




The Trajectory of Indian MSMEs: Evolution, Constraints, and Policy Implications

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<https://doi.org/10.55041/ijst.v2i4.363>

Cite this Article: V, H. (2026). The Trajectory of Indian MSMEs: Evolution, Constraints, and Policy Implications. International Journal of Science, Strategic Management and Technology, 02(04). <https://doi.org/10.55041/ijst.v2i4.363>

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Abstract

This paper aims to analyse the current scenario of MSMEs in India and explore the prospects of the MSME sector in the era of tense global economic volatility. This paper is purely a conceptual paper.

This paper examines the pivotal role of Micro, Small, and Medium Enterprises (MSMEs) as the "backbone" of the Indian economy. Contributing significantly to industrial output, exports, and employment generation, the MSME sector acts as a primary driver of equitable growth and regional development. This study analyses the current landscape of Indian MSMEs, exploring their contributions to the Gross Domestic Product (GDP) and their resilience in the face of global economic shifts and conflicts between nations. It also highlights the key factors that hinder the growth of MSMEs and advocates for policy recommendations to support their development.

Key Words -MSMEs economic growth, inclusive growth, driver of regional development, Composition of MSMEs.

Paper Type- Conceptual paper.

Introduction:

Micro, Small and Medium Enterprises (MSMEs) are considered as one of the most dynamic and vibrant sectors of economies around the world. This vital sector is characterized mainly by low capital investments, use of traditional or inherited skills, local resource utilization and high employment potential. According to the data provided by International Council for Small Business (ICSB), formal and informal MSMEs together make up over 90% of all firm across the world. These MSMEs account for 70% of total employment and 50% of Gross Domestic Product (GDP) of all economies in the world (International Council for Small Business, 2019).¹ MSMEs employs most of the vulnerable population such as women, youth, and rural poor. By providing employment and income generation opportunities to such vulnerable population, MSMEs have been a major driver of poverty alleviation and rural development around the world. Recognizing the importance of MSMEs, the United Nations General Assembly (UNGA) has announced to celebrate 27th June of every year as the Micro, Small and Medium Enterprises (MSME) Day. The United Nations has also identified MSMEs as one of the important contributors in achieving Sustainable Development Goals (SDGs) Governments of all countries around the world put a premium on these MSMEs and provide sufficient funding provisions for the sector in their plans and policies (United Nations, 2018).² The MSME sector is a vital constituent of the industrial sector in any economy and India is no exception. MSMEs have played a major role in making India one of the fastest growing economies in the world. MSME sector is the second largest employment provider in India after agriculture sector. More than 80% of the total enterprises in India are MSMEs (MSME Mentor, 2017).

History and Evolution of MSMEs in India.

MSMEs are considered the pillar of the Indian economy and a mechanism for a country's inclusive growth and sustainable development. The second largest employment-providing sector after the agriculture sector in India.

Micro, small, and medium-sized enterprises (MSMEs) are generally classified based on the amount of money they invest in plant, machinery, or equipment.

1. The post-Independence Era (1947–1990): Protectionism and Small-Scale Industries (SSI)

In the years immediately after independence, government policy was predominantly agrarian and aligned with Gandhian principles of self-reliance. During this period, the sector was officially referred to as “Small Scale Industries” (SSI). The Karve Committee (1955): This committee formally recognized the SSI sector as a crucial instrument for decentralized rural development and substantial employment generation. Policy of Reservation: To shield nascent small enterprises from large domestic monopolies and foreign competition, the government implemented a stringent protectionist policy. Hundreds of product categories (including textiles, leather, and matches) were exclusively reserved for SSI production. Focus: Survival, employment creation, and poverty alleviation rather than global competitiveness or technological advancement.

2. Economic Liberalization (1991–2005): Deregulation and the Shift to Competitiveness

The economic reforms of 1991 significantly changed the trajectory of the small-business sector. The dismantling of the “License Raj” exposed Indian SSIs to global markets and multinational corporations. De-reservation: The government progressively dismantled product reservation, compelling SSIs to compete on quality and price rather than relying on state protection. Shift in Focus: The policy emphasis moved from “protection” to “promotion.” The government began establishing institutions such as the Small Industries Development Bank of India (SIDBI) to improve credit flow and launched schemes for technological upgrading to help SSIs survive in an open market.

3. Statutory Recognition and Expansion of Scope (2006)

The year 2006 represents the most consequential structural milestone in the sector’s history’s Act, 2006: The Micro, Small and Medium Enterprises Development Act established the first comprehensive legal framework for the sector. Introduction of "Medium" and "Services": Importantly, the Act formalized the acronym "MSME." It added the “Medium” enterprise category to acknowledge that smaller firms require room to scale, and, for the first time, explicitly encompassed the Services sector alongside manufacturing. Classification Basis: Enterprises were strictly categorized based on their initial investment in plant and machinery.

4. The Modern Era (2020–Present): Reclassification and Digital Formalization

The economic impact of the COVID-19 pandemic compelled a complete redefinition and monitoring of MSMEs, giving rise to the current regulatory framework. The Composite Definition (July 2020): To deter firms from artificially limiting growth to maintain MSME benefits, the government replaced the prior investment-only criteria with a composite standard of Investment AND Annual Turnover. Additionally, the distinction between manufacturing and service MSMEs was entirely removed. Digital Integration: The launch of the Udyam Registration Portal (2020) and the Udyam Assist Platform (2023) signified a fundamental shift toward digital formalization. By tying registration to PAN and GST networks, the state transitioned from a fragmented, manual tracking system to real-time, data-driven policymaking.

The MSMED Act, 2006

The Micro, Small and Medium Enterprises Development (MSMED) Act was enacted in 2006 to create a robust legal framework that addresses the specific needs of this sector. Its primary aim is to promote, develop, and improve the competitiveness of MSMEs. One of the Act's most significant contributions was establishing a clear, uniform classification system for enterprises based on investment in plant and machinery or equipment (which has since been revised to include annual turnover). Beyond classification, the Act provides a legal basis for the National Board for MSMEs, mandates policies to tackle the persistent issue of delayed payments, and delineates preferential procurement policies by the government. By streamlining administrative processes and offering a mechanism for dispute resolution through Facilitation Councils, the MSMED Act serves as a vital foundation for safeguarding the interests of small-scale entrepreneurs in India. Definition as per act.

The earlier classification of MSMEs in India was based solely on investment thresholds, with separate criteria for manufacturing and services sectors. In the manufacturing sector, micro enterprises were defined as those with investment in plant and machinery below ₹25 lakhs, small enterprises between ₹25 lakhs and ₹5 crores, and medium enterprises between ₹5 crores and ₹10 crores. In the services sector, the thresholds were lower: micro enterprises had investments below ₹10 lakhs, small enterprises ranged from ₹10 lakhs to ₹2 crores, and medium enterprises ranged from ₹2 crores to ₹5 crores. This dual classification created sectoral distinctions and often led to structural fragmentation in policy interpretation.

The revised definition introduced in Budget 2025 adopts a more integrated and comprehensive approach by combining both investment and turnover criteria, applicable uniformly across sectors. Under this framework, micro enterprises are those with investment below ₹1 crore and turnover below ₹5 crores; small enterprises have investment below ₹10 crores and turnover below ₹50 crores; and medium enterprises are defined by investment below ₹50 crores and turnover below ₹250 crores. This revised classification enhances scalability, promotes formalization, and aligns MSME definitions with contemporary economic realities.

MSME sector in Gujarat is a significant pillar of the state's economy, comprising approximately 603,000 micro, small, and medium enterprises that collectively employ around 3,851,000 individuals (Srivastava, 2020). The composition of these units is predominantly manufacturing-oriented, with the manufacturing industry accounting for 63% of MSMEs in the state, followed by trading activities at 19% (Chandreshkumar, 2018). Gujarat is recognised as one of the top ten states in India for MSME concentration, contributing nearly 25% of the country's total product exports (Sahoo, 2020; Srivastava, 2020). Within the state, regions like Vadodara serve as critical industrial hubs and focal points for urban and economic expansion (Joshi & Bhatt, 2024). While specific academic datasets for the Vadodara district often aggregate into state-level figures, the city's MSMEs function as vital components of its industrial landscape, supported by District Industries Centres that facilitate registration and growth for local entrepreneurs (Hamid, 2017; Zanjurne, 2018). Furthermore, Gujarat distinguishes itself from other states by showing a positive trend in the growth of small and medium-scale enterprises alongside the naturally dominant micro-sector (Mohapatra, 2020).

Within the overall MSME landscape of Gujarat, the sector is heavily skewed toward micro enterprises, reflecting the typical structural pattern observed across India. Out of the estimated 6.0–6.5 lakh registered MSMEs in the state, nearly 90–93% are micro enterprises, amounting to approximately 5.5–6.0 lakh units, primarily consisting of small manufacturing workshops, service providers, and informal-to-formal transitioning businesses. The small enterprise segment constitutes around 6–8% (roughly 35,000–50,000 units), generally comprising more organised manufacturing and service firms with moderate capital investment and employment capacity. In contrast, medium enterprises form only about 1% or less (approximately 5,000–7,000 units), representing relatively larger industrial establishments with higher turnover and technological integration. A similar distribution pattern is observed in Vadodara district, where out of an estimated 25,000–35,000 MSMEs, around 92–94% are micro units, 5–7% are small enterprises, and less than 1% are medium enterprises. This dominance of micro units highlights the grassroots entrepreneurial base of the region, while the presence of small and medium firms supports industrial depth, supply chain integration, and export competitiveness within the district and the state economy.

The development of Micro, Small, and Medium Enterprises (MSMEs) in India is supported by a comprehensive framework of central and state schemes aimed at promoting entrepreneurship, boosting competitiveness, and fostering inclusive economic growth. At the national level, major initiatives like the Prime Minister Employment Generation Programme (PMEGP), Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE), and Pradhan Mantri Mudra Yojana (PMMY) provide financial support through subsidies, collateral-free loans, and micro-financing to encourage enterprise creation and growth. Furthermore, schemes such as the MSME Champions Scheme, Credit Linked Capital Subsidy Scheme (CLCSS), ASPIRE, and SFURTI focus on technology upgrades, rural industrialisation, cluster development, and innovation. Targeted interventions, including the National SC/ST Hub, also promote inclusive entrepreneurship among disadvantaged groups. Complementing these national efforts, the Government of Gujarat implements proactive policies under the Gujarat Industrial Policy (2020–2025) and the Aatmanirbhar Gujarat MSME Scheme (2022–2027), offering capital investment subsidies, interest subsidies, electricity duty exemptions, and support

for technology acquisition and market growth. These coordinated policy measures collectively strengthen the MSME ecosystem by alleviating financial constraints, enhancing productivity, and improving the global competitiveness of enterprises, thus making a significant contribution to industrial growth and regional development.

MSMEs are performing a pivotal role in the Indian economy. In terms of the MSMEs' role, they provide regional job opportunities and overcome regional disparities. Utilising local resources and efficiently utilising them in the production process, with low capital investment, they are capable of producing high-value goods. Boost the entrepreneurial activity in the country. Assist in the balance of payment correction through the export of goods and services.

Objective:

01 systematically identify and analyse the major issues impeding the growth of India's MSME sector.

02 To suggest policy recommendations to strengthen the growth and performance of MSMEs

Review of Literature:

This paper observes a mixed-methods approach, combining a survey of 500 MSMEs with interviews from 30 experts to identify growth barriers. It finds that 70% of MSMEs rely on informal credit and 60% view inadequate infrastructure as their primary constraint. The paper emphasises the urgent need for digitalisation (e-commerce and digital payments) and recommends that the government prioritise technology adoption to improve global competitiveness. (Kumar-2025)

This paper focuses specifically on institutional finance and the role of the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE). It highlights that banks often avoid MSME lending due to a lack of immovable collateral and high servicing costs. While CGTMSE provides collateral-free guarantees for 50% to 85% of loan amounts, the author notes that high guarantee fees and a lack of awareness among entrepreneurs remain significant bottlenecks. The study suggests extending this guarantee to medium enterprises and lowering fee rates to encourage more participation. (Mund-2020)

This paper observed comprehensive review tracks MSME performance trends from 2000 to 2015, noting that while the sector is an "engine of growth," its average annual growth rate (CAGR 0.45%) was lower than the overall industrial sector (CAGR 1.81%) during the study period. It details the 2020 revised definition based on investment and turnover and categorises challenges into exogenous (regulations, raw materials) and endogenous (inefficient management). The author recommends regular awareness seminars and skill development schemes to resolve technological unawareness. (Kumari Annu -2024)

This study analyses the MSMEs through the lens of equitable development, using parameters like regional distribution and social group participation. It finds that MSMEs are more evenly distributed across India compared to large industries, which tend to concentrate in states like Maharashtra and Gujarat. Notably, the sector fosters entrepreneurship among marginalised groups, with OBCs owning 41.94% of enterprises, and highlights that 55.34% of units are located in rural areas, helping to mitigate regional inequalities. (Ahmed and sanu-2016)

This paper examines a broad analysis of MSME contributions to export earnings and output, noting that the sector produces over 6,000 products. It identifies poor market linkages for non-clustered MSMEs as a major hurdle, as these units cannot easily organise to reduce procurement costs. The study also outlines government initiatives like the mandatory 20% procurement policy for central departments to support small-scale units. (Lone & Mehraj-2015)

This paper provides a detailed historical and legal overview, focusing on the MSMED Act of 2006 and the sector's role as a "nursery of entrepreneurship". It reveals a stark divide between the registered and unregistered segments, noting that 94% of MSMEs operate in the informal sector. Key challenges identified include the multiplicity of labour laws, the absence of social security, and the lack of a suitable mechanism for the quick revival of sick units. (Singh Jaswal-2014)

Investigate how MSMEs serve as the foundation of the Indian economy by making substantial contributions to employment, exports, and GDP. Additionally, their analysis highlights MSMEs contributions to gender equality, poverty

alleviation, and sustainable development by connecting their expansion with the SDGs. The authors also note that by offering job opportunities at a reduced capital cost, MSMEs support inclusive growth and rural industrialisation. Shelly, Sharma, and Bawa (2020)

Highlight that MSMEs are the second-largest contributor to employment after agriculture and play a crucial role in reducing regional imbalances. The study emphasises that MSMEs contribute significantly to production, exports, and the development of entrepreneurship. However, the sector faces major constraints such as a lack of finance, inadequate infrastructure, and limited access to technology. Rathore and Mathur (2019)

Contribution of MSMEs in the Indian Economy.

1. Employment generator.

MSMEs are one of the largest sources of employment, especially in developing countries like India. They create job opportunities for both skilled and unskilled workers at relatively low investment costs. They absorb the shock of additional work force enter into employment sector due to rapidly increase in population in a developing economy, and overcome the unemployment rates and maintain the overall basic standard of living in the country. These enterprises also support self-employment and entrepreneurship. As a result, they help reduce unemployment and improve living standards.

MSMEs are universally recognized as the second-largest employment generator in India, trailing only the agricultural sector.

The sector accounts for approximately 40% of India's total non-agricultural workforce. In absolute terms, this translates to an estimated 110 million to 150 million people working within formal and informal MSMEs. With the recent inclusion of informal micro-enterprises under the Udyam Assist Platform (UAP), some government aggregates now track this footprint even higher

2 Regional Development through Small-Scale Industry

MSMEs promote balanced regional development by setting up small-scale industries in rural and semi-urban areas. They reduce the concentration of industries in big cities and utilise local resources effectively. This leads to infrastructure development and improved economic activity in backward regions. It also helps in reducing migration to urban areas and creating job opportunities in local areas.

3 Contribution to Exports and assist to earning forex reserves for the country.

MSMEs play a vital role in boosting exports by producing a wide range of goods such as textiles, handicrafts, and engineering products. Their flexibility allows them to adapt to global market demands quickly. They also help in earning valuable foreign exchange for the country. This strengthens India's position in international trade and reduces the Balance of payment deficit problem in the long run. mitigates global-level standards for the product.

MSMEs are critical to India's global trade balance, consistently contributing nearly half of the country's total merchandise exports.

While the exact percentage fluctuates slightly year-over-year based on global supply chains, the MSME share currently stands between 45.7% and 48.5%. This is driven predominantly by high-export clusters in textiles, leather, auto components, and gems/jewellery.

Detailed observation

(1) Issue related to finance.

This paper demonstrates that inefficient working capital management directly threatens the day-to-day survival of SMEs. It links poor cash conversion cycles and delayed receivables directly to a lack of financial literacy among entrepreneurs, noting that those who cannot optimize their inventory and payables often resort to destructive, high-cost short-term borrowing. Chadha, R., et al. (2023).

This comprehensive assessment reveals that an estimated 84% of MSME debt demand in India is financed through informal sources (family, friends, and local unregulated moneylenders). The study highlights how the exorbitant interest rates associated with these informal channels take the profitability of micro-units and prevent capital reinvestment. World Bank. (2018).

A high-level policy review addressing the severe liquidity crises caused by delayed payments from large corporate buyers and state-owned entities. The report highlights how delayed receivables artificially stall the cash flow cycle, effectively forcing MSMEs to act as free financiers for larger corporations, pushing many healthy small businesses into bankruptcy. NITI Aayog. (2024).

This literature focuses on the disproportionately high cost of capital for small units compared to large corporate enterprises. The paper illustrates that even when MSMEs *do* secure formal financing, the risk premiums attached to their loans are so high that debt servicing consumes the majority of their profit margins, trapping them in a state of mere survival rather than growth. Das, P., & Das, S. (2023)

(2) Infrastructure related issues

This study maps the physical supply chain friction faced by small manufacturers. Poor road conditions connecting rural/semi-urban manufacturing clusters to major national highways lead to high transit times, increased fuel costs, and frequent damage to raw materials and finished goods. Kumar, A., & Singh, R. (2022)

Focusing on agro-allied and food-processing MSMEs, this paper identifies a severe lack of modern warehousing and cold storage infrastructure. This deficit forces MSMEs into distress selling to avoid spoilage, actively preventing them from scaling up production or maintaining inventory for better market pricing.: Patel, V., & Deshmukh, A. (2023).

This paper examines the three-dimensional realities of micro-units, noting that complex land acquisition laws and a lack of affordable plots in designated Special Economic Zones (SEZs) force MSMEs to operate in cramped, residential, or unplanned areas, severely limiting their physical capacity to expand production lines. Singh, D., & Gupta, P. (2022).

Even when MSMEs secure export orders, this study shows they face high turnaround times and congestion at domestic ports. The lack of dedicated, fast-track infrastructure for small-volume shipments at major ports erodes the cost competitiveness of MSME exports in the global market. Mukherjee, S. (2021).

Classifying physical machinery as core infrastructure, this paper argues that a massive segment of the MSME sector operates with outdated, low-efficiency equipment. The lack of infrastructure-upgradation funds prevents the integration of automated or CNC (Computer Numerical Control) machines, keeping production volumes low. Das, A., & Das, S. (2020).

(3) Raw Material & Procurement Issues

This paper highlights the volume disadvantage of MSMEs. Because micro-units have limited working capital, they purchase raw materials in very small batches. Consequently, they miss out on bulk-purchase discounts (economies of scale) and face higher per-unit freight costs. This structural issue means that an MSME's baseline cost of production is artificially higher than a larger competitor's before the manufacturing process even begins. Mukherjee, A., & Banerjee, S. (2021).

Focusing on export-oriented MSMEs, this research identifies the risk of sourcing from unorganized, local vendors. Because MSMEs cannot afford premium, certified raw materials, they often rely on cheaper, unstandardized inputs. The study shows that this inconsistency in raw material quality is the leading cause of final product rejection by international buyers, heavily damaging the credibility and export potential of Indian small businesses. Reddy, K., & Rao, T. (2023).

(4) Skill gap related issue

This paper investigates the readiness of manufacturing MSMEs to adopt modern technologies like automation, the Internet of Things (IoT), and Artificial Intelligence (AI). The researchers found that the primary bottleneck is not merely the

financial cost of the technology itself, but a severe lack of technically trained shop-floor workers capable of operating and maintaining advanced machinery or digital supply chain software. This human capital deficit keeps MSMEs trapped in low-tech, labour-intensive production cycles. Agrawal, R., & Kumar, S. (2022).

The skill gap is not limited to blue-collar or technical workers; it extends directly to the business founders themselves. This study highlights that most micro-entrepreneurs start businesses based on strong functional or trade skills but entirely lack professional managerial training or financial literacy. This "managerial myopia" leads to poor inventory forecasting, structural non-compliance with tax frameworks, and an inability to present bankable business plans for formal venture capital. Chadha, V., & Sharma, A. (2021).

Discussion:

Many researchers in their studies observe that Micro, Small, and Medium Enterprises (MSMEs) in India face multiple challenges that hinder their growth and long-term viability. A significant barrier is limited access to finance, as many MSMEs struggle to obtain sufficient credit due to strict lending requirements and inadequate collateral. Additionally, these enterprises find it difficult to adopt advanced technologies and innovate, which limits their competitiveness both domestically and internationally. Operational inefficiencies are worsened by regulatory complexities and bureaucratic delays, increasing compliance costs and processing times. Furthermore, infrastructural deficiencies—such as unreliable electricity supply and inadequate transportation networks—impair productivity. MSMEs also face shortages of skilled labour and limited market access, restricting their growth potential. Overcoming these challenges is vital to strengthening MSMEs' contributions to India's economic development and employment creation.

Conclusion:

The MSME sector in India has significant potential to create employment, reduce regional disparities, and support export-led growth by absorbing the expanding workforce. However, the sector encounters major challenges that hinder its development and competitiveness. Key infrastructural deficiencies include unreliable and costly power supply, inadequate distribution networks, and poor connectivity via roads, railways, and ports—all of which diminish MSMEs' competitive advantage and profitability. Moreover, limited access to affordable finance—due to a shortage of financial institutions and high borrowing costs—restricts industry expansion and investment capacity. Adding to these difficulties is a notable skills mismatch, where the labour force lacks the specific competencies needed by MSMEs, thereby limiting their ability to innovate and grow.

Tackling these bottlenecks involves targeted actions such as improving infrastructure reliability and connectivity, expanding affordable financial services tailored to MSMEs, and implementing skill development programmes aligned with industry needs. Strengthening these

areas will boost MSMEs' productivity, competitiveness, and contribution to inclusive economic growth.

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