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Growth Potentials of Micro and Small-Scale Enterprises in Nepal

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ABSTRACT

Micro, Small and Medium Enterprises constitute a critical component of Nepal's economy by generating employment, enhancing household incomes, reducing poverty, and promoting inclusive and balanced economic development. To strengthen the MSE sector, the Government of Nepal has implemented several support initiatives, including the Micro Enterprise Development Programme for Poverty Alleviation (MEDPA) and the Youth and Small Entrepreneur Self Employment Fund (YSEF). Alongside these programs, a large number of enterprises have also been established independently through private initiative. This study evaluated the effectiveness of these support modalities using a longitudinal causal comparative research design. A total of 1,219 enterprises representing all seven provinces and three ecological regions of Nepal were followed over a three-year period (2023 to 2026) through baseline, follow up, and endline surveys. The study compared four groups: MEDPA supported enterprises, YSEF supported enterprises, independently established enterprises, and project supported beneficiaries. The results identified inadequate access to finance as the most significant constraint to enterprise growth, reported by 77% of YSEF beneficiaries, 71% of both MEDPA beneficiaries and independent entrepreneurs, and 60% of project beneficiaries. Access to affordable credit emerged as the highest priority financial need, identified by approximately 80% of respondents, underscoring the importance of expanding affordable financing mechanisms for enterprise growth. Comparative analysis further showed that project supported enterprises consistently outperformed the other groups, achieving the highest levels of product development (80%), process improvement (86%), sales growth (84%), and enterprise sustainability (84%). These findings demonstrate that integrated project-based support combining financial assistance, technical services, and business development interventions is more effective in enhancing enterprise performance than conventional support programs alone. The study highlights the need for strengthening access to finance, business development services, technology adoption, and market linkages to improve the competitiveness and long-term sustainability of micro and small enterprises in Nepal.

KEY WORDS: MSMEs, Entrepreneurship, Employment, Growth Indicators, Sustainability

INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) are widely recognized as the backbone of economic development because of their substantial contribution to employment generation, income creation, innovation, and poverty reduction. Globally, MSMEs account for approximately 90% of all businesses, generate more than 50% of total employment, and contribute significantly to national output and exports. In developing countries, MSMEs play an even more critical role by promoting inclusive growth, fostering entrepreneurship, and creating livelihood opportunities for disadvantaged groups. Consequently, strengthening the MSME sector has become a central policy priority for achieving sustainable economic growth and meeting the Sustainable Development Goals (SDGs).

In Nepal, MSMEs constitute the dominant segment of the business sector, accounting for 99.8% of all registered establishments and employing more than 84% of the national workforce. According to the Ministry of Finance (2021), small and medium enterprises alone contribute approximately 22% of the national Gross Domestic Product (GDP) and generate more than 1.7 million employment opportunities, highlighting their importance for inclusive economic growth and structural transformation. Despite their numerical dominance and economic significance, Nepal's MSME sector remains characterized by low productivity, limited innovation, and weak competitiveness. These challenges have constrained the sector's ability to expand production, penetrate export markets, and contribute more substantially to industrialization and economic diversification.

The evolution of entrepreneurship and MSME development in Nepal reflects a gradual transition from traditional cottage industries to a more structured, policy-oriented enterprise development system. The institutional foundation was established during the Rana regime through the formation of *Udhyog Parishad* (BS 1992), followed by the Company Act (BS 1993), which introduced the country's first legal framework for business registration. Subsequent institutions, including *Gharelu Tatha Gramin Udyog* (BS 2030) and the Department of Cottage and Small Industries (BS 2049), strengthened support for rural and small-scale enterprises. Since the 1990s, successive Industrial Policies and the Industrial Enterprises Act have further promoted private sector development, industrial competitiveness, and entrepreneurship, reflecting the government's increasing recognition of MSMEs as key drivers of economic development.

To accelerate enterprise development and address socioeconomic challenges, the Government of Nepal has implemented several entrepreneurship and innovation support initiatives, including the Micro Enterprise Development Program (MEDEP) initially and Micro Enterprise Development Program for Poverty Alleviation (MEDPA) afterwards, the Youth and Small Entrepreneur Self-Employment Fund (YSEF), Women Entrepreneurship Development Programs, and other enterprise promotion schemes. These interventions aim to improve entrepreneurial capabilities, expand access to finance, promote innovation, generate employment, and reduce poverty, particularly among youth, women, and marginalized communities. Together, these programs represent Nepal's shift from traditional enterprise promotion toward a more inclusive and innovation-driven MSME development strategy.

Despite these policy efforts, MSMEs continue to face persistent structural constraints that limit their growth and competitiveness. Limited access to finance, inadequate technological adoption, weak managerial and technical capabilities, poor infrastructure, and insufficient market linkages remains major barriers to enterprise expansion. Although numerous government and development partner programs have attempted to address these challenges, there is limited empirical evidence regarding their effectiveness in improving enterprise performance. Moreover, little is known about which interventions produce the

greatest impact, which categories of entrepreneurs benefit most, and whether public resources are being allocated efficiently to achieve inclusive and sustainable outcomes.
Against this background, this study evaluates the effectiveness of major entrepreneurship and Innovation Support Programs (ISPs) in promoting MSME growth in Nepal. Using key enterprise performance indicators—including product development, process improvement, market expansion, employment generation, access to finance, and sales growth—the study compares the outcomes of government-supported, project-supported, and non-supported enterprises. By generating robust empirical evidence on the effectiveness of existing support mechanisms, the study seeks to inform evidence-based policymaking, improve the design and implementation of MSME support programs, and contribute to strengthening Nepal's entrepreneurship ecosystem for sustainable and inclusive economic development.

LITERATURE REVIEW

Acharya (2025) compares the performance of MSMEs across South Asian countries and found substantial variation in their contributions to GDP and employment generation. The study reported that Sri Lanka had the highest MSME contribution to GDP at 52%, followed by Afghanistan at 50%, whereas the Maldives recorded the lowest contribution at 5.7%. In terms of employment, MSMEs account for 80% of non-farm employment in Pakistan, compared with 45% in both Nepal and Sri Lanka. India has the largest MSME sector, with 63.39 million (633.9 lakh) enterprises, yet ranks third in employment generation and fourth in GDP contribution. Bangladesh and Nepal demonstrate moderate MSME performance, whereas comparable data for Bhutan remain unavailable. These cross-country differences suggest that the economic contribution of MSMEs is shaped not only by their size but also by the policy environment, institutional support, and the stage of economic development.
CBS (2020) in the National Economic Census, 2018 Report spelled out that in developing economies, MSMEs contribution can reach up to 40% of GDP, highlighting their macroeconomic significance. In the Nepalese context, MSMEs constitute a substantial share of the enterprise landscape, with 923,356 establishments recorded, of which approximately 27% are women-owned.
Cravo and Piza (2016) reported that small and medium enterprise (SME) support programs are widely implemented in low- and middle-income countries to stimulate business growth and employment. These programs primarily focus on improving the business environment, expanding access to finance, strengthening entrepreneurial skills, promoting innovation, and enhancing market and value chain integration. Although such interventions generally contribute to improved enterprise performance and job creation, empirical evidence on their effectiveness remains limited. The authors therefore emphasize the need for more rigorous impact evaluations to identify the most effective support mechanisms and the conditions under which they generate sustainable outcomes.
Faye and Goldblum (2022) emphasize that small and medium sized enterprises (SMEs) are the backbone of employment generation and economic development worldwide. SMEs account for approximately 90% of all businesses, provide more than half of global employment, and contribute up to 40% of gross domestic product in many emerging economies. Despite their significant economic contribution, the growth and competitiveness of SMEs in developing countries are constrained by limited access to finance, which restricts investment, innovation, and business expansion.
Grimm M. and Paffhausen A. L. (2014) realize the fact that employment generation remains one of the most challenging outcomes of enterprise development for MSMEs. Although support interventions often improve business management, sales, profitability, and entrepreneurial capacity, these improvements do

not necessarily translate into additional employment. Expanding the workforce requires substantial increases in productivity, investment, and market demand, making job creation a gradual process. Consistent with the findings of Cho and Honorati (2014), finance and business training programs effectively enhance business knowledge, management practices, and, in some cases, enterprise income; however, their impact on sustainable employment generation is generally limited and statistically insignificant.

KC (2026) mentions that the Government of Nepal aims to achieve a USD 100 billion economy, 7% sustained economic growth, and USD 3,000 per capita income within the next 5–7 years through private sector-led development. Although MSMEs account for about 90% of businesses in developing economies, they contribute only 22% of Nepal's GDP, reflecting a barbell-shaped private sector with few medium-sized firms. Around 40% of Nepal's GDP remains informal, 49.5% of establishments are unregistered, and only 52% of registered firms maintain transaction records, limiting tax collection and business growth.

RU, NRB, Birgunj Office (2026) states that MSMEs are the backbone of Nepal's economy, making significant contributions to economic growth, employment generation, innovation, and social inclusion. They account for 99.8% of all business establishments (923,356 enterprises), employ 84.7% of the country's workforce (3,228,457 people), and generate 62.2% of total annual sales (NPR 2,915.6 billion). MSMEs also play a pivotal role in advancing women's entrepreneurship, with 99.96% of female-managed businesses (273,436 enterprises) belonging to this sector. These figures underscore the strategic importance of MSMEs as a key driver of Nepal's inclusive and sustainable economic development.

UNESCAP (2020) states that Nepal's economy grew at an average annual rate of approximately 4% over the past two decades; however, this growth has not translated into sufficient employment opportunities. As a result, the country has experienced rising labor migration, relatively slower economic progress than other South Asian economies, and a widening trade deficit. The report emphasizes that the Government of Nepal recognizes the strategic importance of MSMEs and has prioritized the development of an enabling business environment to enhance their productivity, competitiveness, and contribution to economic growth. Despite these efforts, MSMEs continue to face significant financing constraints due to limited access to formal credit, inadequate entrepreneurial and managerial capabilities, and persistent supply- and demand-side barriers in the financial sector. Further argues that strengthening financial inclusion, improving the policy and regulatory environment, and expanding access to appropriate financial services are critical to fostering MSME development and supporting Nepal's long-term structural transformation and sustainable economic growth.

UNCTAD (2018) indicates that access to finance is a key determinant of enterprise growth, employment creation, productivity, and business survival, particularly in least developed countries where financing constraints are severe. Small and young enterprises play a major role in generating employment, while larger firms contribute more substantially to productivity growth and structural transformation. The study further highlights the importance of supportive public policies, including improved infrastructure, effective state institutions, and targeted support for women and youth entrepreneurs to address barriers to entrepreneurship. It concludes that a balanced entrepreneurial ecosystem, supported by access to finance, innovation, and strong institutional frameworks, is essential for sustainable enterprise development and long-term economic transformation.

SIGNIFICANCE OF THE RESEARCH

Micro, Small, and Medium Enterprises (MSMEs) constitute the backbone of Nepal's private sector and play a pivotal role in employment generation, poverty reduction, entrepreneurship development, and inclusive economic growth. As MSMEs account for the overwhelming majority of business establishments and provide livelihoods to a large proportion of the workforce, strengthening their performance is essential for achieving sustainable economic transformation. Their widespread presence across both urban and rural areas contributes to balanced regional development by creating economic opportunities in locations where large-scale industries are either absent or economically unviable. Moreover, their relatively small scale and operational flexibility enable MSMEs to respond quickly to changing market conditions, promote innovation, and support local value addition.

Despite their economic significance, MSMEs in Nepal continue to face persistent constraints, including limited access to finance, inadequate technological capability, weak managerial skills, and poor market integration. To address these challenges, the Government of Nepal has introduced several entrepreneurship and innovation support programs aimed at enhancing enterprise productivity, competitiveness, and employment creation. However, there is limited empirical evidence regarding the effectiveness of these interventions in improving enterprise performance and achieving their intended development outcomes. Consequently, a systematic evaluation of these programmes is essential to determine whether public investments are generating measurable economic and social benefits.

This study is therefore significant because it provides evidence-based insights into the effectiveness of MSME support programs in Nepal using key enterprise growth indicators, including product development, process innovation, market expansion, employment generation, access to finance, and sales growth. The findings will help identify successful policy interventions, reveal existing implementation gaps, and support the design of more targeted, efficient, and inclusive entrepreneurship policies. The study will also contribute to the existing literature on MSME development while providing practical recommendations for policymakers, development partners, financial institutions, and entrepreneurs to strengthen Nepal's MSME ecosystem and promote sustainable and inclusive economic growth.

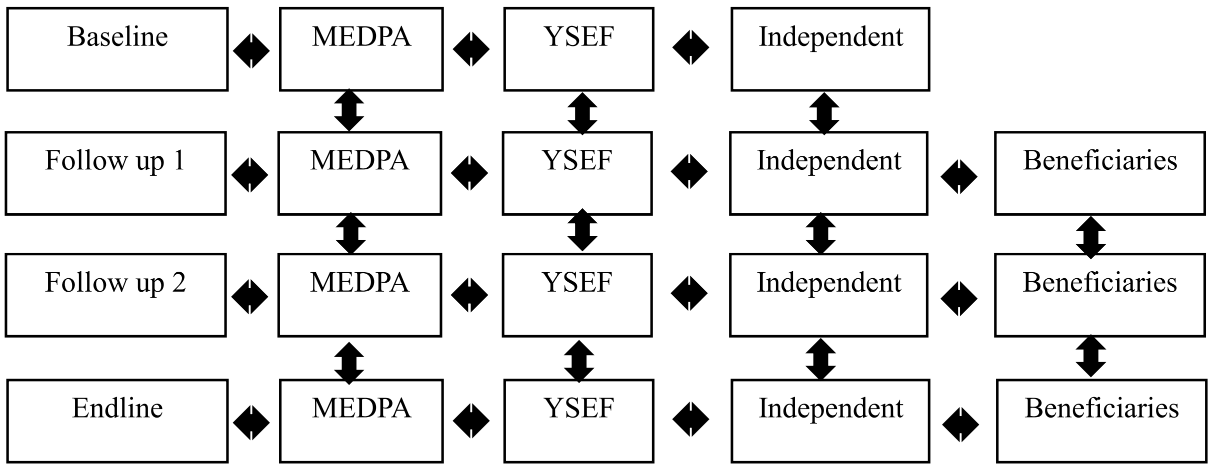
RESEARCH METHODLOGY

This study employed a mixed-methods approach by integrating both primary and secondary data sources. Initially, a comprehensive desk review was undertaken to examine past and ongoing MSME support programs implemented by the Government of Nepal. The review assessed the objectives, implementation modalities, institutional arrangements, and geographical coverage of these programs and identified the need for a more rigorous empirical assessment of their effectiveness. To complement the secondary evidence, exploratory field visits were conducted across all seven provinces to gain contextual insights into program implementation and stakeholder experiences. During these visits, extensive consultations were held with representatives from local governments, Cottage and Small Industries Offices, Provincial Ministries of Industry, the National Agriculture Modernization Program (formerly the Prime Minister Agriculture Modernization Project), YSEF, MEDPA (formerly MEDEP), and business associations, including the Federation of Nepalese Chambers of Commerce and Industry (FNCCI), the Federation of Nepal Cottage and Small Industries (FNCSI), and the Federation of Women Entrepreneurs' Associations of Nepal (FWEAN). Findings from the desk review and stakeholder consultations guided the selection of the two-flagship government entrepreneurship support programs—MEDPA and YSEF—for detailed empirical investigation.

Research Design and Sampling

The study adopted a causal-comparative research design with a longitudinal panel approach to evaluate and compare the performance of entrepreneurs supported under MEDPA and YSEF with two comparison groups. MEDPA and YSEF were selected because of their nationwide implementation, long operational history, and substantial contribution to the promotion of micro and small enterprises across Nepal. In addition to the two government-supported groups, the study included a project-supported group comprising 40 entrepreneurs who received need-based business support packages and a control group of independent entrepreneurs who had not participated in any structured support program. Data were collected from the same entrepreneurs over a three-year period through four consecutive survey rounds, enabling the assessment of changes in enterprise performance over time. Enterprise growth was evaluated using key indicators, including product development, process improvement, market expansion, employment generation, access to finance, sales growth, and business sustainability. The longitudinal design, combined with repeated observations and comparative analysis across the four study groups, strengthened the study's ability to identify the relative effectiveness of different MSME support interventions and generate robust evidence for policy and program improvement (Figure 1).

Figure 1: Research Design



The methodology and research design were developed and later validated through a workshop involving federal-level stakeholders. The study covered the High Himalayan region, the Middle Hill region, and the Lower Plain area representing all 3 ecological zones, 7 provinces and 753 local municipalities of Nepal. As people living in these zones experience different climates and shocks, social and economic conditions, opportunities, and cultural backgrounds. Taking these differences into account, the study selected at least one local government randomly from each ecological zone comprising both urban and rural municipalities. Cochran's formula for sample calculation was used, which was useful for determining a scientifically justified sample size even when precise population data were unavailable. It ensured the sample was representative by accounting for population variability and controlling the margin of error, shown in the formula below.

$$n = \frac{z^2.p.(1-p)}{e^2} = 384.16$$

where,

n is initial sample size (for large or infinite populations)

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z = Z-score corresponding to the desired confidence level (e.g., 1.96 for 95% confidence)
p = estimated proportion of the population with a particular characteristic
e = margin of error (level of precision), (e.g., 0.05 for ±5%)

The sample size for each of the three principal study groups—MEDPA beneficiaries, YSEF beneficiaries, and independent enterprises—was determined using Cochran's sample size formula, yielding a minimum of 384 MSMEs per group. To facilitate proportional allocation across provinces and ensure operational efficiency, the sample size was rounded to 400 enterprises for each group. In addition, 40 project-supported enterprises were purposively included as an intervention group to evaluate the effectiveness of demand-driven business support, resulting in an initial sample of 1,240 enterprises**.** The sample for each intervention group was proportionately allocated across the seven provinces based on the provincial distribution of MSMEs, and this allocation was maintained during the baseline survey. During the longitudinal follow-up, a small number of enterprises were lost because of business closure, migration, or non-response, while a limited number of replacement enterprises were enrolled to preserve sample representation. Consequently, the final analytical sample comprised 1,219 enterprises, as presented in Table 1**.**

Table 1: Sampled MSMEs by Province, Ecological Region, Municipalities and study groups

Province	Ecological Region*	No. of Municipalities	MEDPA	YSEF	Independent	Experiments	Total
Koshi	M, H, T	4 rural/7 urban	70	69	72	10	221
Madhesh	T	1 rural/1 urban	48	52	50	3	153
Bagmati	M, H, T	2 rural/7 urban	122	119	115	3	359
Gandaki	M, H, T	1rural/5 urban	41	41	49	3	134
Lumbini	H, T	4 rural/4 urban	64	66	62	10	202
Karnali	M, H	1 rural/2 urban	20	21	20	2	63
Sudurpaschim	M, H, T	1 rural/4 urban	25	25	28	9	87
Total		44	390	393	396	40	1219

*Note: *M=Mountain, H= Hill & T= Terai (plain area)*

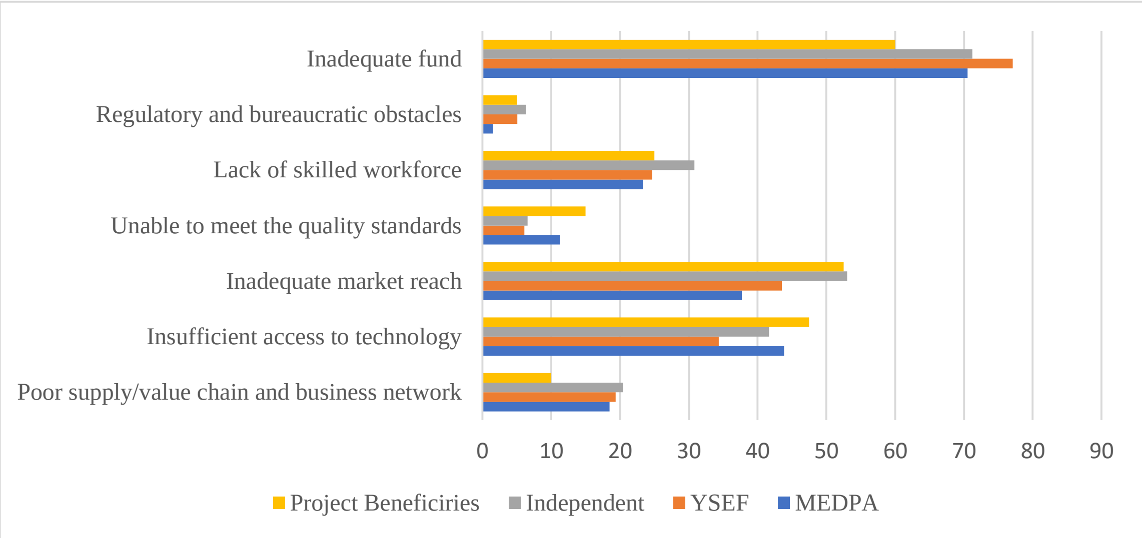
Sectoral Coverage

To capture the diversity of Nepal's MSME sector, the sampled enterprises were classified according to the Nepal Standard Industrial Classification (NSIC)**.** Enterprises were grouped into three broad sectors: agriculture-based enterprises**,** manufacturing and production enterprises, and service enterprises, each comprising multiple subsectors. Furthermore, enterprises were categorized as micro, small, or medium enterprises in accordance with the prevailing definitions specified in Nepal's Industrial Enterprises Act. This sectoral stratification ensured adequate representation of different enterprise types and enhanced the generalizability of the study findings across Nepal's MSME sector.

KEY FINDINGS

The sampled MSMEs across the four study groups, namely MEDPA, YSEF, Independent, and Project Beneficiaries, were asked to identify the most significant challenge constraining their business growth. The findings revealed that inadequate access to finance was the predominant constraint, reported by 77% of MSMEs under YSEF, 71% of MSMEs under both MEDPA and the Independent group, and 60% of MSMEs under the Project Beneficiaries group. In addition to financial constraints, respondents identified several other factors limiting enterprise growth, including inadequate market access, limited access to appropriate technology, a shortage of skilled workers, weak supply and value chain linkages, limited business networking opportunities, and an inability to comply with required quality standards (Figure 2).

Figure 2: Percentage Response on Most Significant Challenge Constraining



The sampled MSMEs were asked to identify the types of financial support they considered most beneficial for sustaining and expanding their businesses. The findings indicate that access to affordable credit was the most preferred form of financial assistance, with approximately 80% of respondents identifying it as a critical requirement for business growth. This was followed by grants for business development, which were preferred by 78% of the respondents, while 43% emphasized the need for financial literacy and financial management training to strengthen their managerial and financial capabilities. These findings suggest that MSMEs require not only financial resources but also capacity building interventions to improve the effective utilization and management of those resources.

A notable finding of the study is that nearly 90% of MSMEs supported under the Youth Self Employment Fund (YSEF) also identified access to affordable loans as their primary financial need. This result indicates that, despite receiving financial assistance through the YSEF program, the existing loan amount is generally insufficient to meet the working capital and investment requirements necessary for business expansion and long-term growth. Consequently, many YSEF supported enterprises continue to face financial constraints that limit their ability to increase production, adopt improved technologies, diversify products, and access new markets. These findings underscore the need to review the size and terms of institutional financing schemes so that they better align with the evolving capital requirements of growing MSMEs (Table 2).

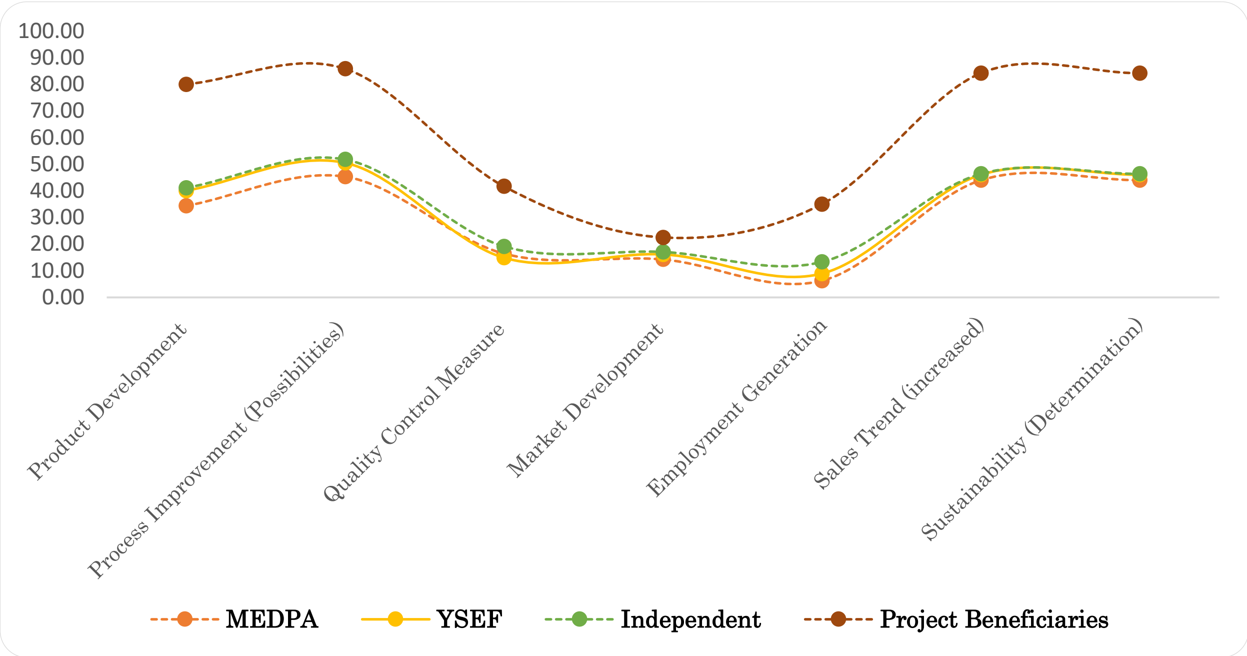
Table 2: Type of Expected Financial Support by Support Groups (Multiple Response)

Groups	Type of Expected Support											
	Financial Literacy and Management Training			Grants for Business Development			Access to Affordable Loan			Others		
	f	Total	%	*f*	Total	%	*f*	Total	%	*f*	Total	%
MEDPA	162	390	41.5	321	390	82.3	271	390	69.5	29	390	7.4
YSEF	152	393	38.7	282	393	71.8	352	393	89.6	14	393	3.6
Independent	191	396	48.2	323	396	81.6	319	396	80.6	16	396	4.0
Project Beneficiaries	17	40	42.5	26	40	65.0	28	40	70.0	2	40	5.0
Grand Total	522	1219	42.8	952	1219	78.1	970	1219	79.6	61	1219	5.0

Note: *f* stands for the frequency of MSMEs out of total respondent MSMEs in Multiple Response Question.

Enterprise growth was assessed using seven key indicators: product development, process improvement, quality enhancement, market development, employment generation, access to finance, sales growth, and enterprise sustainability. Using a causal comparative research design, the performance of MSMEs across the four study groups was monitored over a three-year period to evaluate the effects of different support interventions on enterprise development. The comparative analysis revealed substantial differences among the four groups. Overall, Project Beneficiaries consistently outperformed MEDPA, YSEF, and independent enterprises across most indicators. They recorded the highest levels of product development (80%), process improvement (86%), sales growth (84%), and enterprise sustainability (84%), indicating that project-based interventions were highly effective in promoting business innovation, productivity, and long-term growth. Among the remaining groups, independent enterprises generally performed better than MEDPA and YSEF beneficiaries, particularly in process improvement (52%), quality enhancement (19%), and sales growth (47%), reflecting relatively stronger managerial capacity and market responsiveness. YSEF beneficiaries exhibited comparable performance, especially in product development and process improvement, whereas MEDPA beneficiaries consistently recorded the lowest performance across most enterprise growth indicators. Despite the superior performance of Project Beneficiaries, all four groups showed relatively weak outcomes in market development and employment generation, with achievement levels ranging from 6% to 35%. These findings suggest that limited market expansion and low employment creation remain persistent constraints for MSMEs regardless of the type of support received, highlighting the need for interventions that strengthen market linkages and promote business expansion (Figure 3).

Figure 3: Percentage Performance of MSMEs by Growth Indicators and Type of MSMEs Groups



CONCLUSION

This study provides empirical evidence on the effectiveness of major entrepreneurship and innovation support programs in promoting the growth of Micro, Small, and Medium Enterprises (MSMEs) in Nepal. Using a longitudinal causal comparative research design, the performance of 1,219 enterprises was monitored over a three-year period across four study groups: MEDPA beneficiaries, YSEF beneficiaries, independent entrepreneurs, and project supported enterprises. The findings demonstrate that although all support mechanisms contributed to enterprise development to varying degrees, their effectiveness differed substantially across key enterprise growth indicators.

Access to finance emerged as the most critical constraint limiting MSME growth irrespective of the type of support received. A large majority of enterprises identified affordable credit as their highest priority, indicating that existing financial support mechanisms remain inadequate to meet the capital requirements of growing businesses. Even among YSEF beneficiaries, who had already received financial assistance, nearly nine out of ten respondents expressed the need for additional affordable loans, suggesting that current financing arrangements are insufficient to support enterprise expansion, technology adoption, and market diversification.

The comparative analysis further revealed that enterprises receiving integrated project-based support consistently achieved superior performance in product development, process improvement, sales growth, and enterprise sustainability compared with MEDPA, YSEF, and independent enterprises. These findings indicate that comprehensive support packages combining financial assistance with technical guidance, business development services, and continuous mentoring are substantially more effective than standalone financial or entrepreneurship support programs. The relatively better performance of independent enterprises over some government supported groups also suggests that entrepreneurial capability and market orientation play important roles in determining enterprise success.

Despite these positive outcomes, the study found persistently weak performance in market development and employment generation across all enterprise groups. This suggests that existing support programs have focused primarily on enterprise establishment and operational improvement while giving comparatively less attention to market expansion, value chain integration, business networking, and employment creation. Addressing these structural constraints will be essential for enabling MSMEs to achieve higher productivity, greater competitiveness, and stronger contributions to national economic development.

Overall, the findings highlight the need to strengthen Nepal's MSME support ecosystem through more integrated, demand driven, and growth-oriented interventions. Future policies should prioritize expanding access to affordable finance, strengthening business development services, promoting technology adoption, improving market linkages, and enhancing entrepreneurial and financial management capabilities. Such reforms will improve the effectiveness of public investments in entrepreneurship promotion while enabling MSMEs to contribute more substantially to employment generation, poverty reduction, innovation, and sustainable economic growth in Nepal.

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