
LEGAL FRAMEWORK FOR START-UPS AND MSME: FOSTERING INNOVATION WHILE ENSURING REGULATORY ACCOUNTABILITY

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ABSTRACT

The rapid and often disruptive emergence of startups and Micro, Small, and Medium Enterprises (MSMEs) demands a legal regulatory framework that is both adaptable and conducive to technological innovation, without compromising essential regulatory protection. The central challenge lies in striking a balance between fostering innovation which thrives on agility, speed and enforcing rigorous oversight across diverse industries. Traditional compliance systems, originally designed for large corporations, tend to be rigid and burdensome. These inflexible frameworks impose overwhelming demands on nascent businesses, stifling their market entry and growth potential. Consequently, there is a pressing need for a paradigm shift towards proportionality and flexibility in regulation.

This essay advocates for a tiered compliance model, wherein regulatory obligations are calibrated according to a company's size, revenue, and market impact. Such a system ensures that smaller enterprises face requirements commensurate with their scale, reducing unnecessary barriers while maintaining essential safeguards. We analyze the limitations of a "one-size fits all" compliance model, which disproportionately burdens fledgling ventures, thereby stifling creativity and market entry. Key components of this approach include the establishment of regulated testing environments such as regulatory sandboxes that allow innovators to trial novel business models under relaxed oversight. Additionally, streamlining mechanisms like self-certification for standard compliance and expedited Intellectual Property Rights (IPR) procedures can significantly reduce administrative burdens. By adopting this nuanced and adaptive regulatory strategy, the legal system can evolve from a rigid obstacle into a dynamic enabler. This transformation preserves market stability and protects stakeholders, while simultaneously nurturing the innovative spirit that drives economic progress.

Keywords: MSMEs, Start-ups, Legal Framework, Regulatory Accountability, IPR, Regulatory Compliance

“Innovation distinguishes between a leader and a follower.”¹ – Steve Jobs

1. INTRODUCTION

In today's global economy, innovation drives a nation's strength and competitiveness. In India, startups and MSMEs form the backbone of progress. They create jobs, boost technology, and promote inclusive growth, shaping a future where innovation and opportunity grow together.

India's journey of economic reform since the 1990s tells a story of transformation from an era ruled by rigid controls to one that encourages enterprise and openness. Over the years, the government has reshaped its role, moving away from being a gatekeeper to becoming a facilitator of growth. This shift has made it easier for startups and MSMEs to operate, with regulations now designed to promote transparency, protect investors, and ensure that competition remains fair. Yet, striking the right balance between accountability and ease of doing business remains a delicate challenge. As new kinds of enterprises emerge-especially gig-based startups, digital platforms, and globally funded ventures-fresh questions come to the surface. How should India tackle data privacy, safeguard intellectual property, improve access to funding, and simplify regulatory processes without stifling innovation? The answer lies in creating a system that not only rewards enterprise but also upholds trust and equity. Innovation should lead to shared progress, not just disruption.

This essay examines the evolution, challenges, and prospects of India's legal framework for startups and MSMEs. It argues that regulatory accountability need not be an obstacle to innovation; instead, when effectively designed.

2. EVOLUTION OF START-UPS AND MSMEs

In India's early years, government policies supporting entrepreneurs mainly revolved around Small Scale Industries (SSIs).² These efforts gradually shaped the small business ecosystem and ultimately led to the enactment of the MSME Development Act in 2006.³ However,

¹ Steve Jobs, *The Innovation Secrets of Steve Jobs* (McGraw Hill 2010) 23.

² Ministry of Statistics and Programme Implementation, '5.3 Small Scale Industries' <https://mospi.gov.in/53-small-scale-industries>, accessed 5 November 2025.

³ Micro, Small and Medium Enterprises Development Act 2006.

startups as a unique category didn't have any formal recognition or dedicated policy framework until the government introduced the Startup India initiative in 2016.⁴

2.1 Initial Stages of MSME Regulation (Pre-1991 Era)

Before 1991, government policies in India largely centered on the small-scale industry (SSI)⁵ sector. These policies were shaped by several key resolutions introduced in 1948,⁶ 1956,⁷ 1977,⁸ and 1991,⁹ along with the Industries (Development and Regulation) Act of 1951.¹⁰ The Small Industries Development Organisation (SIDO), set up in 1954¹¹ and later renamed the MSME Development Organisation,¹² was responsible for guiding and promoting growth in this sector. During this time, small-scale industries were defined mostly through policy measures rather than a dedicated legal structure, with recognition based on investment levels in plant and machinery. Because there was no unified legal definition covering both manufacturing and service-based enterprises, regulatory support remained fragmented and primarily administrative.¹³

2.2 Shift Towards Entrepreneurial Development: Post Liberalization Era

The economic liberalization of the 1990s¹⁴ brought a major shift to India's small-scale industry (SSI)¹⁵ landscape which is driving innovation, entrepreneurship, and growth. At the heart of this transformation was the end of the restrictive "*License Raj*,"¹⁶ which had long burdened entrepreneurs with bureaucratic hurdles. By easing government controls and approvals, liberalization gave business owners much-needed freedom to start and expand enterprises,

⁴ Department for Promotion of Industry and Internal Trade, 'About Startup India Initiative', <https://www.startupindia.gov.in/content/sih/en/about-startup-india-initiative.html>, accessed 5 November 2025.

⁵ Ministry of Statistics and Programme Implementation (n 2).

⁶ Government of India, *Industrial Policy Resolution 1948* (1948).

⁷ Government of India, *Industrial Policy Resolution 1956* (1956).

⁸ Government of India, *Industrial Policy Resolution 1977* (1977).

⁹ Government of India, *New Industrial Policy 1991* (1991).

¹⁰ Industries (Development and Regulation) Act 1951.

¹¹ Small Industries Development Organisation, *About SIDO* (Ministry of Small Scale Industries, Government of India) accessed 5 November 2025.

¹² *Id.*

¹³ Office of the Development Commissioner (MSME), Ministry of Micro, Small and Medium Enterprises, Government of India, *MSME Overview* https://www.dcsme.gov.in/ssiindia/MSME_OVERVIEW.pdf accessed 5 November 2025.

¹⁴ Panagariya A, *India in the 1980s and 1990s: A Triumph of Reforms*, IMF Working Paper WP/04/43 (March 2004) <https://www.imf.org/external/pubs/ft/wp/2004/wp0443.pdf> accessed 5 November 2025..

¹⁵ Ministry of Statistics and Programme Implementation (n 2).

¹⁶ Centre for Civil Society, "Licence Raj", India Before 1991, available at: <https://indiabefore91.in/license-raj> (last visited 5 November 2025).

paving the way for a more open and competitive economy. Increasing the investment ceiling for SSIs¹⁷ also allowed firms to modernize operations and adopt new technologies, promoting greater efficiency and innovation.¹⁸

One of the most impactful reforms was the abolition of industrial licensing.¹⁹ Before liberalization, securing licenses was a time-consuming and complex process, especially for smaller enterprises. Removing these restrictions²⁰ lowered entry barriers and helped smaller, more agile firms enter the market with ease. The investment cap for SSIs²¹ was raised to one crore rupees,²² a step that empowered businesses to upgrade their production methods and strengthen competitiveness. Access to capital and technology improved as foreign direct investment (FDI) opened new channels for funding and collaboration.²³ Many SSIs²⁴ gained from partnerships, technical collaborations, and exposure to modern management practices that were previously out of reach.²⁵

With competition intensifying, SSIs²⁶ were driven to innovate and improve product quality.²⁷ The liberalized environment encouraged a shift from state-controlled production to a market-driven model,²⁸ allowing businesses to respond directly to consumer needs. This gave rise to entrepreneurship across new sectors such as information technology, software, and telecommunications.

¹⁷ Ministry of Statistics and Programme Implementation (n 2).

¹⁸ Hemant Singh, 'New Economic Policy of 1991: Objectives, Features and Impacts', *Jagran Josh* (14 October 2019) <https://www.jagranjosh.com/general-knowledge/new-economic-policy-of-1991-objectives-features-and-impacts-1448348633-1> accessed 5 November 2025.

¹⁹ New Industrial Policy 1991 – Indian Economy Notes', *Gyansanchay* <https://gyansanchay.csjmu.ac.in/wp-content/uploads/2022/10/new-industrial-policy.pdf> accessed 5 November 2025.

²⁰ *Id.*

²¹ Ministry of Statistics and Programme Implementation (n 2).

²² Press Information Bureau, 'Definition of Micro, Small and Medium Enterprises' (Government of India, 28 August 2024) <https://www.pib.gov.in/PressNoteDetails.aspx?NoteId=152063&ModuleId=3> accessed 5 November 2025.

²³ Shreya Gupta, 'Foreign Direct Investment and Its Impact on India's Economic Growth' (2024) 10(3) *Innovative Research Thoughts* 111, 122

https://www.researchgate.net/publication/383736034_Foreign_Direct_Investment_and_Its_Impact_on_India%27s_Economic_Growth accessed 5 November 2025..

²⁴ 'The Importance of Small Scale Industries: The Backbone of India's Economy', *Drishti IAS* (13 September 2024) <https://www.drishtiiias.com/blog/the-importance-of-small-scale-industries-the-backbone-of-india%E2%80%99seconomy> accessed 5 November 2025.

²⁵ *Id.*

²⁶ Ministry of Statistics and Programme Implementation (n 2).

²⁷ S Muthukaruppan, 'Globalisation and Its Impact on Small Scale Industries in India' (2019) X(40) *SELP Journal of Social Science* <https://iaraindia.com/wp-content/uploads/2019/03/10-GLOBALISATION-AND-ITS-IMPACT-ON-SMALL-SCALE-INDUSTRIES-IN-INDIA.pdf> accessed 5 November 2025.

²⁸ 'New Industrial Policy 1991 – Indian Economy Notes' (n 19).

Although some smaller firms struggled under increased competition, the overall impact of liberalization was transformative.²⁹ Support institutions like the Small Industries Development Bank of India (SIDBI)³⁰ offered critical financial³¹ and developmental assistance,³² strengthening SSIs³³ capacity to adapt and compete. Collectively, these reforms³⁴ turned the small-scale sector into a vital force for innovation, industrial growth, and economic resilience in post-liberalization India.³⁵

2.3 Institutionalization of MSMEs and Startups: Legal Recognition and Policy Framework

The Micro, Small and Medium Enterprises Development (MSMED) Act of 2006³⁶ marked a defining moment in India's approach to supporting smaller businesses. In June 2006³⁷, it created a unified legal framework for promoting, developing, and enhancing the competitiveness of enterprises across both manufacturing and service sectors.³⁸

Before the introduction of the MSMED Act,³⁹ government efforts were mainly directed toward Small Scale Industries (SSIs)⁴⁰ and ancillary units under the Industries (Development and Regulation) Act of 1951.⁴¹ Over time, various committees and expert groups highlighted the challenges these enterprises faced - particularly in finance, technology, and marketing - and recommended comprehensive reforms.⁴² To strengthen administrative oversight and targeted

²⁹ Wikipedia, "Economic liberalisation in India," (last modified 28 October 2025), available at: https://en.wikipedia.org/wiki/Economic_liberalisation_in_India#:~:text=Growth%20during%20the%201980s%20was,growth%20period%20of%201988%E2%80%931991 (last visited 6 November 2025).

³⁰ The Small Industries Development Bank of India Act, 1989.

³¹ The Small Industries Development Bank of India Act, 1989, sec. 13(1).

³² *Id.*

³³ Ministry of Statistics and Programme Implementation (n 2).

³⁴ *Supra* note 14.

³⁵ Murad Ali, *Liberalization and its impact on small scale industries* (2011) International Journal of Vocational and Technical Education Vol 2(7) pp 81-83, available at: https://www.academia.edu/30893409/Liberalization_and_its_impact_on_small_scale_industries (last visited 6 November 2025).

³⁶ The Micro, Small and Medium Enterprises Development (MSMED) Act, 2006.

³⁷ *Id.*

³⁸ Kishita Gupta, *MSME Act, 2006* (iPleaders Blog, 3 March 2022), available at: <https://blog.ipleaders.in/msme-act2006/#:~:text=According%20to%20suggestions%20made%20by,both%20manufacturing%20and%20service%20companies.> (last visited 6 November 2025).

³⁹ *Supra* note 39.

⁴⁰ Ministry of Statistics and Programme Implementation (n 2).

⁴¹ *Supra* note 10.

⁴² Rameshwary Meena, "Analysis of MSME Sector in India" (Social Research Foundation, Vol IX Issue III, 25 June 2024), available at: [https://www.socialresearchfoundation.com/new/publish-journal.php?editID=9212#:~:text=The%20industry%20confronts%20many%20obstacles%20despite%20its,Micr%C2%20Small%20and%20Medium%20Enterprises%20\)%20sector](https://www.socialresearchfoundation.com/new/publish-journal.php?editID=9212#:~:text=The%20industry%20confronts%20many%20obstacles%20despite%20its,Micr%C2%20Small%20and%20Medium%20Enterprises%20)%20sector) (last visited 6 November 2025).

policy support, the government established two ministries in 1999: the Ministry of Small Scale Industries⁴³ and the Ministry of Agro and Rural Industries.⁴⁴ These were later merged in 2007 to form the unified Ministry of Micro, Small and Medium Enterprises.⁴⁵

These bodies were later merged in 2007 to establish the unified Ministry of Micro, Small, and Medium Enterprises. The MSMED Act⁴⁶ emerged as a long-anticipated reform to replace the previously fragmented regulatory approach to small businesses. It marked a crucial policy shift by granting statutory recognition to MSMEs and setting up a clear framework for their promotion and protection. By addressing key challenges and creating a cohesive legal structure, the Act laid the foundation for a more organized, growth-driven, and competitive MSME ecosystem in India.⁴⁷

Startups in India now enjoy formal recognition and robust institutional backing through the central government's Startup India program, run by the Department for Promotion of Industry and Internal Trade (DPIIT),⁴⁸ which unlocks benefits like funding support, tax reliefs, and simpler compliance once a startup is officially recognized by DPIIT. To qualify, a venture must be registered as a Private Limited Company, LLP, or Partnership Firm in India,⁴⁹ be under ten years old,⁵⁰ have never crossed INR 100 crore in annual turnover,⁵¹ not be formed by splitting an existing business,⁵² and demonstrate innovation or a scalable model⁵³ - applications are filed online at no cost via the Startup India portal/National Single Window interface.⁵⁴

⁴³ *Supra* note 2.

⁴⁴ Ministry of Micro, Small & Medium Enterprises, "*Ministry of Agro & Rural Industries (erstwhile)*", available at: <https://msme.gov.in/ministry-agro-rural-industries-erstwhile> (last visited 9 November 2025).

⁴⁵ Wikipedia, "*Ministry of Micro, Small and Medium Enterprises*", available at: https://en.wikipedia.org/wiki/Ministry_of_Micro,_Small_and_Medium_Enterprises#:~:text=The%20Ministry%20of%20Small%20Scale,Services%20provided%20include: (last visited 6 November 2025).

⁴⁶ *Supra* note 36.

⁴⁷ *Supra* note 41.

⁴⁸ Ministry of Commerce and Industry, Department for Promotion of Industry and Internal Trade (DPIIT), "*About the Ministry*", available at: <https://www.dpiit.gov.in/ministry> (last visited 6 November 2025).

⁴⁹ Ministry of Commerce and Industry, Department for Promotion of Industry and Internal Trade (DPIIT), "*Startup India Scheme*" (Startup India Portal), available at: <https://www.startupindia.gov.in/content/sih/en/startup-scheme.html> (last visited 6 November 2025).

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Supra* note 49.

On incentives and capital, recognized startups can seek a three-year income tax holiday under Section 80-IAC,⁵⁵ qualify for exemption from the so-called “*Angel Tax*”⁵⁶ under Section 56(2) (vii b),⁵⁷ and tap dedicated pools like the Fund of Funds for Startups (FFS),⁵⁸ the Startup India Seed Fund Scheme (SISFS),⁵⁹ and credit guarantees under CGSS⁶⁰ to unlock debt without heavy collateral burdens.⁶¹

For innovation and ecosystems, the initiative fast-tracks IP with fee rebates for patents and trademarks, provides government-paid facilitators, and connects founders with mentors and incubators nationwide through platforms like MAARG⁶² and the Startup India Online Hub to enable knowledge-sharing and expert guidance at scale.

3. LEGAL FRAMEWORK FOR MSMEs AND STARTUPS

The legal and policy environment for MSMEs and startups in India is anchored in distinct legislation and managed by dedicated institutions, with their regulation broadly aligning to constitutional values of economic justice and secure livelihoods. While the Constitution does not reference MSMEs or startups explicitly, Article 43 of the Directive Principles⁶³ calls on the State to ensure work and fair income through economic organization or law.⁶⁴

3.1 Institutional & Legislative Framework for MSMEs⁶⁵ and Startups⁶⁶

⁵⁵ The Income Tax Act, 1961, No. 43 of 1961, sec.80-IAC.

⁵⁶ The Income Tax Act, 1961, No. 43 of 1961, S. 56(2)(vii b).

⁵⁷ *Id.*

⁵⁸ Moneycontrol PF Team, “Startup India scheme decoded: Funding, eligibility and benefits for budding entrepreneurs” (Moneycontrol, 5 October 2025), available at: <https://www.moneycontrol.com/news/business/personal-finance/startup-india-scheme-decoded-funding-eligibility-and-benefits-for-budding-entrepreneurs-13597535.html> (last visited 6 November 2025).

⁵⁹ IndiaFilings, “Startup India Seed Fund Scheme (SISFS)” (IndiaFilings, updated July 29 2025), available at: <https://www.indiafilings.com/learn/startupindiaseedfundsschemesifs/#:~:text=The%20incubator%20should%20be%20operational,legal%2C%20and%20human%20resources%20functions> (last visited 6 November 2025).

⁶⁰ HDFC Bank, “Credit Guarantee Scheme for Startups (CGSS)” (HDFC Bank SME Government Schemes page), available at: <https://www.hdfcbank.com/sme/msme-government-schemes/credit-guarantee-scheme-for-startups-cgss> (last visited 6 November 2025).

⁶¹ *Id.*

⁶² Ministry of Commerce and Industry, Department for Promotion of Industry and Internal Trade (DPIIT), “MAARG – Mentorship, Advisory, Assistance, Resilience and Growth” (Startup India Portal), available at: <https://www.maarg.startupindia.gov.in/> (last visited 6 November 2025).

⁶³ The Constitution of India, 1950, Art.43.

⁶⁴ *Id.*

⁶⁵ Ministry of Micro, Small & Medium Enterprises, *About the Ministry*, available at: <https://msme.gov.in/about-us/about-us-ministry> (last visited 6 November 2025).

⁶⁶ Department for Promotion of Industry and Internal Trade, *Startup India*, available at: <https://www.startupindia.gov.in/> (last visited 6 November 2025).

The Legislative and Institutional framework for MSMEs⁶⁷ and Startups⁶⁸ in India is a comprehensive ecosystem which has been designed to promote growth, provide financial and technical support, and ensure a business friendly environment.

- **Ministry of Micro, Small, and Medium Enterprises (MSMEs)**⁶⁹

The Ministry of Micro, Small, and Medium Enterprises (MSMEs) serves as the chief governing body for the sector. It crafts and implements laws, regulations, and policies related to MSMEs, and launches schemes to expand access to credit, encourage technology adoption, and build market linkages.⁷⁰

- **Department for Promotion of Industry and Internal Trade (DPIIT)**⁷¹

DPIIT⁷², under the Ministry of Commerce and Industry, is the nodal agency for the Startup India initiative and shapes India's broader industrial policies. Its policy tools include DPIIT recognition for startups (which unlocks tax breaks, self-certification for select legal compliance, and swifter IP processes), and the administration of the Fund of Funds for Startups (FFS)⁷³ to boost access to venture capital.⁷⁴

- **Small Industries Development Bank of India (SIDBI)**⁷⁵

SIDBI,⁷⁶ established by an Act of Parliament, acts as the lead financial institution dedicated to MSMEs. Its mandate spans promotion, financing, and development: it offers direct finance, refinances other lenders, manages government credit guarantees, and is a nodal

⁶⁷ *Supra* note 66.

⁶⁸ *Supra* note 65.

⁶⁹ *Id.*

⁷⁰ Press Information Bureau, *Budget 2025-26: Fuelling MSME Expansion*, Government of India website, available at: <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2099687> (last visited 6 November 2025).

⁷¹ *Supra* note 50.

⁷² *Supra* note 50.

⁷³ *Supra* note 60.

⁷⁴ Ashitha Mary George and N. Karunakaran, "MSMEs and Budget 2025: A Study Exploring Indian Entrepreneurial Ecosystem through Government Initiatives" 12 *J. Mgmt. Res. & Analysis* 190 (2025), available at: <https://jmra.in/archive/volume/12/issue/3/article/24625/pdf> (last visited 7 November 2025).

⁷⁵ *Supra* note 33.

⁷⁶ *Supra* note 33.

agency for flagship schemes like the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE)⁷⁷ and the FFS⁷⁸ in collaboration with DPIIT.⁷⁹

- **NITI Aayog⁸⁰**

NITI Aayog is India's central policy think tank.⁸¹ While it does not govern or finance MSMEs and startups directly, it plays an important strategic role, designing national policy blueprints and offering recommendations - such as those aimed at integrating new technology or ramping up R&D - that guide reforms and improvements across the ecosystem.⁸²

3.2 Legislative Framework Governing MSMEs

The legal framework for MSMEs in India is primarily governed by three key components:

1. The Micro, Small and Medium Enterprises Development (MSMED) Act, 2006⁸³

This Act is the foundational legislation for MSMEs, providing a unified structure for their promotion, development, and competitiveness. It classifies enterprises into micro, small, and medium categories based on investment in plant, machinery, and annual turnover, with updated criteria as of 2020.⁸⁴

Key provisions include:

⁷⁷ Credit Guarantee Fund Trust for Micro and Small Enterprises, *About CGTMSE* (2025), available at: <https://www.cgtmse.in/Home/VS/3> (last visited 7 November 2025).

⁷⁸ *Supra* note 60.

⁷⁹ *Supra* note 80.

⁸⁰ NITI Aayog, Government of India, *About NITI Aayog* (2025), available at: <https://www.niti.gov.in/> (last visited 7 November 2025).

⁸¹ *Supra* note 83.

⁸² Press Release, Press Information Bureau, *NITI Aayog Releases Report on "Designing a Policy for Medium Enterprises"* (May 26, 2025), available at: <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2131261> (last visited 7 November 2025).

⁸³ *Supra* note 39.

⁸⁴ Press Release, Press Information Bureau, *Budget 2025-26: Fuelling MSME Expansion* (Feb. 4, 2025), available at: <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2099687> (last visited 7 November 2025).

- Promotion and Development:⁸⁵ The Act facilitates schemes for growth, infrastructure, and technology upgrades.
- Delayed Payment Protection: Buyers must pay MSME suppliers within 45 days;⁸⁶ failure results in penal interest at three times the RBI bank rate, compounded monthly.⁸⁷
- Dispute Resolution:⁸⁸ Micro and Small Enterprises Facilitation Councils (MSEFCs)⁸⁹ in each state resolve payment disputes efficiently, usually within 90 days.⁹⁰
- Institutional Support:⁹¹ This Act establishes the National Board for MSMEs to advise on policy matters and underpins the Udyam Registration portal,⁹² a streamlined process for MSME formalization and access to benefits.⁹³

2. Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE)⁹⁴

Established by the Ministry of MSME⁹⁵ and SIDBI, CGTMSE facilitates collateral-free loans to micro and small enterprises, guaranteeing up to 75-90% of the loan amount to lenders.⁹⁶ This mitigates lending risk, encouraging financial institutions to extend credit without requiring

⁸⁵ Press Release, Press Information Bureau, *Ministry of Micro, Small & Medium Enterprises Takes Various Steps for Promotion and Development of MSME Sector* (Aug. 12, 2025), available at: <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2155677> (last visited 7 November 2025).

⁸⁶ The Micro, Small and Medium Enterprises Development Act, 2006 (Act 27 of 2006), s. 15.

⁸⁷ *Id.* at, s. 16.

⁸⁸ *Id.* at, s. 18.

⁸⁹ *Id.* at, s. 20.

⁹⁰ *Id.* at, s. 18(5).

⁹¹ Press Release, Press Information Bureau, *Budget 2025-26: Fuelling MSME Expansion* (4 Feb. 2025), available at: <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2099687> (last visited 7 November 2025).

⁹² Press Release, Ministry of Micro, Small & Medium Enterprises, *Udyam Registration Portal – Home Page* (2025), available at: <https://www.udyamregistration.in/> (last visited 7 November 2025).

⁹³ *Supra* note 94.

⁹⁴ Credit Guarantee Fund Trust for Micro and Small Enterprises, *About CGTMSE* (2025), available at: <https://www.cgtmse.in/Home/VS/3> (last visited 7 November 2025).

⁹⁵ Ministry of Micro, Small and Medium Enterprises, Government of India, *About Us* (2025), available at: <https://msme.gov.in/about-us/about-us-ministry> (last visited 7 November 2025).

⁹⁶ Credit Guarantee Fund Trust for Micro and Small Enterprises, *About CGTMSE* (2025), available at: <https://www.cgtmse.in/Home/VS/3> (last visited 7 November 2025).

collateral, with limits raised to ₹10 crore per unit as of April 2025.⁹⁷ Special provisions support micro-enterprises, women entrepreneurs, and those in the North-East region.⁹⁸

3. Public Procurement Policy for MSMEs, 2012⁹⁹

This policy mandates that at least 25% of annual procurement by central ministries, departments, and CPSEs be from MSEs, with sub-targets for SC/ST (4%) and women-owned enterprises (3%).¹⁰⁰ Registered MSEs enjoy benefits such as exemption from earnest money deposits and price preference within a defined band, as well as access to government tenders for reserved items.

3.3 Legal and Policy Framework for Startups

The Startup India Initiative launched in 2016¹⁰¹ aims to create a thriving ecosystem for startups to foster innovation and drive economic growth. To access most benefits under this scheme, startups must obtain DPIIT Recognition,¹⁰² which is available to registered Companies, LLPs, and registered partnerships through an online application process on the National Single Window System (NSWS) portal.¹⁰³

The recognition process involves:¹⁰⁴

- Incorporating the business legally.

⁹⁷ Credit Guarantee Fund Trust for Micro and Small Enterprises, *Credit Guarantee Fund Scheme for Micro and Small Enterprises (CGS-I) (updated as on April 1, 2025)* (2025), available at: https://www.cgtmse.in/Default/ViewFile/?id=1743176302611_CGTMSE%20-%20Scheme%20Document%20CGS%20I_updated%20as%20on%20Apr%201%202025.pdf&path=Page#:~:text=%E2%80%9CHybrid%20Security%E2%80%9D%20product%20has%20been,chief%20promoter%20of%20the%20unit. (last visited 7 November 2025).

⁹⁸ *Supra* note 99.

⁹⁹ Ministry of Micro, Small and Medium Enterprises, *Public Procurement Policy for Micro and Small Enterprises (MSEs) Order, 2012* (2012), available at: <https://www.msme.gov.in/public-procurement-policy-micro-and-small-enterprises-mses-order-2012> (last visited 7 November 2025).

¹⁰⁰ Ministry of Micro, Small and Medium Enterprises, Government of India, *MSME SAMBANDH – Public Procurement Policy Monitoring Portal* (2025), available at: https://sambandh.msme.gov.in/PPP_about.aspx#:~:text=Welcome%20to%20Public%20Procurement%20Policy,MSEs%20owned%20by%20Women%20entrepreneurs (last visited 7 November 2025).

¹⁰¹ Ministry of Commerce & Industry, Department for Promotion of Industry and Internal Trade (DPIIT), *About Startup India Initiative* (2025), available at: <https://www.startupindia.gov.in/content/sih/en/about-startup-india-initiative.html> (last visited 7 November 2025).

¹⁰² *Supra* note 50.

¹⁰³ *Supra* note 104.

¹⁰⁴ *Supra* note 51.

- Registering on the Startup India portal and submitting the DPIIT recognition application form.
- Uploading required documents such as the Certificate of Incorporation.
- Self-certifying eligibility criteria compliance.
- Receiving the DPIIT recognition certificate after review.

Regarding tax benefits, recognized startups qualify for Section 80-IAC,¹⁰⁵ allowing a 100% income tax exemption for three consecutive years within their first 10 years. They also enjoy exemption from the "angel tax"¹⁰⁶ on equity shares sold above fair market value, by submitting a separate application on the Startup India portal after recognition.¹⁰⁷

For intellectual property, DPIIT-recognized startups get access to fast-track patent examination, an 80% rebate on patent filing fees, and government-appointed facilitators who assist with Intellectual Property Rights (IPR) processes.¹⁰⁸

Funding is supported through initiatives like the Fund of Funds, a ₹10,000 crore corpus providing financial backing.¹⁰⁹

Together, these mechanisms under the Startup India and DPIIT¹¹⁰ framework provide startups with regulatory ease, fiscal relief, IP support, and funding routes essential for scaling innovative businesses in India.

4. REGULATORY CHALLENGES AND GAPS IN THE LEGAL FRAMEWORK

MSMEs and startups often struggle with complicated and constantly changing regulations that make compliance burdensome and create uncertainty in their operations. At the same

¹⁰⁵ *Supra* note 58.

¹⁰⁶ *Supra* note 59.

¹⁰⁷ TreeLife, *Tax Exemption for Startups in India* (2025), available at: <https://treelife.in/tax-exemption-for-startups-in-india/> (last visited 7 November 2025).

¹⁰⁸ Department for Promotion of Industry and Internal Trade, *Intellectual Property Rights (IPR)* (2025), available at: <https://www.startupindia.gov.in/content/sih/en/intellectual-property-rights.html> (last visited 7 November 2025).

¹⁰⁹ Press Information Bureau, *India's Startup Revolution* (Feb. 1, 2025), available at: <https://www.pib.gov.in/FactsheetDetails.aspx?Id=149106> (last visited 7 November 2025).

¹¹⁰ *Supra* note 50.

time, gaps like weak enforcement, outdated laws, and limited institutional support make it harder for new and small businesses to innovate and grow confidently.

4.1 Fragmented Legal and Institutional Framework¹¹¹

The legal and institutional framework governing startups and MSMEs in India remains fragmented, creating a challenging environment for entrepreneurs. Businesses are required to comply with multiple central and state-level regulations such as the Companies Act,¹¹² the Income Tax Act,¹¹³ the GST Act,¹¹⁴ labour laws like the EPF¹¹⁵ and ESIC Act,¹¹⁶ and the Shops and Establishments Act, along with various environmental and industry-specific laws. These are administered by numerous bodies, including the Ministry of Corporate Affairs,¹¹⁷ the Income Tax Department,¹¹⁸ GST authorities,¹¹⁹ the Reserve Bank of India,¹²⁰ and intellectual property offices,¹²¹ each following distinct procedures and compliance mechanisms. This overlap results in regulatory complexity, heavy compliance burdens, and uneven implementation across states, posing significant hurdles for enterprises operating in multiple regions. Consequently, many businesses choose to remain small and informal to avoid the costs and expertise required to navigate such a complicated system. This has led to the persistence of the “missing middle,”¹²² where only a limited number of firms manage to scale successfully while the majority struggle within a disjointed regulatory framework.¹²³

¹¹¹ Saurabh Barnwal, *Startups and MSMEs: How Legal Frameworks Can Foster Innovation and Growth in India*, 8 Int'l J. L. Mgmt. & Human. 458 (2025) (p. 466).

¹¹² The Companies Act, 2013 (Act 18 of 2013).

¹¹³ The Income Tax Act, 1961 (Act 43 of 1961).

¹¹⁴ The Central Goods and Services Tax Act, 2017 (Act 12 of 2017).

¹¹⁵ The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (Act 19 of 1952).

¹¹⁶ The Employees' State Insurance Act, 1948 (Act 34 of 1948).

¹¹⁷ Ministry of Corporate Affairs, Government of India, *About Us*, <https://www.mca.gov.in/> (last visited 7 November 2025).

¹¹⁸ Income Tax Department, Government of India, *About Us*, <https://www.incometaxindia.gov.in/> (last visited 7 November 2025).

¹¹⁹ Goods and Services Tax Council, Government of India, *GST Portal*, <https://www.gst.gov.in/> (last visited 7 November 2025).

¹²⁰ Reserve Bank of India, *About Us*, <https://www.rbi.org.in/> (last visited 7 November 2025).

¹²¹ Office of the Controller General of Patents, Designs & Trade Marks, Government of India, *IP India*, <https://ipindia.gov.in/> (last visited 7 November 2025).

¹²² R. Nagraj, *Missing Middle and Size-Based Regulations: A Study of Indian Manufacturing* (Institute of Development Studies, Azim Premji University, Bengaluru, Apr. 2018), available at: https://publications.azimpremjiuniversity.edu.in/4335/1/Nagraj_Missing_Middle_And_Size_Based_Regulations_April_2018.pdf (last visited 8 November 2025).

¹²³ *Supra* note 114.

4.2 Complexity and Multiplicity of Compliance¹²⁴

Startups and MSMEs in India often find themselves tangled in a web of complex and overlapping compliance requirements that weigh heavily on their limited resources. From managing endless forms to keeping up with constantly changing regulations, these small businesses face a disproportionate burden compared to their scale. Across taxation, corporate governance, and environmental norms, entrepreneurs must juggle obligations under multiple laws- often at central, state, and local levels. For instance, tax compliance alone demands numerous monthly, quarterly, and yearly filings under Income Tax,¹²⁵ GST,¹²⁶ and TDS¹²⁷ regulations. Similarly, labor laws such as EPF,¹²⁸ ESI,¹²⁹ and the POSH Act¹³⁰ each come with their own rules and reporting procedures, while compliance under the Companies Act¹³¹ requires structured filings, meeting records, and documentation. Certain sectors like food, and healthcare must also meet stringent, industry-specific regulations. In manufacturing, the environmental and safety clearances further add to the compliance load.¹³²

The challenges don't end there. A typical manufacturing MSME may need to manage over 1,400 statutory obligations annually- on top of tracking more than 45 regulatory updates every single day. This complex ecosystem drains resources, as small firms rarely have in-house legal teams or the budget for constant professional help. As a result, many small enterprises hesitate to expand or even formalize their operations, fearing the compliance burden that comes with it. This hesitation not only limits their access to financing and investors but also weakens confidence among potential backers.¹³³

4.3 Weak Enforcement of Payment Protection¹³⁴

¹²⁴ R. Nagarajan, "Navigating Compliance Complexity: How India's MSMEs Can Thrive Amid 1,450+ Regulations", *SME Communities*, 3 weeks ago, available at: <https://smecommunities.com/navigating-compliance-complexity-how-indias-msmes-can-thrive-amid-1450-regulations/> (last visited 8 November 2025).

¹²⁵ *Supra* note 116.

¹²⁶ *Supra* note 117.

¹²⁷ The Income Tax Act, 1961 (Act 43 of 1961), ch. XVII-B.

¹²⁸ *Supra* note 118.

¹²⁹ The Employees' State Insurance Act, 1948 (Act 34 of 1948).

¹³⁰ The Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 (Act 14 of 2013).

¹³¹ The Companies Act, 2013 (Act 18 of 2013).

¹³² *Supra* note 127.

¹³³ *Id.*

¹³⁴ *Payment to MSME Vendors in 45 Days*, *Cretum Advisory Blog*, available at: <https://cretumadvisory.com/blog/payment-to-msme-vendors-in-45-days/> (last visited 8 November 2025).

Weak enforcement of the payment protection provisions (Sections 15–18) of the MSMED Act, 2006¹³⁵ continues to trouble India's micro and small enterprises, often leaving them vulnerable to delayed payments and severe working capital shortages. Many MSME suppliers hesitate to take legal action against larger buyers, fearing damage to long-term business relationships. At the institutional level, the Micro and Small Enterprises Facilitation Councils (MSEFCs),¹³⁶ which handle payment disputes, struggle with staff shortages, heavy case backlogs, and inconsistent functioning across states.

The councils frequently lack sufficient legal expertise, which often results in arbitration awards that are either procedurally weak or poorly reasoned. Such shortcomings make these awards vulnerable to challenges in court. Once an award is issued, larger buyers often exploit procedural gaps by invoking Section 34 of the Arbitration and Conciliation Act,¹³⁷ thereby prolonging disputes for extended periods. Although Section 19 of the MSMED Act prescribes a 75 percent pre-deposit for appeals,¹³⁸ financially stronger buyers still manage to delay proceedings, taking advantage of the financial limitations faced by MSMEs.¹³⁹

Adding to these challenges is the limited awareness among MSMEs about the Act's provisions and the necessity of Udyam registration¹⁴⁰ to access remedies through platforms like the MSME Samadhaan portal.¹⁴¹ Moreover, the exclusion of "works contracts"¹⁴² from the Act's scope leaves many smaller enterprises, particularly in infrastructure and engineering, without essential statutory protection. Ambiguity around buyer awareness of a supplier's MSME status adds another layer of complexity. Collectively, these factors create a cycle of delayed payments, liquidity shortages, and eroded confidence in the legal system. This weak enforcement not only harms the financial stability of MSMEs but also stifles their capacity for growth, innovation, and meaningful economic contribution.¹⁴³

¹³⁵ Micro, Small and Medium Enterprises Development Act, 2006 (Act 27 of 2006), ss. 15–18.

¹³⁶ *Supra* note 92.

¹³⁷ The Arbitration and Conciliation Act, 1996 (Act 26 of 1996), s. 34.

¹³⁸ The Micro, Small and Medium Enterprises Development Act, 2006 (Act 27 of 2006), s. 19.

¹³⁹ *Supra* note 137.

¹⁴⁰ *Supra* note 95.

¹⁴¹ Ministry of Micro, Small and Medium Enterprises, *MSME Samadhaan – Delayed Payment Monitoring System*, available at: <https://samadhaan.msme.gov.in/> (last visited 8 November 2025).

Contracts, available at: <https://bcajonline.org/journal/works-contracts/> (last visited 8 November 2025).

¹⁴² Bombay Chartered Accountants' Society, *Works Contracts*, available at: <https://bcajonline.org/journal/works-contracts/> (last visited 8 November 2025).

¹⁴³ *Supra* note 138.

4.4 Barriers in Access to Finance¹⁴⁴

The lack of adequate collateral remains one of the biggest hurdles for MSMEs and startups seeking formal credit. Traditional financial institutions generally prefer immovable assets such as land or property, which most emerging businesses do not possess. Many entrepreneurs also struggle with limited financial literacy and management skills, resulting in poor record-keeping, weak cash flow management, and limited understanding of loan terms. Particularly in rural and informal sectors, several micro-enterprises function without essential documentation like balance sheets or tax returns, further diminishing their chances of securing bank credit. Additionally, low awareness of government schemes and financial support programs restricts their ability to benefit from available assistance. Access to capital markets is also largely unattainable for most MSMEs due to stringent disclosure requirements and high compliance costs.¹⁴⁵

From the supply side, financial institutions tend to be risk-averse, viewing MSMEs and startups as unpredictable and prone to default. This perception leads to stricter credit norms, cautious lending, and higher interest rates. Lengthy, documentation-heavy loan procedures further deter entrepreneurs, while banks grapple with information gaps and high transaction costs in evaluating small borrowers. These structural bottlenecks collectively weaken financial inclusion and restrain the growth of India's most promising enterprise segment.¹⁴⁶

5. CONCLUSION AND SUGGESTIONS

Ensuring innovation while maintaining regulatory accountability for MSMEs and startups requires a balanced and forward-looking approach that simplifies compliance without constraining growth. The legal framework must shift from a rigid, rule-based structure to one that is adaptive, technology-oriented, and supportive of experimentation. Streamlined, proportional regulations can ease compliance burdens and make governance more transparent and predictable. Mechanisms such as single-window clearances and regulatory sandboxes can give entrepreneurs the space to innovate responsibly while scaling their businesses. At the same

¹⁴⁴ Global Council for the Promotion of International Trade, *MSME Financing in India: Challenges and Initiatives*, available at: <https://gcpit.org/msme-financing-in-india-challenges-and-initiatives/> (last visited 8 November 2025).

¹⁴⁵ *Ibid.*

¹⁴⁶ *Ibid.*

time, a risk-based regulatory model helps ensure that smaller enterprises are not overwhelmed, even as accountability and consumer protection are preserved.

Technology can act as a strong catalyst in this transformation. Tools like automation, digital record-keeping, and AI-driven compliance systems can make adherence to laws more efficient and transparent. However, these must be complemented by robust cybersecurity measures and sound data governance frameworks to build resilience and trust. Strengthening the financial, regulatory, and technological capacities of entrepreneurs through targeted training and institutional support is equally essential. Empowered state-level MSME departments and the active participation of institutions like SIDBI¹⁴⁷ and NITI Aayog¹⁴⁸ will play key roles in bridging policy and implementation gaps. Ultimately, fostering a culture of responsible innovation—where compliance, sustainability, and growth coexist—will define the future success of this sector. A regulatory ecosystem that encourages creativity while upholding accountability can unlock the full potential of India's MSMEs and startups, paving the way for inclusive and sustainable economic progress.

¹⁴⁷ *Supra* note 33.

¹⁴⁸ *Supra* note 84.