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From Delays to Discipline: Unlocking MSME Liquidity through Reforms

This article explores key reforms aimed at addressing liquidity challenges faced by India's MSME sector. It highlights three pivotal developments: the introduction of an AI-enabled Online Dispute Resolution (ODR) mechanism, Section 43B(h) of the Income Tax Act linking tax deductions to timely MSME payments, and the revised MSME classification effective from April 2025. Together, these reforms are designed to formalize the sector, enforce payment discipline, and improve access to finance. The author, through this article, emphasizes the growing awareness among stakeholders, including auditors and regulators, and calls for collaborative efforts to create a sustainable liquidity ecosystem for MSMEs.

Introduction: The Evolution and Formalization of the MSME Sector

Liquidity is the lifeline of any business, but for MSMEs, it is often the defining factor between survival and excellence. Adequate cash flow ensures timely procurement of raw materials, payment of wages, and fulfilment of orders. However, the structural disadvantage of MSMEs in negotiating credit terms often results in delayed payments, forcing them into cycles of working capital stress. As such, any reform that

addresses liquidity constraints directly contributes to the long-term viability and growth of the sector.

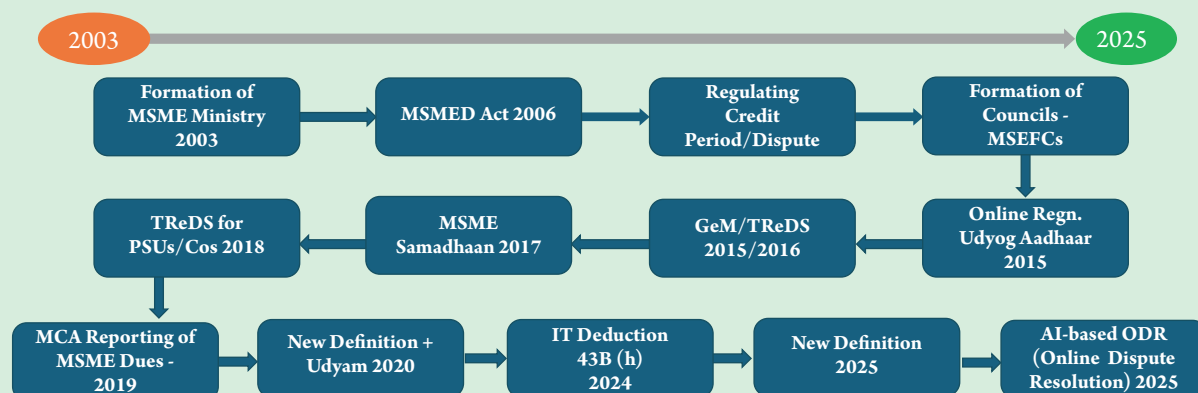
Since the formation of the Ministry of MSME in 2003, India has witnessed steady formalization of the sector through key policy reforms. These include the MSMED Act (2006), digital platforms like Udyog Aadhaar and MSME Samadhaan, and compliance mechanisms like TReDS and MCA's MSME dues reporting. More recent measures such as Section 43B(h), revised definitions under

Udyam Registration, and the rollout of AI-enabled ODR reflect a cohesive push toward liquidity, transparency, and institutional accountability.

Liquidity, the Cultural Challenge

Several liquidity-focused initiatives have improved MSME receivables, yet challenges remain, particularly with PSUs and large corporates, where a cultural shift in payment behaviour toward MSMEs is still needed. In a study done in the year 2022, over ₹10.7 lakh crore, equivalent to nearly 6% of

Formalization Process of MSME Sector



India's gross value added (GVA), were locked in delayed payments owed to MSMEs. A staggering 80% of invoices raised by MSMEs experience delays, with public sector undertakings and government entities among the most delayed payers.

This delay in receivables severely disrupts working capital cycles for MSMEs, compelling them to rely on costly short-term borrowing or to limit operations due to cash flow constraints. The study highlights inherent power imbalance in buyer-supplier relationships, where small enterprises are forced to accept prolonged credit periods to retain business.

It is within this context that reforms like ODR and Section 43B(h) of the Income Tax Act emerge, not as isolated policy tools, but as targeted responses to chronic liquidity bottlenecks that inhibit MSME growth. The revised MSME classification made effective from 1st April 2025 also supports this objective, by allowing larger and growing enterprises to remain within the MSME ecosystem and continue accessing liquidity-enhancing benefits and protections.

Let's discuss these 3 initiatives and their impact on the payment ecosystem of MSMEs:



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1. Online Dispute Resolution: A Digital Solution for Payment Delays

A major stride in the formalization journey of the MSME sector is the introduction of an Online Dispute Resolution (ODR) platform, launched in mid-2025. Conceived under the MSME Development Act and further strengthening the MSME-SAMADHAAN initiative, this system transitions MSMEs from paperbased complaints to a fully end-to-end digital grievance redressal mechanism.

The **MSME-SAMADHAAN** portal, launched in the year 2017, significantly reduced the time taken in filing of dispute by MSEs and service of notices thereof to the respondents. Earlier, it was a manual and time-consuming process. It also brought transparency in the entire process, where the MSEs were able to check the status of their cases online. This also resulted in greater accountability on the part of MSEFC.

The **MSME-ODR** initiative is one step forward compared to MSME-SAMADHAAN, which aims for the entire dispute resolution process being carried out online through the ODR portal. Starting with filing of claim, notice issuance, documentation, hearings, and settlement, all interactions are conducted online through a structured, document-centric workflow, thereby significantly



reducing the entire time and cost involved in the dispute resolution process.

From 15 October 2025, all new delayed payment cases must be filed exclusively on the new MSME ODR Portal (<https://odr.msme.gov.in>) — the Samadhaan portal (<https://samadhaan.msme.gov.in>) stopped accepting new filings and redirects users to the ODR platform.

The Process:

The ODR portal provides an end-to-end dispute resolution process in two stages:

- Pre-MSEFC
- MSEFC

The pre-MSEFC stage is a voluntary, out-of-court solution that shall be undertaken based on consent provided by both parties. In case any or all of the parties opt out of the pre-MSEFC process, the parties will enter the MSEFC stage, which shall be undertaken as per the procedure defined under the MSMED Act, 2006. The pre-MSEFC stage envisages two processes:

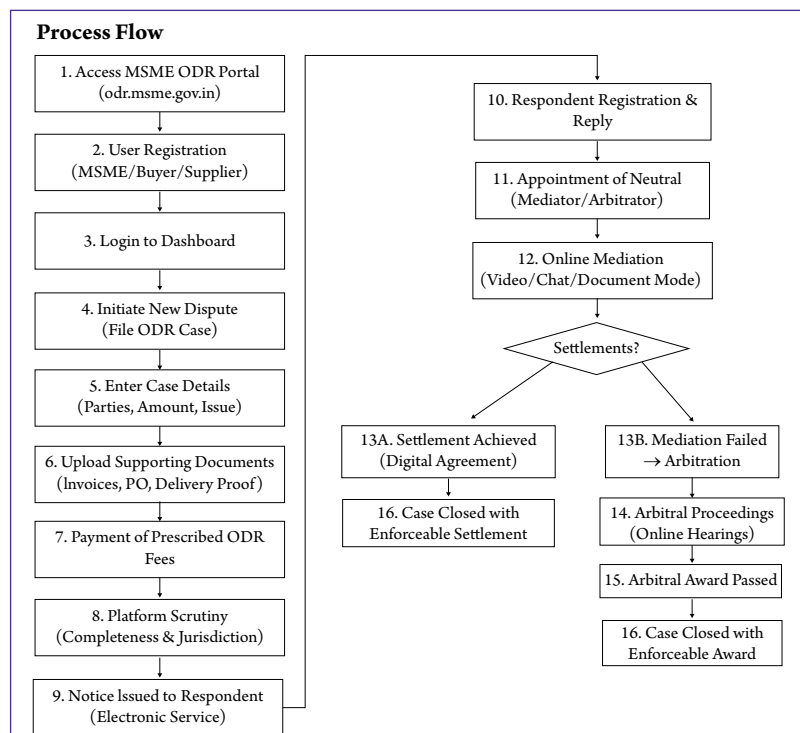
- Digital Guided Pathway
- Unmanned Negotiation

The MSEFC stage is the legal procedure mandated for the resolution of delayed payment applications under the MSMED Act, 2006. As mandated under the Act, the MSEFC stage envisages two processes:

- Conciliation/Mediation
- Arbitration

The entire process flow and the advantages for MSMEs are presented in Table 1.

Table 1.



Advantages for MSMEs

- **AI-facilitated Resolution:** Parties can opt for automated, AI driven negotiation before formal MSEFC proceedings.
- **Empowered Facilitation Councils:** Tech and financial support is provided to MSEFCs, with private ODR providers empanelled.
- **Speedy Resolution:** Designed to deliver outcomes in weeks, not months, ODR significantly reduces delays.
- **Cost Efficiencies:** Digital filing and reduced procedures keep expenses low, aided by concessions on documentation fees.
- **Accessibility and Convenience:** The online process reduces geographical barriers and enable MSMEs, whether in metropolitan or rural areas, to raise payment disputes without logistical constraints.
- **Transparency and Accountability:** Digital logs, AI-generated milestones, and centralized case tracking build trust in the system.
- **Financial Backing to MSEFCs:** States to receive grants to develop in-house legal and IT capabilities and to onboard private ODR entities, as permitted under the MSMED Act.
- **Mandatory Payment Compliance:** Buyers face default liability if they fail to clear dues in 45 days; ODR reinforces this obligation.
- **Strategic Alignment and Pilot Testing:** Developed under the World Bank-supported RAMP initiative, the system has already undergone pilot testing and staff training at MSEFCs.

However, the system is still evolving, with initial challenges currently being addressed.

“The revised definition of MSMEs, effective from 1st April 2025, marks another key reform aimed at increasing the number of enterprises that can avail of government schemes, credit benefits, and legal protections under the MSMED Act.”

2. Tax-based Enforcement: Introduction of Section 43B(h) of the Income Tax Act

A transformative development for payment discipline in the MSME ecosystem is the introduction of Section 43B(h) in the Income Tax Act, effective from AY 2024–25. This amendment mandates that expenditure on purchases from Micro and Small Enterprises (MSEs) will be allowed as a deduction only if a payment is made within the timelines prescribed under the MSMED Act, i.e., within 15 days (or 45 days, if contractually agreed).

This tax provision has effectively linked compliance with the MSMED Act to tax deductibility, making it a powerful enforcement tool. Large buyers and corporates now have a financial disincentive to delay payments, which addresses a long-standing challenge faced by MSMEs. For Chartered Accountants and auditors, this introduces new layers of disclosure and verification while preparing tax computations or certifying financials, adding further to the MSME visibility in formal financial reporting. FY 2025–26, being the third year of compliance post-amendment, greater awareness on the part of auditors and the industry (buyers) will help MSEs strengthen their cash cycle.

“Increased awareness and regulatory emphasis have led auditors to scrutinize company disclosures related to MSME dues more closely, particularly in relation to Form MSME-1 filings and compliance with Section 43B(h).”

The move is a milestone in shifting from moral obligation to statutory enforcement. It also reinforces the government's policy consistency by aligning tax law with the pro-MSME thrust seen in platforms like Samadhaan and ODR.

3. Revised Classification Norms: Broadening the MSME Base

The revised definition of MSMEs, effective from 1st April 2025, marks another key reform aimed at increasing the number of enterprises that can avail of government schemes, credit benefits, and legal protections under the MSMED Act.

The updated classification, based on investment in plant & machinery and turnover, is as follows:

- **Micro:** Investment ≤ ₹2.5 crore and Turnover ≤ ₹10 crore
- **Small:** Investment ≤ ₹25 crore and Turnover ≤ ₹100 crore
- **Medium:** Investment ≤ ₹125 crore and Turnover ≤ ₹500 crore

This revised and expanded definition has widened the net, allowing many growing enterprises to continue benefitting from MSME schemes even as their turnover increases. It ensures alignment with inflationary trends and industry demands, while maintaining ease of registration through the Udyam portal.



The updated thresholds reflect a dynamic approach, ensuring that the classification keeps pace with evolving business realities and doesn't become exclusionary over time. The revision is expected to enhance formalization, ease of doing business, and access to structured credit and dispute mechanisms.

Prior to the 2020 amendment to the MSMED Act, a small enterprise was defined by a gross investment limit of ₹5 crore in plant and machinery. Today, the limit stands at ₹25 crore on a Written Down Value (WDV) basis, along with a turnover ceiling of ₹100 crore. This shift from gross investment to WDV, combined with higher caps, effectively translates into a 5 to 10 times expansion in threshold eligibility for MSEs.

ODR represents a pivotal leap in formalization, one that combines legal certainty with digital ease, ensures timely enforcement of payments, and marks a systemic overhaul in MSME dispute handling. Alongside tax enforcement via Section 43B(h) and the revised classification norms of 2025, these developments reinforce previous progressive steps, such as Samadhaan and Udyam Registration, by closing the enforcement gap that often undermines the sector's fluid operations.

Legal Backbone: Judicial Support to the MSMED Act

The foundation of most MSME-centric initiatives lies in the Micro, Small and

Medium Enterprises Development (MSMED) Act, 2006. Notably, the Act provides a statutory cap on the credit period, restricting it to a maximum of 45 days, regardless of any mutual agreement to the contrary. This provision has consistently received judicial backing, strengthening its enforceability over time.

In the landmark case of *Eden Exports v. Union of India* (2010), the Madras High Court upheld the constitutionality of limiting the credit period, even where the buyer and seller had contractually agreed to a longer term. More recently, in *Silipi Industries v. Kerala State Electricity Board*, the judiciary clarified issues relating to counterclaims and the applicable limitation period for delayed payment cases under the MSMED Act. Finally, the Supreme Court's verdict in *NBCC India Ltd. v. Relcon Infraprojects Pvt. Ltd.* (2025) affirmed that even unregistered MSEs are entitled to their legitimate dues for supplies made, emphasizing substance over procedural compliance.

These rulings collectively underscore the legal robustness of the MSMED Act and enhance confidence among enterprises in invoking its provisions for timely payment enforcement.

Broader Awareness and Institutional Enablers

The role of Chartered Accountants has also evolved significantly in



recent years with regard to audit and reporting of payables to MSE suppliers. Increased awareness and regulatory emphasis have led auditors to scrutinize company disclosures related to MSME dues more closely, particularly in relation to Form MSME-1 filings and compliance with Section 43B(h). This has, in turn, prompted many large buyers to improve their payment discipline. Companies are either paying MSME suppliers within the prescribed timelines or provisioning and disbursing the statutory interest for delayed payments as required under the MSMED Act. This emerging compliance culture reflects the growing influence of financial professionals in promoting accountability and liquidity-focused governance.

Two pivotal developments have proven real enablers to the provisions of the MSMED Act i.e., mandatory disclosures under MCA and introduction of the TReDS platform.

The 2019 notification of the MCA mandated half yearly reporting of MSE dues. The regulatory ecosystem has also started enforcing compliance with liquidity-related obligations. Companies failing to file Form MSME-1 under Section 405 of the Companies Act, which mandates reporting of dues to MSEs beyond 45 days, are subject



to penalties. The penalty framework includes a fine of ₹20,000 and an additional ₹1,000 per day of default, up to ₹300,000, applicable to the company and its officers. Several Registrar of Companies (ROC) offices have initiated adjudication proceedings in such cases.

The 2018 notification of the Ministry of MSME mandates large companies and CPSEs with a turnover exceeding ₹250 crore (reduced from ₹500 crore in November 2024), must onboard with at least one of the three licensed TReDS platforms before 1st April 2025. Non-registration may attract regulatory scrutiny, reputational risks, and compliance notices. These measures signal a shift from passive policy encouragement to active enforcement, further strengthening the government's liquidity push for MSMEs.

The growing adoption of the Trade Receivables Discounting System (TReDS) platforms also reflects this increasing focus on liquidity in the MSME ecosystem. Since their inception, the three RBI-licensed platforms, RXIL, InvoiceMart, and M1xchange, have seen a significant surge in transaction volume. In FY2024 alone, over ₹1.38 lakh crore worth of invoices were financed across 41.6 lakh transactions, reflecting an 80% increase from the ₹75,000 crore recorded in FY2023. Cumulatively, the platforms have processed bills exceeding ₹5.33 lakh crore. These figures point to the growing confidence of MSMEs and financiers in digital trade financing solutions.

It has been observed that there has been a significant shift in awareness among all stakeholders, such as buyers, MSMEs, regulators, and financial institutions, regarding the critical role of liquidity in sustaining enterprise viability.

Conclusion

For India to achieve its vision of "Viksit Bharat" by 2047, MSMEs will play a pivotal role. Their growth



hinges on three key enablers: Robust Infrastructure with seamless last-mile delivery, access to Skilled Manpower, and Assured Liquidity. While progress has been made, especially on liquidity through all initiatives discussed above, there is still a long way to go. Daily hearings by MSEFCs, empowering them to execute awards, and automatic supplier classification without buyer discretion are steps that can further strengthen the liquidity ecosystem and enable faster dispute resolution.

Looking ahead, it is imperative that the government, MSMEs, and Chartered Accountants work in close coordination to build on this momentum. Collective and sustained efforts across policy, compliance, and professional advisory will accelerate the formalization of the MSME sector. This, in turn, will foster a predictable environment for liquidity management, enhancing competitiveness, improving cash flow efficiency, and advancing India's ease of doing business.

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