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Perspectives

Micro, Small, and Medium Enterprises in India: Structural Issues and Prospects

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ABSTRACT

The Micro, Small, and Medium Enterprises (MSME) sector constitutes a foundational pillar of India's economic architecture. It plays a critical role in fostering inclusive industrialization, mitigating regional economic disparities, generating widespread employment opportunities, and anchoring the country's export performance. This article provides a comprehensive, multi-dimensional analysis of the MSME landscape in India. It examines its current macroeconomic contributions to national output, employment, and external trade. The paper systematically explores the major structural bottlenecks impeding the sector—most notably the systemic formal credit deficit, asymmetric digital and advanced technological adoption, and global value chain (GVC) integration hurdles. Finally, strategic policy corrections are proposed to transition Indian MSMEs from domestic survivalist entities into competitive, high-value global enterprises.

KEYWORDS: MSME Sector, Inclusive Growth, Industrial Clusters, Employment, India

INTRODUCTION

The Micro, Small, and Medium Enterprises (MSME) sector is widely recognized as the engine of socioeconomic transformation and industrial dynamism in developing market economies. In the unique macroeconomic context of India, characterized by severe spatial income disparities

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and high structural underemployment within the agricultural workforce, the MSME framework represents a potent vehicle for decentralized, low-capital industrialization (Lahiri, 2024). Often referred to as the backbone of the national economic framework, these enterprises display an inherent capacity to utilize localized raw materials, mobilize domestic savings, and spark grassroots entrepreneurship across economically lagging geographies (Shelke, 2024).

Historically, the administrative and regulatory architecture governing smaller enterprises in India has evolved alongside shifting national economic paradigms. In the decades immediately following independence, policy parameters focused primarily on the protection and promotion of Small-Scale Industries (SSIs). This was achieved via rigid industrial licensing protocols, protective product reservation lists, and fiscal concessions designed to insulate domestic manufacturing from concentrated corporate monopolies and foreign competition (Marathe, 2024). This historical framework was codified under the Industries (Development and Regulation) Act of 1951, which evaluated enterprise scale through limited lenses of capital investments in fixed physical plant and machinery assets.

However, the structural adjustments and liberalization policies of 1991 exposed these traditional SSIs to hyper-competitive market forces and complex international trade agreements. This necessitated a wholesale modernization of the regulatory ecosystem. The conceptual shift from isolated small-scale manufacturing units to an integrated service-and-manufacturing spectrum was formally achieved through the passage of the Micro, Small, and Medium Enterprises Development (MSMED) Act of 2006. The MSMED Act unified the legal frameworks, introduced a tiered architecture of Micro, Small, and Medium categories, and formally integrated the rapidly growing services sector within its regulatory ambit. As the economy grew increasingly complex and digitized, the rigid thresholds defined in 2006 became counterproductive. They incentivized a structural "dwarfism," where firms deliberately constrained their growth to preserve fiscal concessions, subsidized utility tariffs, and regulatory exemptions. To eliminate this systemic growth barrier, the Union Government enacted a structural overhaul on July 1, 2020. This framework eliminated the long-standing regulatory divide between manufacturing and service enterprises. It introduced a composite classification matrix combining initial capital investment in plant, machinery, or equipment with total annual turnover, creating an administrative pathway designed to encourage firms to scale without fear of losing institutional support benefits (Kartik, 2024).

CONTRIBUTIONS OF MSME SECTOR TO ECONOMIC GROWTH OF INDIA

The MSME sector functions as a vital engine for the generation of gross domestic output. According to historical national accounts data, the share of MSME GVA within the country's total GDP rebounded steadily from a pandemic-induced low of 27.3% in FY 2020-21 to 29.6% in FY 2021-22, eventually consolidating at 30.1% during FY 2022-23 (Lahiri, 2024). This structural resilience indicates the sector's capability to absorb macroeconomic shocks and drive post-crisis industrial stabilization.

In addition to the capital formation and output metrics, the sector's most profound socio-economic utility lies in its capacity to generate employment. It represents the second-largest employer in the country, trailing only the primary agricultural sector (Sanap, 2025). Due to lower capital requirements per worker compared to large capital-intensive corporate conglomerates, MSMEs offer an accessible platform for livelihood generation across diverse segments of the population. The sector accounts for more than 110 to 120 million jobs across the country, effectively employing approximately 23% of the total available domestic workforce (Kartik, 2024; Shelke, 2024). These positions act as critical buffers against agrarian distress, providing secondary income streams that help mitigate seasonal unemployment trends in rural and semi-urban clusters.

Indian MSMEs have also integrated themselves into global supply chains, serving as primary or secondary vendors for high-volume export industries. The primary sectors driving this export performance include labor-intensive and craft-heavy segments such as textiles and ready-made garments, leather products, marine and agro-processed items, hand tools, auto components, and gems and jewellery (Shelke, 2024).

REGULATORY ECOSYSTEM FOR MSME SECTOR

The operational parameters defining MSMEs have undergone strategic re-alignments to better reflect prevailing inflation dynamics, asset pricing trends, and industrial growth requirements. Under the baseline provisions of the MSMED Act of 2006, classification thresholds were bifurcated by sector, evaluating manufacturing entities on their investment in plant and machinery, and service providers on their investment in equipment (Kumari, 2024). This split system created complex compliance barriers as the boundary between modern manufacturing and technology-enabled services grew increasingly blurred. The composite criteria enacted in July 2020 solved this issue by matching initial investment and annual turnover across a uniform

framework, which was updated through legislative changes to match subsequent industrial expansion needs.

The unified framework categorizes enterprises into three distinct tiers using dual ceilings for both investment and annual turnover. To remain within a specific tier, an enterprise must comply with both criteria; exceeding either limit shifts the enterprise into the next higher operational tier:

- **Micro-Enterprises:** Entities where the total investment in physical plant, machinery, or operational equipment does not exceed ₹2.5 crore, alongside a total annual sales turnover capped at ₹10 crore
- **Small Enterprises:** Entities where capital asset investment ranges up to ₹25 crore, combined with a total annual market turnover ceiling of ₹100 crore
- **Medium Enterprises:** Larger corporate entities within the segment where the total capital asset base extends up to ₹125 crore, paired with an annual turnover threshold not exceeding ₹500 crore

This structural expansion of investment and turnover caps allows progressive firms to upgrade their manufacturing technologies, attract external equity investments, and broaden their operational scales. Crucially, they can pursue this growth without facing an abrupt loss of primary priority-sector lending benefits or targeted government procurement preferences.

STRUCTURAL ISSUES

The Indian MSME sector possesses substantial latent capacity, but its long-term growth trajectory remains constrained by structural bottlenecks. These issues restrict productivity, lower product quality, and limit competitiveness on the international stage.

The most immediate challenge threatening the survival and growth of MSMEs is a persistent lack of adequate and timely formal bank credit. While large corporate houses have direct access to diversified commercial debt instruments and equity markets, small units rely almost entirely on formal banking channels and non-banking financial companies (NBFCs) for working capital and capacity expansion. However, formal banking institutions frequently view micro-enterprises as high-risk borrowers due to their lack of structured credit histories, verifiable tax records, and real estate collateral (Kumari, 2024).

This creates an acute financial allocation imbalance. This credit rationing forces smaller entrepreneurs to depend on informal credit networks, local moneylenders, and unorganized trade finance channels. These alternative sources charge high interest rates that quickly erode the thin operating margins of small firms. Furthermore, cash-flow stress is frequently worsened by delayed payments from large corporate buyers and public sector departments, which locks up vital working capital for long periods.

In an era dominated by automated manufacturing, enterprise resource planning (ERP) platforms, and predictive artificial intelligence algorithms, a large portion of the Indian MSME framework continues to operate using outdated machinery and manual processes (Kumari, 2024). Smaller enterprises often view advanced technological upgrades as a major capital expense rather than a strategic tool for cost optimization. High upfront costs, a lack of technical internal talent, and uncertainty regarding return on investment (ROI) timelines lead to widespread hesitation among owners. This structural gap is evident in recent technology assessments across the sector: While nearly 94% of technology-driven or urban-adjacent MSMEs report an active awareness of generative and operational artificial intelligence frameworks, approximately 65% admit they lack the foundational knowledge required to select or deploy appropriate tools (Lahiri, 2024). Moreover, nearly 91% of these firms believe that high-cost barriers and limited technical skill bases will prevent them from adopting advanced automated solutions in the near term (Lahiri, 2024). As a result, labor productivity within the sector has faced downward pressures, with some surveys indicating a downward annual trend of -4.3% in comparative labor output efficiencies across unorganized segments (Kartik, 2024).

Although MSMEs contribute significantly to gross domestic export statistics, their positioning within Global Value Chains (GVCs) is concentrated in low-value segments. India's broader participation within high-value downstream global exports remains limited, contributing roughly 1.5% to total global GVC trades (Kartik, 2024). Indian MSMEs are often locked into midstream manufacturing activities, producing basic raw components or low-margin consumer goods rather than highly specialized, high-value components (Kartik, 2024). This low positioning stems from strict international quality standard expectations, sophisticated testing and certification requirements, and long clearance timelines at customs borders—with export clearances taking an average of 17.3 days (Kartik, 2024). Additionally, lingering infrastructure bottlenecks—such as erratic power supplies in rural industrial clusters, poor cold-chain logistics networks, and high domestic transport costs—increase operational expenses,

preventing smaller enterprises from achieving the cost efficiencies needed to compete on price with peers across East and Southeast Asia.

GOVERNMENT SCHEMES AND POLICY INTERVENTIONS

To systematically address these credit, technology, and market access gaps, the Ministry of MSME and the Reserve Bank of India have developed an extensive ecosystem of targeted institutional schemes and statutory policies.

The government's primary financial strategy focuses on replacing traditional, asset-backed lending requirements with cash-flow-based, credit-guaranteed lending systems.

- **Pradhan Mantri Mudra Yojana (PMMY):** This scheme provides collateral-free institutional loans up to ₹10 lakh to non-corporate, non-farm micro and small enterprises. Structured into three operational segments—*Shishu* (loans up to ₹50,000), *Kishor* (loans up to ₹5 lakh), and *Tarun* (loans up to ₹10 lakh)—PMMY leverages institutional networks including commercial banks, Regional Rural Banks (RRBs), and microfinance institutions (MFIs) to extend credit to women entrepreneurs, low-income communities, and rural micro-startups.
- **Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE):** To encourage commercial banks to lend to higher-risk segments without demanding land or real estate collateral, CGTMSE provides state-backed credit guarantee cover to institutional lenders. Over the years, the maximum eligible loan limit covered under the trust has been raised to ₹500 lakh. This structure mitigates credit default anxieties for commercial banks by ensuring the trust absorbs a substantial portion of the underlying loss in the event of liquidation or default.
- **Emergency Credit Line Guarantee Scheme (ECLGS):** Launched as an emergency response during pandemic-induced disruptions, ECLGS offered fully guaranteed, collateral-free automatic credit lines to inject operational liquidity into struggling businesses. The scheme was highly effective due to its simple operational design, sanctioning over ₹2,370 billion to approximately 11.4 million borrowers. This intervention prevented widespread insolvencies and provided the liquidity required to restart supply links.

Apart from liquidity support, long-term competitiveness requires institutional support for innovation and modern industrial infrastructure.

- **Raising and Accelerating MSME Performance (RAMP):** Backed by a structural co-investment from the World Bank totaling ₹6,000 crore over a five-year horizon, RAMP aims to strengthen center-state institutional collaborations, improve market access, and optimize central policy monitoring mechanisms. It funds Strategic Investment Plans (SIPs) at the state level to directly address localized market failures and support technology-transfer projects.
- **SFURTI & ASPIRE Clusters:** The Scheme of Fund for Regeneration of Traditional Industries (SFURTI) focuses on organizing traditional rural artisans into collaborative clusters, introducing modern machinery, and establishing shared common facility centers (CFCs) to achieve economies of scale (Shelke, 2024). This is complemented by ASPIRE (A Scheme for Promotion of Innovation, Rural Industries, and Entrepreneurship), which funds livelihood business incubators to promote agro-based rural entrepreneurship (Shelke, 2024).

The integration of digital public infrastructure has enabled the government to streamline regulatory onboarding and address long-standing data asymmetries across the sector.

- **The Udyam Registration Portal:** This paperless, self-declaration platform simplifies the formal registration process by linking directly with the Income Tax and GSTN systems. It provides registered units with a permanent Udyam Registration Number, which serves as an official identity document required to access priority sector lending, credit guarantees, and government public procurement tenders (Shelke, 2024).
- **Open Network for Digital Commerce (ONDC):** ONDC is designed to break up market concentration on large, proprietary e-commerce platforms. It offers an unbundled, open-source network protocol that allows micro-retailers and small-scale manufacturers to showcase their products across multiple consumer facing applications (Shelke, 2024). By reducing customer acquisition costs and intermediary commissions, ONDC enables small firms to access national and international consumer bases directly.

STRATEGIC POLICY RECOMMENDATIONS

To transition India's MSME sector from survivalist entities focused on local markets into competitive, high-growth global enterprises, several policy adjustments are required as discussed below.

Transitioning to Alternative Cash-Flow Based Credit Underwriting: Traditional commercial banking models that rely heavily on real estate collateral exclude a large portion of the micro-enterprise segment. Financial regulators should incentivize commercial banks and NBFCs to transition toward algorithmic, data-driven cash-flow underwriting. By leveraging the digital footprints generated via the Account Aggregator framework, GST invoice filings, and Udyam data repositories, financial institutions can accurately assess a firm's real-time creditworthiness based on transparent transaction histories rather than physical fixed assets.

Expansion of Low-Cost "Plug-and-Play" Technology Hubs: To lower the high upfront capital expenditures that deter small firms from adopting modern technologies, state governments should invest in public-private partnerships to build specialized Plug-and-Play Industrial Parks. These centres can offer shared access to advanced CNC machining centres, industrial 3D printing equipment, automated packaging lines, and green testing laboratories on a pay-per-use or subsidized leasing model. This allows micro-enterprises to manufacture export-grade products without taking on heavy debt burdens for technology procurement.

Rationalization of Compliance and Single-Window Clearances: Despite progress in digital governance, small entrepreneurs still face a fragmented array of compliance requirements across municipal, state, and central bodies, particularly concerning environmental consents, labor laws, and factory licenses. Integrating these processes into a unified, legally binding National Single-Window Clearing System with strict timelines for approvals would significantly reduce regulatory friction. Furthermore, implementing a "deemed approval" mechanism for non-hazardous micro-units would allow entrepreneurs to focus resources on product scaling and market expansion rather than administrative compliance.

CONCLUSION

The Micro, Small, and Medium Enterprises sector remains vital to India's long-term economic strategy, acting as an essential bridge between economic growth and social inclusion. The sector's structural metrics—contributing 30% of total national output, providing livelihoods to over 110 million citizens, and driving nearly half of national outbound merchandise trade – highlight its foundational role in sustaining economic stability. However, addressing the long-standing structural challenges within the sector is essential to unlocking its full potential.

Resolving the systemic formal credit deficit requires transitioning from collateral-heavy lending models to cash-flow-based digital underwriting. Similarly, bridging technology gaps requires targeted support for automation, digital platforms, and skill development to enhance labor productivity. While programmatic interventions such as the PMMY, CGTMSE, and RAMP frameworks have established a strong baseline of institutional support, their long-term efficacy depends on continuous administrative simplification and the deeper integration of digital public infrastructure like ONDC. By systematically reducing regulatory friction and supporting technological upgrades, India can enable its vast ecosystem of micro and small enterprises to scale effectively, integrate into global value chains, and serve as competitive drivers of sustainable industrial growth.

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