



Revised MSME Classifications in India: A Pathway to Enhanced Financial Inclusion and Policy Access

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ABSTRACT:

The Micro, Small, and Medium Enterprises (MSME) sector is crucial in the context of India's growth, economic development, productive employment, and balanced growth. The year 2020 saw the Government of India unveiling a new classification of MSMEs, which integrated the services sector with manufacturing for the first time as well as altered investment and turnover limits. This review article analyses the implications of the revised classifications on the financial access and policy access gaps within institutional support frameworks for these enterprises. The paper attempts to demonstrate through government documents, RBI reports, and SIDBI's MSME Pulse reports how the enhanced thresholds allow a greater number of enterprises to meet the criteria for MSMEs, with associated benefits of credit, subsidies, and government assistance programs. The review notes greater access to formal credit for small and medium enterprises, as well as wider participation in MSME policies post-reclassification, but also lacks awareness from micro-enterprises and institutional barriers to credit allocation as some of the enduring challenges. This paper seeks to evaluate, using empirical evidence, whether the reclassification has inclusively integrated the MSME's micro level into formal financial systems, economically justifying the classification revision and, at the same time, providing policy recommendations for fostering sustainable development.

KEYWORDS:MSME Classification, Financial Inclusion, Policy Access, Corporate Credit.

INTRODUCTION:

The Micro, Small, and Medium Enterprises (MSME) sector has been historically recognized as one of the key pillars of Indian economy by providing large scale employment, industrial output, exports, and regional development. The sector is reported to contribute approximately 30% of the GDP of



MSME and provide employment to over 110 million people across the region. However, even with this significance, many enterprises, especially those hovering just above the mid classification cut-off points, have had a long standing challenge of formally accessible credit, policy aid, government subsidies, and policy assistance due to rigid eligibility criteria. ^[1]

With the aim of tackling such issues and widening the scope of policy assistance, the Government of India unveiled an updated MSME classification in June 2020, which revolutionized the definition of micro, small, and medium enterprises. Some of the major updates included increasing the limits of investment, adding turnover-based criteria to go along with investment, and integrating manufacturing and service enterprises under one classification framework. These amendments sought to mirror the changing business realities of firms, cut artificial fragmentation, and allow more businesses to become eligible for MSME benefits. ^[2]

Since a broader definition makes it possible for previously excluded businesses, particularly expanding small and medium-sized businesses to receive institutional loans, loan guarantee programs, subsidies, and other government-backed initiatives, the modification is especially important in the context of financial inclusion. Positive trends in formal credit flow to the sector after the reclassification are suggested by early reports from organisations such as the Small Industries Development Bank of India (SIDBI) and the Reserve Bank of India (RBI). However, issues with unequal understanding, gaps in implementation, and ongoing financing restrictions for microbusinesses at the lowest end of the spectrum continue to be problems.

The purpose of this review paper is to critically assess how the updated MSME categorisation has affected policy access and financial inclusion in India. The paper investigates whether the reclassification has significantly increased access to credit and policy benefits across various enterprise segments by combining data from academic studies, official publications, and publications from organisations like the Reserve Bank of India (RBI) and the Small Industries Development Bank of India (SIDBI). To give a thorough grasp of the reform's efficacy in promoting equitable growth in the MSME sector, it also addresses issues and policy implications that have emerged from the body of the existing literature. ^[4]

OVERVIEW OF MSME CLASSIFICATION REVISIONS:

In June 2020, the Indian government implemented a major change to the definition and categorisation of MSMEs, substituting a composite metric that takes into account both investment and turnover for the previous investment-based criterion. This action sought to address long-standing issues facing the MSME sector, including legislative exclusion, artificial division between manufacturing and service businesses, and under-representation in formal financial institutions.

Significant effects of the reclassification were also felt in rural areas. For instance, the move to a turnover-based criteria benefited several agro-processing firms in the Vidarbha and Marathwada areas of Maharashtra. Under the new definition, these units—which had previously been classified as micro-enterprises despite their operational scale—were reclassified as small enterprises. They were able to obtain official recognition as a result of this reclassification, which enhanced their creditworthiness and qualified them for capital subsidies through PMEGP and financial assistance like the Emergency Credit Line Guarantee Scheme (ECLGS). As a result, several units strengthened



their incorporation into the formal economy by formalising their activities through Udyam Registration and taking part in cooperative and cluster development programs. [8]

Table 1: Comparison of Old and New MSME Classification Criteria

Enterprise Category	Old Criteria (Investment in Plant & Machinery/Equipment)	New Criteria (Investment + Turnover)
Micro	Up to ₹25 lakh (Mfg), ₹10 lakh (Service)	Investment ≤ ₹1 crore; Turnover ≤ ₹5 crore
Small	Up to ₹5 crore (Mfg), ₹2 crore (Service)	Investment ≤ ₹10 crore; Turnover ≤ ₹50 crore
Medium	Up to ₹10 crore (Mfg), ₹5 crore (Service)	Investment ≤ ₹50 crore; Turnover ≤ ₹250 crore

(Source: Ministry of MSME, Govt. of India, 2020)

The key changes included:

- **Raising investment limits:** Enabling growing enterprises to stay within MSME status longer.
- **Introducing turnover criteria:** Accounting for revenue-based metrics along with asset investments.
- **Merging manufacturing and services:** Eliminating artificial distinctions and allowing service enterprises equal benefits.

These revisions were designed to increase policy coverage, simplify classification, and formalize a larger portion of the MSME sector into the institutional credit and support system.

As per the survey results reported in the MSME Report (2023), a considerable percentage of firms benefited from the new standards. As per the revised categorisation, nearly 24% of medium enterprises reported to be eligible for MSME-specific loan facilities for the first time, and 18% of small enterprises reported having access to new government schemes not covered under the previous definition. This extension of eligibility is consistent with the policy objective of greater financial inclusion by broadening coverage. [5]

The paper further observes that the highest expansion in MSME registrations after reclassification took place in states such as Tamil Nadu, Gujarat, and Maharashtra, implying higher take-up in industrially developed regions. However, even with the broader classification, microbusiness registration levels in low-income states continued to remain relatively lower, reflecting persistent regional disparities.

Therefore, the revised classification marks a considerable policy shift that seeks to encourage an integrated and modernized structure for MSME development and opening up policy and finance access to a broader spectrum of enterprises. [6]



IMPACT ON FINANCIAL INCLUSION: REVIEW OF EVIDENCE:

The 2020 amendments to the MSME categories have had measurable impacts on financial inclusion across business types. The plan has enabled more small businesses to access formal lending and government assistance programs through expanding the qualifying criteria and eliminating sectoral caps. Enhancements in formal credit access and policy coverage following the reclassification are underscored by recent sectoral analysis and survey data, particularly for underbanked and informal business firms.

The experience of the Small Industries Development Bank of India (SIDBI) is an example of enhanced financial inclusion following the reclassification. SIDBI shifted its lending practices to include a greater range of micro and small firms, especially service sector firms, in response to the revised MSME categorizations. Consequently, SIDBI experienced a significant increase in disbursements of microloans and attracted a large pool of first-time borrowers who were otherwise rejected by earlier qualifying standards. This institutional outreach fostered more inclusive economic growth as it facilitated easy access to formal credit, technical assistance, and financial inclusion instruments for people, particularly in rural and semi-urban areas.^[3]

Impact on Micro Enterprises

Formal finance access has typically been most difficult for microbusinesses. Micro unit eligibility was slightly increased by the updated categorisation, but problems still exist. Compared to 28% the year before, about 32% of microbusinesses reported using formal loan facilities in FY 2022–2023. Even while there has been some progress, more than 60% of microbusinesses cited lack of collateral and delayed payments from significant customers as ongoing obstacles.

In 2022–2023, 38% of microbusinesses used digital payment solutions, up from 29% in 2021–2022. This increasing digital usage helped microbusinesses become more eligible for formal financial products and improve their paperwork. However, there were noticeable geographical differences, with microbusinesses in the northern and eastern states continuing to report lower formal credit penetration than their counterparts in the southern and western states.^[7]

Impact on Small Enterprises

It seems that small businesses have benefited the most from the updated thresholds. The number of small businesses that qualified for credit guarantee programs increased by 16% in 2022–2023 as compared to 2019–20. Additionally, in FY 2022–2023, almost 48% of small businesses reported using new or extended credit lines made possible by the reclassification.

The majority of emergency loan packages were also used by small businesses, which helped to boost credit exposure by ₹1.7 lakh crore overall between June 2020 and December 2023. The goal of this strategy is to increase the number of small businesses that are able to acquire formal loans.^[9]

Impact on Medium Enterprises

Among the main recipients of the higher thresholds under the updated categorisation were medium-sized businesses. After 2020, over 24% of medium-sized businesses were initially eligible for



MSME-targeted financing and programs. As a result, by December 2023, the loan exposure to medium-sized businesses had increased by 18.2% year over year to ₹4.3 lakh crore.

Furthermore, after being included in the updated MSME framework, 51% of medium-sized businesses said they had easier access to export incentives and market development assistance. The merging of the manufacturing and service sectors made it possible for more varied medium-sized businesses to take use of advantages that were previously exclusive to manufacturing facilities. ^[10]

Overall, the data suggests that the updated MSME designation made it easier for small and medium-sized businesses in particular to be included more widely in official financial and policy institutions. The increases for microenterprises, however, were rather slight, indicating the necessity of more focused interventions for the smallest companies.

CHALLENGES AND CRITIQUES IN LITERATURE:

Despite the positive impacts of the revised MSME classification, several challenges and critiques have been highlighted in recent analyses and sectoral discussions.

Persistent Exclusion of Micro Enterprises

Even though eligibility was broadened by the new categorisation, many microbusinesses are still not part of the official financial ecosystem. According to studies, more than 55% of microbusinesses still obtain their loans from unofficial sources as they lack proper documents, collateral, or credit history. The paperwork requirements for formal credit are difficult for smaller micro entities, especially those in rural and semi-urban regions, to satisfy, even under simplified schemes.

Furthermore, particularly small, informal businesses that lack even the most basic accounting or registration procedures were not significantly impacted by the higher qualifying requirements. This suggests that the reclassification favoured mid-tier or more formalised businesses within the micro category, underserving the smallest businesses.

Continued Risk Aversion Among Banks

Despite requirements to extend lending, banks and formal lenders nevertheless behave in a risk-averse manner towards small or first-time customers. High perceived default risks and the challenge of determining microbusinesses' trustworthiness are two of the main causes of hesitation, according to lending institutions. Collateral and personal guarantees are nevertheless frequently needed, according to anecdotal information, even among qualified small and medium-sized businesses. This restricts access for individuals without enough assets.

Furthermore, data indicates that although total credit exposure to MSMEs rose after reclassification, credit growth was concentrated among medium-sized businesses and current borrowers, whereas microbusinesses that were previously unbanked had slight increases.



Awareness, Documentation, and Implementation Issues

Recent studies and surveys have identified persisting gaps in MSMEs' access to financing and understanding of policy changes as a major concern. Access to sufficient funding is still a problem for many businesses, even though the updated MSME categorisation sought to increase eligibility for official credit and government programs. Despite the fact that 80% of MSME respondents said they had access to financing, 40% of manufacturing businesses and 41% of service businesses said the available financing was insufficient to satisfy their company needs, according to the MSME Outlook Survey (January–March 2025). Furthermore, despite more expansive qualifying requirements, around 20% of MSMEs in both sectors expressed persistent concerns about their ability to obtain financing in the near future. ^[11]

Documentation issues continue to exist in addition to financial obstructions especially for micro and small businesses. Maintaining the official paperwork, audited financial statements, and tax compliance necessary to be eligible for institutional loans and policy advantages is a challenge for many businesses. The successful implementation of programs meant to advance financial inclusion under the updated categorisation is hampered by this documentation gap.

Additionally, different areas have implemented the updated criteria differently. According to stakeholder comments, there may be differences in how revised eligibility requirements are distributed and interpreted at the local banking level, which might result in uneven implementation of the policy's advantages. As a result, many businesses particularly microbusinesses in underserved or informal areas remain excluded from the full scope of financing and policy assistance meant by the reform, even with the broader categorisation structure.

POLICY IMPLICATIONS & RECOMMENDATIONS:

The analysis of literature and sector reports highlights several policy implications stemming from the revised MSME classification, alongside recommendations to enhance its impact on financial inclusion and access to policy benefits.

Strengthening Awareness Campaigns

Research consistently suggests that MSMEs, particularly micro and small businesses in rural and semi-urban regions, should be the focus of extensive awareness efforts. Many qualified businesses are still oblivious of their categorisation status and the advantages that the updated framework offers. To increase understanding of various programs and qualifying requirements, awareness campaigns might use bilingual instructional brochures, localised seminars, collaborations with trade groups, and internet outreach.

Simplifying Credit Processes

Literature emphasizes the importance of simplifying loan application and approval processes to translate expanded eligibility into actual credit access. Recommendations include reducing documentation requirements for small loans and promoting alternative credit assessment methods such as cash-flow-based lending or using GST transaction data.



Enhancing digital loan application platforms for faster, paperless processing

Simplifying processes can particularly benefit micro enterprises and informal businesses that struggle to meet conventional documentation standards.

Expanding Credit Guarantee Mechanisms

Several reports suggest that credit guarantee schemes need to be expanded in coverage and depth to address lender hesitancy. Increasing guarantee coverage ratios for micro and small enterprise loans, offering partial guarantees for collateral-free loans, and setting up specialized guarantees for first-time borrowers could incentivize banks to expand credit outreach.

Supporting Informal to Formal Transition

Policy discussions also highlight the need for targeted support to encourage informal enterprises to formalize operations. This could involve:

- a. Incentives for registration under Udyam portal.
- b. Reduced compliance costs for newly formalized micro units.
- c. Integration of formalization incentives with access to credit and government schemes.
- d. Facilitating formalization is key to enabling more micro enterprises to qualify for financial products and policy benefits linked to formal status.
- e. Enhancing capacity building for lenders

Improving efficiency and frequent training to bank employees at the regional and branch levels is another suggestion to guarantee uniform application of eligibility requirements and knowledge of MSME-related regulations. Frontline employees can more effectively assist MSMEs in navigating schemes and application procedures with the support of training programs.

CONCLUSION:

In India's MSME policy environment, the 2020 introduction of the updated categorisation of Micro, Small, and Medium Enterprises (MSMEs) represents a significant change with the goal of increasing financial inclusion and policy access through the expansion of eligibility criteria and the unification of the manufacturing and service sectors. As evidenced by increased credit exposure, more involvement in government programs, and better access to export and market development incentives, this assessment concludes that the reclassification has in fact made it easier for small and medium-sized businesses to be included more fully in formal credit networks. The updated criteria have benefited small and medium-sized businesses in particular, taking advantage of fresh chances for institutional lending and governmental support.

The effect on microbusinesses, however, is still modest and uneven. Even while formal loan availability among micro units has slightly increased, the amount of financial inclusion at the lower end of the enterprise spectrum has been constrained by enduring issues including poor knowledge, complicated paperwork requirements, and lenders' ongoing risk aversion. Regional differences also limit the advantages of the updated framework, with businesses in developing areas trailing behind in terms of formalisation and policy adoption.



These results highlight the need for complementing policies to achieve deeper and more equal financial inclusion, even if the updated categorisation has effectively broadened the regulatory net for many businesses. Critical policy concerns include bolstering awareness campaigns, streamlining loan processes, increasing credit guarantee mechanisms, facilitating informal-to-formal transfers, and strengthening lending institutions' ability. By filling up these gaps, the updated categorisation can promote equitable and sustainable growth by increasing eligibility on paper and providing meaningful access to funding and assistance for all MSME sectors.

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