

MSMEs: The Second Engine of Growth, Stalled by Regulatory Hurdles

MSMEs may be the second engine of the economy, but without the fuel of deregulation, they won't take off.

At present, more than 1 crore registered MSMEs employ 7.5 crore people and contribute 36% to manufacturing. Apart from this, they are also responsible for 45% of exports. The Budget has increased the turnover and investment limits for MSMEs by 2 times and 2.5 times, respectively, to improve efficiency and performance. It has also aimed at increasing credit availability with a guarantee cover. For Micro and Small Enterprises, the credit cover has increased from ₹5 crore to ₹10 crore, while for startups, it has increased from ₹10 crore to ₹20 crore. Well-run exporter MSMEs can now avail term loans of up to ₹20 crore. Additionally, credit cards for Micro Enterprises registered on the Udyam portal (an online system that allows MSMEs to register their businesses) will be introduced with a ₹5 lakh limit, and up to 10 lakh such cards will be issued.

However, the Budget's MSME provisions seem to be over-exaggerated. While the figures appear grand, their impact will be limited unless regulatory constraints are relaxed. In spite of the focus on credit access, MSMEs licensing constraints, bureaucratic inefficiencies, and compliance burdens—challenges that loan guarantees alone cannot resolve. The Economic Survey 2024-25 emphasizes the need for urgent deregulation, pointing out that excessive regulatory barriers hamper efficiency and innovation. Many MSMEs choose to continue to be small in order to avoid stringent regulations, particularly in areas like labor laws and safety standards, ultimately curtailing their ability to scale up to their true potential in terms of job creation and innovation. By remaining small, firms lose out on institutional funding, skilled labor, and technology adoption, often operating outside formal supply chains. This propels a parallel informal economy and contributes to low labor productivity.

The increase in the MSME turnover threshold from ₹250 crore to ₹500 crore has also raised concerns that larger corporations will benefit the most. This shift is expected to favor the top 1% of MSMEs, who could receive 95% of the benefits, while the vast majority—67% of MSMEs with a turnover below ₹10 lakh and 99% below ₹1 crore—may see little to no impact. Stretching the definition of MSMEs to include firms with turnovers of up to ₹500 crore indicates a policy shift that prioritizes larger corporate entities over small businesses.

Key reform measures should focus on simplifying regulations, revising licensing norms, adjusting regulatory thresholds, removing barriers to growth, and introducing procedural safeguards. For instance, Haryana has expanded the exemption limit under the Factories Act,

1948, doubling the worker threshold for small industries—from 20 to 40 employees for units operating without power and from 10 to 20 employees for those using power. This move reduces compliance burdens and allows small enterprises to operate with greater flexibility.

Excessive regulation hampers innovation and economic vitality. While regulations are intended to safeguard consumers, workers, and the environment, they often create unintended obstacles, reducing competition and slowing the pace of innovation. A strategic, structured approach to deregulation can serve as a catalyst for growth, innovation, and competitiveness.

To steer sustained economic growth, both the union and state governments must continue to introduce reforms that enable MSMEs to operate efficiently and compete effectively. Moving forward, the focus of economic policy must shift toward systematic deregulation to unleash the true potential of India's MSMEs. Regulations should be streamlined to impose only what is essential to meet their objectives while remaining reasonable, given the limited managerial and operational capacities of small and medium enterprises. Considering the limited managerial and financial resources of MSMEs, excessive regulations only hinder progress.

The right balance between regulation and freedom is essential to unleash the full creative and productive potential of India's small and medium enterprises, fostering innovation, competition, and overall economic prosperity. A risk-based regulatory approach—where enforcement aligns with actual risk levels—would help eliminate unnecessary compliance burdens while ensuring effective oversight. By rationalizing regulations and prioritizing systemic deregulation, India can create a business environment that fosters growth, innovation, and long-term economic resilience. For India's MSMEs to truly become the second engine of growth, reforms must go beyond announcements. Deregulation is not an option—it is a necessity.