

A Critical Review of Constraints Affecting Micro, Small, and Medium Enterprises

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Abstract

Micro, Small, and Medium Enterprises (MSMEs) play a pivotal role in the socio-economic development of nations by generating employment, fostering innovation, enhancing production capabilities, and reducing regional disparities. They contribute significantly to GDP, trade, and industrial growth, particularly in developing economies. Despite their importance, MSMEs face a wide range of challenges that constrain their performance, growth, and long-term sustainability. Key obstacles include limited access to finance, inadequate managerial and technical skills, operational inefficiencies, infrastructural deficiencies, regulatory complexities, and restricted market access. This paper provides a critical review of these constraints, drawing on empirical studies and global literature to identify patterns and underlying causes. It also examines the interventions and support mechanisms offered by government policies, financial institutions, and technological innovations such as fintech solutions, which include digital lending platforms, peer-to-peer financing, and crowdfunding. The findings underscore the need for integrated approaches combining financial, managerial, technological, and policy support to empower MSMEs to thrive in increasingly competitive national and global markets.

Keywords: - MSMEs, Constraints, Financial Problems, Performance, Economy.

Introduction

Micro, Small, and Medium Enterprises (MSMEs) play a crucial role in both developing and developed economies, acting as key drivers of economic growth, job creation, and innovation. Globally, MSMEs make up more than 90% of all businesses and provide 40% to 60% of total employment in many countries (World Bank, 2022). In India, the MSME sector is particularly important, contributing around 30% to the national GDP and nearly 45% of the country's total industrial production (Ministry of MSME, Government of India, 2023). These enterprises not only stimulate local development but also help reduce regional disparities by fostering inclusive growth (Lownes-jackson et al., 2014; Franco et al., 2021). MSMEs in India play a crucial role in strengthening and sustaining the country's economy (Mittal & Raman, 2021b). This sector forms a fundamental pillar of the national economy and is instrumental in promoting continuous growth and comprehensive development (Okello et al., 2020; Prakash et al., 2021). Despite their significance, MSMEs face a range of challenges that hinder their performance and long-term sustainability. Financial constraints, limited managerial capabilities, technological gaps, and infrastructural inadequacies are among the most pressing issues confronting these enterprises. Additionally, regulatory complexities, market access barriers, and supply chain vulnerabilities further exacerbate the situation, particularly in the post-pandemic economic scenario. The COVID-19 crisis highlighted the vulnerability of MSMEs, with numerous enterprises struggling to continue operations because of cash flow problems and a sharp decline in demand (Singh et al., 2016; Maiti, 2017; OECD, 2021). They play a key role in the global economy by manufacturing and delivering a wide range of goods and services, while also offering employment to a large segment of the population (Prijadi et al., 2020).

Micro, Small, and Medium Enterprises (MSMEs) form the backbone of both developed and developing economies. Globally, they constitute the largest share of business establishments and contribute significantly to national GDP, employment generation, and trade facilitation. In India, MSMEs account for over 30% of the GDP and provide employment to millions, demonstrating their pivotal role in economic development. In recent years, measures such as demonetization and the implementation of the Goods and Services Tax (GST) have placed significant financial strain on MSMEs. Furthermore, the global economic slowdown, the COVID-19 pandemic, and prolonged nationwide lockdowns severely disrupted business operations. Challenges related to workforce

management and declining export demand further intensified the financial stress faced by small enterprises (Bagodi and Raravi, 2021; Mittal and Raman, 2021). Additionally, factors such as climate change, poor infrastructure, political uncertainty, excessive regulatory procedures, and limited market access have constrained the growth and development of enterprises (Rajpal, 2014). The MSME sector contributes substantially to the growth of the country's Gross Domestic Product (GDP). A strong and well-established MSME base is vital for fostering a balanced socio-economic structure and minimizing disparities in regional development (Maiti, 2017; Singh, 2019). Enhanced access to finance and stronger promotional support can significantly strengthen the MSME sector, which plays a crucial role in driving growth and development across both developed and developing economies (Baker et al., 2020). Taking into account the region's advantages and challenges, and acknowledging the growing importance of MSMEs and entrepreneurship in stimulating economic development, several measures have been implemented to encourage and strengthen these enterprises (Thingo et al., 2015). The MSME sector includes micro-enterprises, traditional small and medium-sized firms, innovative high-technology companies, and emerging start-ups (Hakeem, 2019). The Startup initiative provides an enabling and socially responsible platform that encourages young individuals to establish innovative enterprises. Additionally, through the Stand-Up India Campaign, women and individuals from "Scheduled Castes" and "Scheduled Tribes" are being empowered to promote and manage MSMEs across the country, particularly in rural, semi-urban, remote, and underserved regions (Nagayya and Rao, 2017). When the unorganized sector is taken into account, women's entrepreneurship is anticipated to assume an even more significant position within the MSME landscape (Mukherjee, 2010).

This study aims to examine how different challenges, particularly financial constraints, influence the performance of MSMEs. It seeks to address the following questions: How do various problems affect the performance of MSMEs? Which specific challenge has the most significant impact on their overall performance?

Literature Review

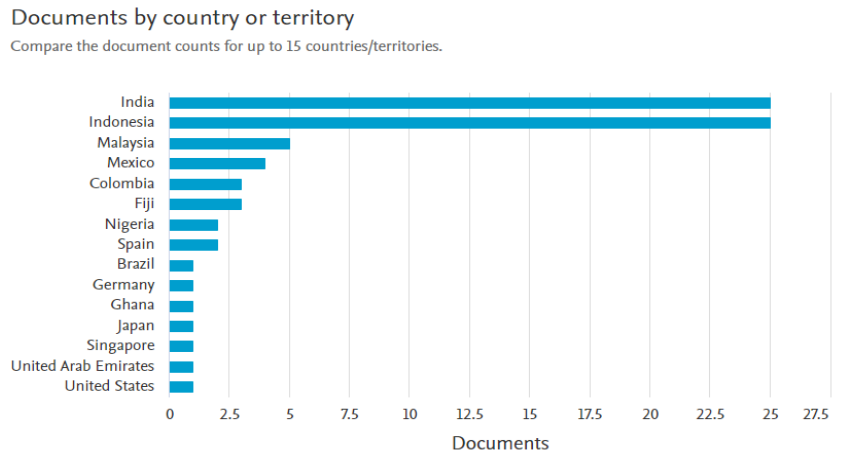
In different countries, MSMEs have been analyzed using a range of indicators such as workforce size, value of marketable securities, production capacity, major input factors, level of technological adoption, capital utilization, managerial efficiency, contribution to economic growth, investment patterns, turnover limitations in manufacturing and service sectors, and the specific challenges encountered by these enterprises (Lownes-jackson et al., 2014; Abiodun & Entebang, 2015). Financial limitations are among the most documented obstacles for MSMEs. Studies indicate that access to credit is disproportionately difficult for small firms due to lack of collateral, high transaction costs, and perceived riskiness (Beck & Demirgüç-Kunt, 2006; Ayyagari et al., 2011). In India, surveys show that only 40% of MSMEs have access to formal banking credit, with the remainder relying on informal sources such as moneylenders or internal funds (KPMG, 2022). Moreover, high interest rates and stringent repayment conditions further discourage entrepreneurs from availing formal finance, limiting their ability to invest in technology, human resources, and market expansion. In India, the criteria used to define MSMEs have often been debated and remain a subject of discussion (Kumar et al., 2009). According to the most recent definition provided by the Ministry of MSMEs, Government of India, enterprises are categorized based on their investment in plant and machinery or equipment, as well as their annual turnover in the manufacturing and service sectors. The primary objective of the Ministry is to extend financial support and promote the growth of MSMEs to strengthen the country's economic development (Annual Report, Micro, Small, and Medium, 2021). Supply Chain Finance (SCF) offers significant advantages to MSMEs, particularly because it does not rely heavily on an extensive credit history. Broadly, SCF mechanisms can be categorized into two types: supply chain-oriented solutions and finance-oriented solutions (Alora and Barua, 2019).

Data and Methodology

The researchers conducted an extensive search using "Scopus", a globally recognized database of abstracts and citations. They explored publications across multiple disciplines, including "business", "management", "accounting", "economics", "econometrics", and "finance", by using the keywords "problems" or "financial problems" in combination with "MSME" or "MSMEs." After examining the abstracts, studies that were not directly related to the challenges faced by MSMEs and their impact on performance were excluded. Figure 1 presents an analysis of publications by country or territory from 2006 to 2021, covering up to 15 regions. The

findings indicate that “India” and “Indonesia” lead with 25 publications each. In contrast, countries such as the “United States”, “Brazil”, “Germany”, “Ghana”, “Japan”, “Singapore”, and the “United Arab Emirates” have only one publication each during the same period.

Figure-1: shows country or territory-wise publications from 2006 to 2021.



Discussion

Tambunan (2011) analyzed the recent growth of MSMEs in Indonesia and investigated the challenges affecting their performance, particularly in terms of productivity, contribution to GDP, and the constraints limiting their development. Munim et al. (2020) highlighted the substantial financing gaps present in emerging economies. It also identified crowdfunding as an innovative approach that can help bridge these financial shortfalls. Sharma (2018) examined how MSMEs in the MENA region approach and manage innovation. It found that these enterprises encounter significant financial and operational challenges while striving to compete with larger firms.

Adetiloye et al. (2020) examined the primary obstacles that limit women entrepreneurs' access to financial resources, aiming to promote long-term financial inclusion for women-owned micro, small, and medium enterprises. Naidu and Chand (2013) assessed the extent and intensity of the financial challenges encountered by SMEs in Fiji. Babajide et al. (2020) examined recent developments, innovative approaches, and available financing channels that assist MSMEs in addressing financial exclusion in Nigeria. It also assessed the extent of the financing gap faced by MSMEs in the country and proposed practical recommendations to bridge this gap.

In addition, the study provided recommendations for prospective financial service providers such as government institutions and regulatory agencies to more effectively foster the expansion and progress of this developing sector. It emphasized that limited access to capital remains a major challenge for small and medium-sized enterprises. Mushtaq et al. (2021) categorized financial access into two tiers: basic and advanced. Basic financial access was measured by factors such as the firm's bank balance and the credit limit extended by a financial institution. Advanced financial access, on the other hand, was assessed based on the extent to which bank financing supports the company's operating expenses and liquidity reserves. Mittal and Raman (2021) examined how financial constraints influence entrepreneurial outcomes, particularly in terms of sales growth, profitability, and the accumulation of assets. According to Naidu and Chand (2012a), the financial difficulties faced by MSMEs can be broadly categorized into three areas: funding-related issues, administrative and operational challenges, and problems associated with sales and receivables management. Abiodun and Entebang (2015) evaluated firm performance by examining the relationship between various independent and dependent variables. It identified limited access to financial support as one of the primary barriers to the success of SMEs in Africa. Singh et al. (2016) examined cross-country data from 119 developing nations to identify the key barriers limiting SME growth and to understand the factors that shape entrepreneurs' perceptions of these obstacles.

MSMEs operate in a highly competitive environment and face multidimensional constraints. Financial limitations are the most critical, affecting almost every aspect of business operations. However, a combination of supportive government policies, institutional financing, and innovative fintech solutions can significantly alleviate these

challenges. Collaborative efforts between public and private sectors are necessary to improve access to finance, provide managerial training, enhance technological capabilities, and expand market access.

The researchers concluded that entrepreneurs with higher educational qualifications tend to demonstrate significantly greater financial literacy. They also found that the firm's profitability ratio plays a crucial role in shaping entrepreneurs' level of financial literacy. The findings indicate that fintech solutions simplify access to funding, facilitate digital transactions, help expand market reach, and improve financial reporting and management for MSMEs.

Conclusion

This research examines the wide range of difficulties encountered by MSME entrepreneurs, including challenges related to human resource practices, access to finance, regional imbalances, market analysis, infrastructure gaps, availability of raw materials, managerial experience, educational background, and budgetary constraints. Among these factors, limited access to finance stands out as the most significant barrier affecting their expansion and long-term viability.

MSMEs are vital to economic growth, employment generation, and innovation. Nevertheless, they face significant challenges related to finance, operations, management, infrastructure, and market access. Financial constraints remain the most pressing barrier, but strategic interventions through government policies, institutional support, and fintech solutions can enhance MSME performance. Addressing these constraints comprehensively is essential for sustainable growth and for enabling MSMEs to contribute fully to national and global economies. The study further emphasizes the crucial role of institutional support in mitigating these financial challenges. Government agencies contribute through subsidies, policy support, and development schemes; Non-Banking Financial Companies (NBFCs) extend credit facilities at varying interest rates; and fintech firms offer technology-driven financial solutions such as peer-to-peer lending, equity crowdfunding, digital wallets, and personal finance applications. Strengthened collaboration between public institutions and private entities is vital to ensure sufficient funding, improve technical competencies, and support MSMEs in embracing modern technologies within an increasingly competitive business landscape.

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