged by government efforts, but entrepreneurs are not aware of schemes that can help companies and therefore face financial problems. (Priti, 2019). MSMEs account for 60 to 80 percent of total jobs, which is a crucial influence on the nation's economic development. For MSMEs to learn and develop new skills in marketing, logistics, management, resourcing, technology and innovation, the availability and access to BDS providers (public and private) is essential (Bruno et. al 2015). SMEs have proven to be more resilient than large and multi-national companies because of their versatility, entrepreneurial spirit and creativity capabilities, as demonstrated by the previous financial and economic crisis (Matt 2007) .There are also studies suggesting a holistic approach, combining the influences of the internal and external world into a synergetic effect on the success of SMEs. According to Aceleanu, Traşcă, and Şerban (2014), three types of factors affect the degree of growth and output of SMEs:

1) The general economic environment that directly or indirectly affects GDP and gross national product (G.N.P.), as well as the willingness to invest.

2) Structural economic characteristics, expressed in the amount of technology used, public and private expenditure on R&D and innovation, and creative activities carried out.

 3) Microeconomic variables, such as the number and structure of undertakings by size class or survival rate.

The MSME sector has made an immense contribution, but it still faces major challenges. Some of the most common problems faced by MSMEs are insufficient access to financial services, incomplete knowledge of the financial market and MSMEs are considered to be less creditworthy by financial institutions. The smaller SMEs are the greater the chance that this revolution will not be able to help them. European SMEs are mindful of the information they have about adaptation deficits. This opens up the need for more study and action plans in the technological and organizational direction to prepare SMEs (Sommer 2015). While most published literature analyses various specific elements of the internal and external environment of the company as essential to its success, there are also a number of studies that take macroeconomic/contextual factors into account as well. In this regard, Kanu (2015) focuses on studying the effect on SME efficiency of the general degree of corruption.

In order to obtain evidence on the level of company efficiency, authors are developing various types of models: a structural model based on innovation (Hall, Lotti, & Mairesse, 2009), a decision model based on the implementation of a decision aid system based on multiple criteria (Voulgaris, Doumpos, & Zopounidis, 2000) or a two-part equation model to investigate the main company- and industry-specific constraint model. Ipinnaiye, Dineen, and Lenihan (2016) consider that the output determinants of both SMEs stem from their internal environment (company characteristics and strategy) as well as macroeconomic determinants (unemployment rate [UR], inflation rate, national competitiveness, real effective exchange rate, and private sector domestic credit).Last but not least, corporate responsibility and environmental responsibility will lead to improved company efficiency through 'green practices'.

Methodology

1. **Measures of SME Development**

To measure the impact of SMEs in the countries France, Italy and India we use the database on the share of total employment accounted for by the SMEs and one for total number of SME enterprises in a country. Both were taken in terms of annual growth rate. These are the two most important and relatively easily available data for various countries. Though time series data for India was unavailable and that for Italy and France was highly irregular. The missing data points in the time series were filled with the average over the data available. Another potential problem is that in the data for France, everything except industry is excluded. Additionally, the informal employment and the unorganized sector is unaccounted for in the data due unreliability of the data available. Moreover, data points on employment of France does not include medium sized enterprises as the data was stated as confidential on World Bank database, and the Eurostat database. 2003 data for number of employees and number of SMEs is used for 2002.

**SMEEMP (in %)** is the annual growth rate of share of SME sector in each country of the total labor force of the country. The cutoff level of 250 employees is used for the definition of an SME for France and Italy.

**SMENO (in %)** is the annual growth rate of share of total enterprises in the country contributed by the SME sector.

Data for SMEEMP and SMENO was taken for the time period 2000 to 2018. The SMEEMP data for Italy was averaged over the time period 2010 to 2018 and used for the rest of the time period. Data was collected from the following sources: World Bank Database, Eurostat Structural Business statistics. The data cover the total business economy excluding financial services.

1. **Measures of Economic Development**

To measure SME sectors impact on the economic development. This has been done using the statistic of GNI per capita (for measuring economic growth) and poverty headcount ratio (for measuring economic development) relating to the relative changes in poverty with expanding (or contracting) SME sector in each country.

**LN(GNIPC)** is the log of Gross National Income (GNI) per capita is collected from the world bank database based on US dollars. Aggregates are based on constant 2010 U.S. dollars. Gross National Income (GNI) per capita specifies the per capita income earned in a particular year.

**HCR (in %)** is Poverty headcount ratioat $5.50 a day is the percentage of the population living on less than $5.50 a day at 2011 international prices. The cutoff of $5.50 is taken as standard for both France and Italy.

1. **Regressions**

Finally, to measure the impact of SME sector on economic development we have taken two regressions each for France and Italy which are mentioned as follows:

This is a time series regression.

β0 - is the intercept term of the model, the proportional per capita GNI if no growth in SME share of labor force and share of enterprises

β1 – coefficient measuring the marginal change in log GNI per capita with 1% change in SME sector’s share of total labor force of the country growth rate.

β2 - coefficient measuring the marginal change in log GNI per capita with 1% change in SME sector’s share of total number of enterprises of the country growth rate.

α0 - is the intercept term of the model, the proportional poverty headcount ratio if no growth in SME share of labor force and share of enterprises

α1 – coefficient measuring the marginal change in log GNI per capita with 1% change in SME sector’s share of total labor force of the country growth rate.

α2 - coefficient measuring the marginal change in log GNI per capita with 1% change in SME sector’s share of total number of enterprises of the country growth rate.

Here ε1 and ε2 are the white noise error terms for the respective regressions.

1. **Special case of India**

Due to lack of time series data on India of the above-mentioned SME related datapoints it was unfortunately impossible to run any meaningful regression. Thus, the data available on India is used for descriptive statistics instead of inferential as last time. We have analyzed the how much the MSME sector contributes to the GDP and employment in India. Moreover, the changes in employment as share of total is also analyzed. Lastly, we see how the MSME sector has fared over the past few years using the annual MSME sector report by the Government of India. Though most of the data is highly reliable, less availability of data for India has restricted our ability for further analysis of the nation.

India defines enterprises into micro, small, medium and large enterprises on basis of their turnover. The first three are called MSME businesses. As of 2019 63.38 million MSME operations in various industries have provided employment to more than 111 million people.

In India most of the sector is unorganized (approximately 94 percent), informal and un-registered. These enterprises though small but being unregistered are not included as SMEs. The MSME sector accounts for 30% of the country’s GDP in 2020, well below the European average of 56.4% value addition to business and economy. Therefore, though there is underestimation of SME contribution to the economy, it's well below the SME contribution in European and other developed nations. Lack of entrepreneurship, innovation and skill among Indian citizens can be a potential reason for this.

Forecasts by Netscribes (India) Pvt. Ltd suggests that MSME will contribute 50% to India’s GDP which is a positive indicator of sustained growth in this sector.

As of 2019, the overall addressable demand for external credit was ~INR 41.64 Tn, while the total supply of fund stood at INR 13.54 Tn. This shows there is a significant credit gap (INR 28.10 Tn) that financial institutions are incapable to fill it. But this may not be the case in future as with greater innovation, accessibility and awareness of fintech products, easy credit for SMEs will be available in both rural and urban areas.

Small firms being most vulnerable to unexpected crises like ongoing covid-19 because of their size, scale of business operation and limited financial management resources, they are in most stress now. However currently the policy measure of the government of India for business is targeted long-term repo operation of INR 500 Bn, a grant of INR 3 Tn collateral-free automatic loans, INR 200 Bn subordinated debt to stressed MSMEs, and a complete ban on global tenders for procurement of goods and services for up to INR 2 Bn. This is

hopeful to be beneficial for small SMEs.

Share of MSME sector in GDP and GVA in India

Source: Annual Reports of msme.gov.in and self-computed calculations (Appendix A.1)

The contribution of the MSME sector to India’s GDP currently stands at ~8 per cent for 2011-12 and is growing at a rate higher than the projected GDP growth rate. The contribution of MSME segment to the GDP in some of the global economies is in the 25-60 per cent range. MSME in India has the potential to increase the share of contribution to GDP from the current 8 per cent to about 15 per cent by the year 2020.

Source: Appendix A.2

And as we can see from the graph that employment has been increased significantly over the last years along with SMEs indicating that SMEs give employment opportunities to peoples.

Results and Conclusions

1. **Impact on GNI per capita for France**



The French regression model shows a R-square of 16.83%. At F-statistic 1.62 the model is insignificant at 10% confidence level. This leads us to believe that the regression model or the independent variables used in our model does not do much to change the GNI per capita factor. This might be attributed to the fact that unorganized sector and the informal employment is unaccounted for in the data. Where the share of total enterprises by the SMEs partially explain (at 10% confidence level) the GNI per capita trend, the share of labor force is outright insignificant even at 10% confidence level. Another reason might be attributed to the fact that data available was highly irregular as in, in France medium size enterprises datapoints were mostly confidential and were thus aggregated.

1. **Impact on Poverty Headcount ratio for France**



A F-statistic of 2.93 results in significant model at 10% confidence level. The model explains the poverty headcount ratio over the years to some extent with an R square of 26.85%. Both the independent variables, share of employment and the share of total number of enterprises were explanatory at 10% with the former being significant at 5% also. The exclusion of medium-size enterprises might be a reason of unreliable results of the regression.

1. **Impact on GNI per capita for Italy**

The model shows R-square of 19.24%. A F-statistic of 1.90 results in an overall insignificant model at 10% confidence. This leads us to believe that the regression model or the independent variables used in our model does not do much to change the GNI per capita factor. This might be attributed to the fact that unorganized sector and the informal employment is unaccounted for in the data. Where the share of total enterprises by the SMEs partially explain (at 10% confidence level) the GNI per capita trend, the share of labor force is outright insignificant even at 10% confidence level. In Italy more than 90% of the total SME enterprises were micro and thus did not contributed much to GNI per capita as compared to medium and large enterprises.

1. **Impact on Poverty Headcount ratio for France**



There was an astonishing result. The F-statistic of 0.18 implies an overall insignificant model at 10% confidence level. Italy’s model has negative adjusted R-square and thus shows that the variable defined does not affect the poverty headcount ratio (at 5.50$ per day at 2011 prices) much. Micro-enterprises being the major portion of SMEs in Italy, the unorganized sector (major in micro-enterprises) might have resulted in the inefficiency.

1. **Indian MSME sector**

So overall India is currently behind the European nations (France and Italy) if compared to employment level, economic development and has to work a lot on creating employment opportunities that are long term and self-sustaining, and become self-reliant on indigenous goods. This way I believe it can reach on par with developed nations.

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Appendix

A.1 MSME sector share in GDP and GVA

|  |  |  |  |
| --- | --- | --- | --- |
| Year | Growth (%) | Share of MSME in GVA (%) | Share of MSME in GDP (%) |
| 2012-13 | 15.17 | 32.82 | 30.4 |
| 2013-14 | 12.23 | 32.71 | 30.2 |
| 2014-15 | 9.29 | 32.21 | 29.7 |
| 2015-16 | 8.65 | 32.03 | 29.2 |
| 2016-17 | 9.44 | 31.83 | 28.9 |

Source: Annual MSME reports from 2010 to 2018

A.2 Employment data for India

|  |  |
| --- | --- |
| Year | Employment (lakh) |
| 2012-13 | 1061.4 |
| 2013-14 | 1114.29 |
| 2014-15 | 1171.32 |

Source: Annual MSME reports from 2010 to 2018