PP No-04/2026

EGROW Foundation

FOUNDATION FOR ECONOMIC GROWTH & WELFARE

EGROW POLICY PAPER

MSMEs in India: Lessons from European Union

Charan Singh and Mahesh MV

January 2026

MSMEs in India: Lessons from European Union

Charan Singh[1] and Mahesh MV[2]

Executive Summary

Micro, Small and Medium Enterprises (MSMEs) are vital to economic growth, employment, and industrial diversification. In India, MSMEs contribute about 30 per cent of GDP and provide employment to nearly 30 million people. Despite their scale, Indian MSMEs underperform in productivity, manufacturing value addition, exports, and technology adoption. This contrasts with the European Union (EU), where MSMEs operate in high-cost environments yet contribute 45–70 per cent of GDP and a dominant share of manufacturing output, underscoring the importance of institutional and ecosystem support rather than firm size alone.

This policy note analyses MSME experiences in selected EU countries and draws lessons for strengthening India's MSME ecosystem, particularly in manufacturing. EU experience shows that MSME success is anchored in coherent ecosystems combining finance, skills, innovation, clusters, standards, and predictable regulation.

Country experiences highlight distinct strengths. Germany's Mittelstand benefits from patient finance, strong vocational and apprenticeship systems, and export orientation. France demonstrates the value of integrated public platforms that combine finance, innovation, advisory, and export support to help MSMEs scale. Italy shows how dense industrial districts and clusters generate collective efficiency, enabling small firms to compete globally. Other EU economies illustrate the role of MSMEs in supplier development, digitalisation, innovation, and sustainability transitions.

Indian MSMEs, by contrast, face persistent structural constraints. Productivity remains low due to limited technology adoption, skill gaps, informality, and inadequate infrastructure. Access to finance is skewed toward short-term credit, with limited patient capital for scaling and technology upgrading. Regulatory and compliance burdens are fragmented and unpredictable. Most critically, Indian MSMEs remain weakly integrated into domestic and global value chains.

The note distils key lessons for India: MSMEs must be placed at the core of industrial and export policy rather than addressed through fragmented schemes; institutional integration and one-stop delivery systems are essential; cluster and value-chain development can generate collective efficiency; skills and standards should be treated as productive assets; and digitalisation and the green transition should be leveraged as drivers of productivity and competitiveness.

A strategic shift toward a system-based MSME policy framework is essential to unlock higher productivity, deeper value-chain integration, and resilient, inclusive growth in India.

[1] Chief Executive, EGROW Foundation

[2] Professor, Operations Management, MYRA School of Business

1. Introduction

Micro, Small and Medium Enterprises (MSMEs) constitute the backbone of modern economies. Across both advanced and emerging countries, MSMEs play a decisive role in employment generation, regional economic balance, industrial diversification, and innovation diffusion. In India, MSMEs account for nearly 30 per cent of GDP and employ nearly 30 million people, making them indispensable for inclusive growth and social stability. Yet, despite their scale and entrepreneurial dynamism, Indian MSMEs continue to underperform in terms of productivity, manufacturing value addition, export participation, and technology absorption.

In contrast, MSMEs in the European Union (EU) operate in high-cost, high-regulation environments but contribute between 45 and 70 per cent of respective GDP of different countries and, in many countries, a majority share of manufacturing value added. This divergence highlights a central policy insight: MSME performance is not determined by firm size alone, but by institutional design, ecosystem support, and integration into industrial and financial systems.

This brief public policy note examines the cross-country experience of MSMEs in the EU, identifies salient practices and policy frameworks, analyses the challenges faced by MSMEs in India, and distils actionable lessons that can strengthen India's MSME ecosystem—particularly in manufacturing. The objective is to move beyond scheme-by-scheme analysis and propose a system-based policy perspective.

2. Cross-Country Experience in the EU – Importance, Practices and Policy Support for MSMEs

This section examines the performance of MSMEs in select countries of EU.

Germany

In Germany, MSMEs form the structural backbone of the economy, contributing around 50–55 per cent of GDP and nearly half of manufacturing value added. German MSMEs, commonly referred to as the Mittelstand, are globally recognised for their technological specialisation, export orientation, and long-term business horizons. They dominate precision engineering capital goods, machinery, automotive components, and industrial services, often occupying niche global markets.[3]

[3] Juuhi R. and C. Singh, *India-Germany Ties: Unlocking Economic Potential Through MSME Partnership*, EGROW Public Policy Paper no.-02/2025

Government support in Germany is characterised by predictable regulation, strong vocational and apprenticeship systems, patient finance, and export facilitation. Public development banks, export credit agencies, and innovation programmes are closely aligned with industry needs. Importantly, policy focuses not on firm survival but on capability deepening and global competitiveness.

France

In French, MSMEs contribute approximately 45–50 per cent of GDP and 35–40 per cent of manufacturing value added, playing a vital role in employment generation and regional economic cohesion. While large enterprises dominate certain sectors, MSMEs are critical in agri-processing, intermediate manufacturing, chemicals, and industrial services.

France has developed a highly integrated institutional support system for MSMEs, combining finance, innovation support, export promotion, and advisory services under unified public platforms. Government schemes are explicitly designed to help MSMEs scale up, internationalise, and innovate, rather than remain perpetually small.

Italy

Italy represents the most MSME-intensive manufacturing economy in Europe, with MSMEs accounting for 65–70 per cent of GDP and a similar share of manufacturing value added. Italian MSMEs are organised into dense industrial districts, specialising in textiles, leather, furniture, machinery, food processing, and design-intensive manufacturing.

Government support emphasises cluster development, export promotion, and shared infrastructure, rather than firm-level subsidies. The Italian experience demonstrates that MSMEs can dominate manufacturing output when embedded in geographically concentrated production systems that enable collaboration, knowledge spillovers, and flexible specialisation.

Spain

In Spain, MSMEs account for 60–65 per cent of GDP and around half of manufacturing value added. Their primary economic role lies in employment absorption, especially in light manufacturing, food processing, construction-linked industries, and services.

Spanish policy has increasingly focused on digitalisation, access to finance, and resilience-building, recognising MSMEs as stabilisers during economic downturns. Government schemes aim to reduce operational fragility and integrate MSMEs into broader service–manufacturing ecosystems.

Austria

Austrian MSMEs contribute 55–60 per cent of GDP and over half of manufacturing value added, playing a crucial role in regional economic stability and exports. Strong institutional finance, advisory systems, and skill development programmes support long-term competitiveness and balanced growth.

Poland and Czech Republic

In Central Europe, MSMEs have been pivotal in economic convergence and industrial upgrading. In Poland and the Czech Republic, MSMEs contribute around 50–55 per cent of GDP and 40–50 per cent of manufacturing value added, serving as suppliers to automotive, electronics, and machinery value chains.

Government support in these countries has focused on export readiness, standards alignment, supplier development, and integration with foreign direct investment (FDI). MSMEs are treated as vehicles for domestic value addition within global production networks.

Netherlands, Sweden and Denmark

In Northern Europe, MSMEs contribute 55–70 per cent of GDP, though their manufacturing share is relatively lower. Their importance lies in innovation, logistics, sustainability, and high-productivity services.

Governments in these countries support MSMEs through innovation ecosystems, applied research linkages, green finance, and digital infrastructure. MSMEs act as carriers of technological and environmental transitions, reinforcing national competitiveness despite high labour and regulatory costs.

3. Challenges Facing MSMEs in India

Despite their numerical strength, Indian MSMEs face persistent structural challenges. Productivity levels remain low, particularly in manufacturing, due to limited technology adoption, skill gaps, and inadequate access to quality infrastructure. Informality remains widespread, raising transaction costs and constraining access to finance and markets.[4]

Access to finance is heavily skewed toward short-term credit, with limited availability of patient capital for technology upgrading and scaling. Regulatory and compliance burdens are often fragmented and unpredictable, disproportionately affecting small firms. MSMEs also

[4] Assocham and EGROW, *MSMEs Facing Challenges in Doing Business* - https://egrowfoundation.org/research/msmes-facing-challenges-in-doing-business/

face difficulties in meeting global standards related to quality, sustainability, and traceability, limiting export participation.[5]

Perhaps most critically, Indian MSMEs remain weakly integrated into value chains, both domestic and global. Many operate as standalone units rather than as part of coordinated production systems.

A comparison of the productivity of the MSME sector in general in India and Europe as shown in below table clearly indicate the productivity lag in India.

Table 1: A competitive Analysis of MSMEs in India and EU

Category	**Europe (e.g., Germany, France, Italy, Poland)**	**India**
Micro & Small 1-49 employees	Productivity ~50-60 percent; 92 percent digital adoption	Productivity ~20-30 percent; skills mismatches and limited market access cut 20 percent potential. Low digital adoption
Medium >50 employees	Productivity Up to 104 percent; closest to large firms via internationalization and digital maturity. Government support adds 15 percent productivity (Oliver Wyman Closing the Gap 2024).	~30-50 percent; better integration but organization, technology and sustainability gaps persist

4. Lessons from EU Country Experience for Strengthening MSMEs in India

The EU experience highlights that MSME success depends less on firm size and more on the surrounding ecosystem—clusters, finance, skills, standards, and predictable rules—that allows small firms to operate at high productivity. For India, five sets of lessons are particularly salient: ecosystem-centric industrial policy, institutional integration, cluster and value-chain development, skills and standards as productive assets, and leveraging digital and green transitions as competitiveness strategies.

[5] EGROW Webinar, *Union Budget and MSMEs for Viksit Bharat@2047* - https://egrowfoundation.org/events/union-budget-and-msmes-for-viksit-bharat-2047/

4.1 MSMEs at the Core of Industrial Policy

EU countries deliberately place MSMEs at the heart of industrial strategy, linking them to sectoral roadmaps, export plans, and innovation missions. Rather than treating MSMEs as beneficiaries of stand-alone schemes, policy frames them as core actors in automotive, machinery, textiles, food processing, logistics, and green technology ecosystems.

For India, this implies that MSME policy should be fully integrated with manufacturing, export, and innovation strategies, not confined to a separate “MSME silo”. Sectoral plans (for example, PLI schemes, export promotion, and logistics reforms) can systematically incorporate supplier development, standards support, and cluster strengthening for MSMEs.

4.2 Institutional Integration over Scheme Proliferation

EU practice shows that a smaller number of well-designed, integrated instruments—combining finance, advisory, innovation, and export support—can be more effective than a large menu of fragmented schemes. Many countries use “one-stop” interfaces or ecosystem coordinators (development banks, regional agencies, chambers) that help MSMEs navigate programmes and meet compliance requirements.

In India, MSMEs often face overlapping schemes, multiple portals, and complex eligibility criteria, which increase search and transaction costs. Consolidating programmes around integrated service platforms at district or regional level, with clear accountability and data-sharing across agencies, would mirror EU-style institutional coherence.

4.3 Clusters, Supplier Networks and Collective Efficiency

Italian industrial districts and German supplier networks illustrate how geographically concentrated clusters and structured value chains can transform small firms into globally competitive producers. Shared infrastructure, joint marketing, common training centres, and collective access to technology and testing services enable “collective efficiency” that compensates for individual firm size.

India already has numerous natural clusters (textiles, leather, auto components, food processing), but institutional support is often underdeveloped and fragmented. Strengthening cluster governance institutions (SPVs, associations, park management entities) and linking them to finance, R&D, and export support would bring Indian clusters closer to EU models of district-based upgrading.

4.4 Skills, Vocational Systems and Standards

EU MSMEs benefit from strong vocational and apprenticeship systems that are closely aligned with local industry needs, especially in Germany, Austria, and Denmark. Formal qualifications, modular credentials, and industry-recognised certifications ensure that MSMEs can access a steady supply of skilled workers without bearing the full training cost individually.

In India, MSMEs often face acute skill shortages and weak links between training institutions and local employers. Adapting elements of the dual apprenticeship model—where training is co-designed and co-financed by firms and public institutions—could improve the relevance and scale of vocational education, while targeted support could help MSMEs adopt and maintain global quality and sustainability standards.

4.5 Digitalisation as an Enabler of Productivity

Across the EU, policy increasingly treats digitalisation (ERP, CRM, e-commerce, cloud, AI-enabled tools) as a key driver of MSME productivity, resilience, and market access. EU funds and national programmes support MSMEs through digital innovation hubs, advisory services, vouchers, and blended finance that lower the cost and risk of adopting new technologies.

For Indian MSMEs, digital adoption remains uneven, with many micro and small firms lacking both capabilities and finance to invest in digital tools. A focused strategy combining subsidised access to foundational digital platforms (payments, accounting, logistics), capacity-building, and targeted credit for technology upgrades could help close the productivity gap with European peers.

4.6 Green Transition and Sustainability as Competitiveness

EU policies embed MSMEs in the green transition through dedicated instruments for energy efficiency, renewable adoption, circular economy practices, and low-carbon technologies. Rather than viewing environmental regulation purely as a cost, many programmes link compliance with innovation and market opportunities, especially in export markets that increasingly require sustainability credentials.

India’s MSMEs face growing pressure to meet environmental, social, and governance standards from both domestic regulators and global buyers. Designing cluster-based and value-chain-based support for cleaner production, resource efficiency, and sustainability certification can simultaneously reduce costs (energy, waste) and improve export readiness, echoing EU practice.

4.7 Best Practices in EU

Some of best practices of the sector in Europe are listed below -

- Internationalization — EU single-market access and networks boost productivity 15–20 percent (France 86 percent view single market as crucial; Poland 90 percent international expansion)
- Digital Adoption — 90–95 percent adoption drives 2× productivity via AI/CRM; Spain overcomes skills gaps through targeted investment
- Market Dissemination — Bottom-up clusters (Italy) and regional financing close funding and market-access gaps
- Bureaucratic Support — Simplified EU regulations and agile strategies reduce burdens
- Talent Development, Skill Development, and Certifications — Training and international certifications yield 1.9–2.4× gains
- Innovation — R&D collaborations sustain innovation (Germany 28 percent innovators; Italy Lean 4.0 employee engagement)
- Government Support — Subsidies, financing ecosystems, and policy alignment accelerate recovery
- Sustainability — Cluster-based adoption (up to 95 percent in leading countries) and human-capital focus improve efficiency 10–15 percent

5. Conclusion and Way Forward for MSMEs in India

International experience, particularly from the EU, demonstrates that MSMEs can contribute half or more of GDP and manufacturing output when embedded in coherent ecosystems combining finance, skills, innovation, and predictable rules. The central challenge for India is therefore not entrepreneurial capacity, but structural and institutional enablement that unlocks higher productivity and deeper integration into domestic and global value chains.

A strategic reorientation is needed from fragmented, scheme-driven approaches toward a system-based competitiveness framework in which MSMEs are placed at the core of industrial, export, and innovation policy. This implies aligning sectoral strategies with MSME cluster development, supplier upgrading, and standards adoption so that small firms become integral components of national and global production systems rather than peripheral subcontractors.

Concretely, five priorities emerge for the way forward:

- Strengthen cluster and value-chain institutions so that MSMEs gain access to shared infrastructure, technology, and markets, replicating the collective efficiency seen in EU industrial districts.
- Integrate finance, skilling, innovation, and export promotion into unified delivery systems at regional and sectoral levels, reducing transaction costs and improving programme effectiveness.
- Build robust vocational and apprenticeship systems linked to local industry, enabling MSMEs to access a steady pipeline of skilled workers and adapt to technological change.
- Accelerate digital adoption through targeted credit, advisory support, and digital public infrastructure, enabling MSMEs to formalise, integrate into supply chains, and improve productivity.
- Embed green transition objectives into MSME policy, using cluster-based support and incentive structures to turn environmental compliance into a source of cost savings and export competitiveness.

Positioning MSMEs at the centre of India's manufacturing and export strategy is essential not only for growth and employment, but also for building a resilient, inclusive, and globally competitive economy in an era of technological and ecological transition. The EU experience is not mechanically replicable, but it offers a rich menu of institutional designs and policy instruments that can be adapted to India's federal structure, developmental priorities, and entrepreneurial strengths.