

CHAPTER 12

Debt Restructuring for Micro, Small and Medium Enterprises: Appropriate Laws, Awareness and Enforcement

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CHAPTER 12

Debt Restructuring for Micro, Small and Medium Enterprises: Appropriate Laws, Awareness and Enforcement

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Micro, Small and Medium Enterprises (MSMEs) are the most critical constitutions in the production and manufacturing economy. Their character, nature and scale of economies seem insignificant relative to the mid cap and Large cap Corporates. With specific reference to the MSMEs financial requirement the funding through debt is the pivotal subject that decides the rise and fall of the MSME enterprises. While MSMEs required a quicker and seamless sanctioning of loans the Banks concerns about the recovery of the loans and not allowing it to be categorized as Non-Performing Assets (NPAs). This study generated, as well as extracted data to find if there was a need to enact a new law or amend the existing laws related to debts and banking systems. All the stakeholders who are involved in the process of creating the debt, securing it, deploying it were interviewed. It concluded that the debt restructuring is essential to treat the loans, repayment consideration and restructuring of debts of MSMEs in a manner to differentiate it from the other corporate debts. Interpretation sharpness and enforcement of the acts in force are the significant consideration rather than authoring new laws or amending the existing laws. There is a requirement of more sensitisation and awareness programs among the MSMEs through their representative bodies.

1 INTRODUCTION

Micro, Small and Medium Enterprises (MSMEs) are a part of an economy which contributes the highest in the macroeconomic and microeconomic development indexes. Without the considerations of these enterprises the existential issue of large corporate companies will become insignificant. The contributions of MSMEs are recognised to be the most critical and significant to the overall nation's productivity and growth. They are the primary vendors or the composite of larger corporations.

Though MSMEs have the same legal structure as an entity, they largely differ in nature, character, language and culture of business, from the Mid-cap and Large-Cap corporates.

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Despite the difference in function and character of MSMEs, they are regulated by several economic laws and regulations such as Tax, Insurance, and Compliances to accounting standards and Company Secretarial and other regulations in the manner the large corporates are treated. Though the structure is the same the nature and characters differ starkly, especially in the treatment of Borrowings and recovery.

Generally the enterprises start out as unregistered enterprises and only as much as 9% of the unregistered entities get formalised¹ (Porta & Shleifer, 2014) and 90% of MSMEs fall under the informal sector (ILO, 2023). The policies and legal mechanisms are to encourage MSMEs to leverage on the ecosystem.

The greatest of all challenges of these MSMEs is related to the financial function related to structuring of the entity in contrast to the larger corporates which are fully structured and formalised. The corporates are to deal with challenges such as taxes and duties.

Not much of the legislation lays emphasis on a support mechanism under situations and events that naturally lead to a collapse of the debt asset. Focus is more on recovery from the enterprise rather than reconstructing the Bad or Collapsed asset even though the business is highly viable and caters to a strong and expanding market. On the other hand the bias against the lenders always exists not until the assets become bad.

There are various factors which may cause a loan to turn into an NPA. They may be broadly classified as Internal Factors and External factors. Debt becomes a bad loan and as under the provisions of the law and the RBI regulations they will be placed under consequential categories based on the norms of the payment of interest on time and adhering to the repayment requirements set by the lender or the banks. They may be placed under Special Mention Accounts (SMAs) and later as Non-Performing Assets (NPAs) if over a period of time such NPAs are still kept in the same status for a longer period of time it becomes inevitable for the banker or the NBFC or any institutional lender to use the provisions of the law and initiate recovery.

Loan restructuring is a process in which borrowers facing financial distress renegotiate and modify the terms of the loan with the lender to avoid default. It helps to maintain continuity in servicing the debt and gives borrowers a certain degree of flexibility to restore financial stability.

Rehabilitation provides for restructuring of payment norms and sanction of additional credits as per the need. The restructuring norms should be revised with improved relaxation in asset classification and provisioning for the deserving cases (businesses having potential to generate profits). Upgradation of Standard Accounts can be done only when all the outstanding credit facilities of the unit perform satisfactorily during the specified period.

¹ R. L. Porta & A. Shleifer, *Informality and Development*, 28 J. ECON. PERSPS. 109–26 (2014).

Several solutions are in practice and most of them are procedural most of which are under the framework of laws and regulations. There are specific laws, statutes and regulations which set frameworks and guidelines for classifying, recovery, restructuring the bad debts by an enterprise. These laws are applicable to all the enterprises irrespective of the nature and the size of its business. The consideration of smaller and more formal enterprises are treated the same under the law. The issues related to recovery and debt restructuring are not much known.

2 LEGISLATION DEALING WITH DEBT FINANCING AND MSME

Several regulatory frameworks and laws have been enacted and enforced such as Regulatory Framework for Debt Funding & Restructuring (2025-2026) where the RBI was raised to be the regulator. Debt funding and restructuring regulations in India are regulated by the Reserve Bank of India (RBI) and guided by the MSMED Act, 2006. All these acts have undergone significant revisions (2024-2026). Key reforms include increasing collateral-free loan limits, creating specialized frameworks for NPA. In this study a closer analysis is based on classifying and identifying appropriate laws relevant to the MSME financing and restructuring of the bad debts. It looks at the legal implications in redressal and restructuring mechanism for Sick MSMEs with particular relevance and scale using legislations specific to Non-Performing Assets or Loans. The revamping of the legal, procedural and institutional mechanisms for interventions to prevent bad debts is high. The revisions have been enacted in the acts like. Specific provisions were enabled under IBC (Amendment) Bill 2025 and SARFAESI Act, for out-of-court insolvency process (CIIRP) and restructuring responsibility specifically for MSMEs. Arbitration provisions were enabled for quicker remedies.

A summation of the understanding of the legal landscape for MSME especially in the Financing, credit access and debt reconstruction so far there have been provisions in Chapter III-A of the IBC which defines and offers an insolvency process exists precisely for MSMEs, pre-packaged to are MSMEs specific. However, there seems to be lack of percolation of understanding and interpretation of the statutes found therein for which the RBI has been issuing circulars since January 2019 for a fairness in understanding and implementation of the statutes. This study takes a deeper analysis in order to bring to light the requirement of provisions to treat the Financing, classifying and restructuring of debts are adequately covered so as to a clarity and adequacy in understanding and enforcement of such laws. The problem focuses on the legislature, existing statutes and mechanisms that the MSMEs claim to be the biggest stumbling block of their progress and contribution to the nation's overall economic growth.

3 LITERATURE REVIEW

MSMEs are the most significant and crucial contributors to economy and employment. Finance is the lifeblood of business especially MSMEs. MSMEs secure their fund in the form of debt primarily for early growth stages (Kumar and Sharma, 2016)². Financing poses challenges for MSMEs (borrower) and the Banks (Lenders) (Mugunthan S, AS Pillai, et al., 2018)³. The nature, limited exposure and information, the low quantum of the loan to the high cost of it is the reason for failure (Chandrasekhar Mund, 2020)⁴.

Various financial policies and measures led by RBI have constituted several committees. Frequent notifications and circulars have been issued to reform to revive the MSME sector. The objective of the government with schemes and initiatives such as ECLGS, SAMRIDH, Specific funds to MSMEs, and reforms in taxes specific to MSMEs was implemented to help MSMEs to restructure their (Kadaba et al., 2023)⁵.

There is completely no awareness about the legal support systems for interpretation of statutes in particular context to debt restructuring, this is reported (Gautam, 2022).⁶ Very few studies and publications are available to have analysed the relation between legislation their reforms and have attempted to understand the impact of the procedures of existing laws in specific relationship the debt reconstruction. Few studies have also addressed the restructuring possibilities by Institutions like banks and NBFCs (Divya and Swati, 2025).⁷ Shri and Elizabeth (2022)⁸ have reported on the challenges in debt restructuring with specific reference to the Banks and the borrowers in Pune in the state of Maharashtra. Amit and Vijaylaxmi (2022)⁹ have considered the need of such Law and Policy Reforms in India studied and published with the pandemic background. It is very evident that there is a need for an investigation into the lacunas that address the regulation of restructuring for MSMEs through legislation.

² S. Kumar & P. Sharma, *Financing Patterns of SMEs in India During 2006 to 2013 - An Empirical Analysis*, 28 J. SMALL BUS. & ENTREPRENEURSHIP 97–131 (2016).

³ MUGUNTHAN S., A.S. PILLAI, MUKESH KUMAR, GAUTAM PRAKASH, Y. R. A. & M., SPECIAL STUDY ON ISSUES AND CHALLENGES IN ACCESS TO FINANCE FOR MSMEs 35 (June 2018).

⁴ C. S. Mund, *Problems of MSME Finance in India and Role of Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE)*, 11 IOSR J. ECON. & FIN. 01–06 (2020).

⁵ D. M. Kadaba, P. Aithal & K. Sharma, *Government Initiatives and Digital Innovation for Atma Nirbhar SMEs/SMEs: To Achieve Sustainable and Inclusive Economic Growth*, 8 INT'L J. MGMT. TECH. & SOC. SCIS. 68–82 (2023).

⁶ N. Gautam, *Addressing the Gap Areas Crucial for Survival by Focusing on the Key Growth Determinants of Micro, Small and Medium Enterprises in India: A Critical Analysis Pertaining to Textile Sector MSMEs*, 70 INDIAN ECON. J. 577–96 (2022).

⁷ Divya & Swati S., *Role of NBFCs on MSME Financing: A Special Reference of Credit Accessibility and Economic Growth*, 14 INT'L J. BUS. ETHICS DEV. (2025).

⁸ SHRI P.S.B. & ELIZABETH J., A REPORT ON ISSUES AND CHALLENGES IN FINANCING MSME IN PUNE, MAHARASHTRA (Indian Institute of Banking & Finance 2022).

⁹ Amit K.K. & Vijaylaxmi S., *Law and Policy Reforms in India Amidst COVID-19 to Mitigate Risk in Infrastructure Structured Project Financing*, 19 US-CHINA L. REV. 35–52 (2022).

SIDBI (2011) has explicitly brought out¹⁰ the exact need of legal intervention as a The Global Best Banking Practices in Micro, Small and Medium Enterprises (MSME) Financing. Shal et al. (2025) have explored, though not deeply, but have found¹¹ that there is an attribute of legal mechanism which can make the restructuring procedures easier and more viable.

4 METHODOLOGY

The primary data was generated using a questionnaire in the form of Google forms with questions that are to be mandatorily answered was sent to identified target respondents as well as random mails and phone numbers through mail and WhatsApp. Interviews in-person, over video or voice calls were also conducted.

The respondents were grouped as Lenders, Borrowers and Influencers. Lenders and Borrowers are the 'Primary Respondents' and the Influencers are 'Supportive Respondents'. There were 100 targeted respondents and 200 random target heads but specific to either a BANK or NBFC (Lenders), Directors or Partners of an MSME, Professionals (Lawyers, Chartered Accountants, Corporate lawyers (who were pursuing cases in DRT or any such debt dispute redressal body) and Company Secretaries). Personal and critical personal data was not called for and any identity was coded as requested.

The borrowers were further classified into Formal and Informal, also as Manufacturing, Services and Trade/Retail. Data on the MSME borrowers was acquired from CODISIA and Coimbatore District Industrial Centre.

The Primary data was collected, collated, curated and tabulated. This data was so structured and designed to be compared with the secondary data extracted from various sources including print material, online peer-reviewed journals, guidelines, reports, statutes and also extracts of judgements. The web portals of the relevant departments were used to scout and curate data. Data sourced for a period of 15 years spanning from 2010 to 2026.

Two-dimensional plotting was done because the study was a very simple analysis and preliminary data is also presented as presentation 2D tabular format or 2D Bar chart. SPSS statistical tools were used to analyse data and holographic representations model were to visualize differences.

¹⁰ SIDBI, THE GLOBAL BEST BANKING PRACTICES IN MICRO, SMALL AND MEDIUM ENTERPRISES (MSME) FINANCING AND DEVELOPMENT (Policy Paper Series, 2011).

¹¹ Shal et al., *Exploring MSME Loan Defaults: The Role of Borrower and Loan Characteristics from a Micro-level Perspective*, J. ECON. THEORY & PRAC., at 1–26 (2025).

5 RESULTS

Data generated and acquired for the purpose of this study are presented below. There were 5 questions which were centric and set the premise to the study and based on which the data collection was constructed. The principal question was to know if legal reforms are required for the debt restructuring specific to MSMEs.

Table 1. The Respondents Profile Scape

Table 1 shows the demography of responses out of 300 emails sent 100 in specific known sources and 200 to sources connected through LinkedIn there were only 224 responses in total. Of the 224 total responses the maximum response came from the borrowers followed by the Professionals and then the lawyers. Responses from known sources had higher participation than the unknown sources to the questionnaire. The bias was removed using the weighted average as 212 closed off to 200 as unbiased and balanced responses.

	MSME	BANK	PROF	REGU	LAW	INDB
Total No. of forms sent	100	20	100	20	50	10
No. Response Received	75	10	80	10	45	4
Need Amendment	52	2	10	0	20	0
Need Enforcement Not Amendment	10	8	70	10	20	4

Table 1 shows the aspiration of respondents in the need for reforms. Irrespective of the bankers (Lenders) or MSME owners (Borrowers) both the sides are expecting a reform to safeguard both the sides' interest. The bankers are interested because of dealing with rising NPAs because of non-disposal, the borrowers interested in accessing the fund rather than a plan for repayment. Both parties wanted support systems that enable a smooth and faster debt solution. The majority of the respondents agreed that they were not able to understand nor were they aware of the intricate details and grounds of the debt restructuring. All the respondents agreed that there should be a structural change in the laws being enforced. Some who had insights of the laws in force expressed that the laws in force are good enough but the interpretation mechanisms have no scale of standards and references. However all of them had agreed to the fact that the MSMEs are being treated in the same scene despite the fact that they should have specific considerations.

From the Table 1 it could be inferred that the total respondents were keen on regularising and strictly enforcing the regulations rather than enacting a new bill or amending existing statutes. This apparently was mentioned during the interviews that it will take a minimum of 5 years for the bill to come to enactment or 3 years for an amendment to be clear and enforced properly.

Table 2. Reason stated by MSME Defaulters for exclusive law/amendment is needed for debt restructuring.

	Classification of NPA	Special Legal treatment of MSME	Financial Mismanagement
Manufacturing	98%	100%	85%
Services	62%	100%	50%
Formalised	95%	95%	75%
Non-Formal	80%	10%	40%

Table 2 shows data wherein it can be inferred that both the service sector and the manufacturing sector responses were significant on the need for regulation in classification norms for the assets and a special consideration be given for the MSMEs in terms of all financial laws and regulation and more specifically on the point of Restructuring of debts. The entire borrowing fraternity admitted to the fact that there is lack of financial understanding that leads to financial mismanagement. The significant finding that both the service sector and the service sector all the responses (100%) registered that they need an exclusive law or reform. A provision or an explanation to interpret the existing statutes is the most preferred means of remedy to debt restructuring.

All respondents need reforms in Insolvency and Bankruptcy Code (2016) and SARFAESI Act (2002). 50% and above of all the respondents have registered that if not reforms more clarity is needed and 95% and above of the Borrowers need clarity on stand because they feel the delay of turnaround is hampering their decision. 85% of the Bankers (the lenders) are expecting reforms or remediation with subjects pertaining to the IBC (2016). Industrial representative bodies are also in concurrence to the same.

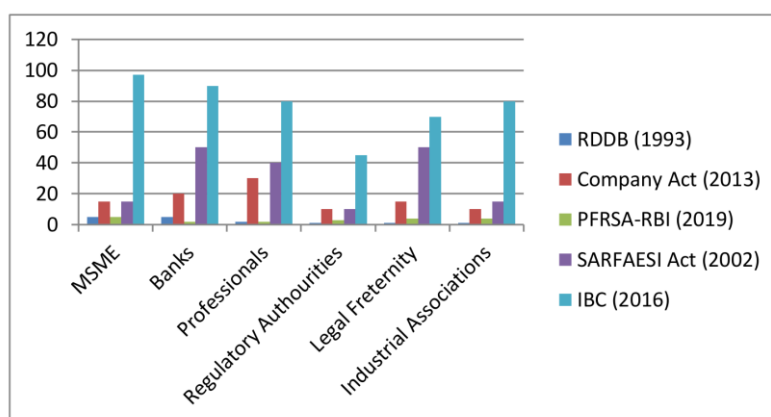


FIGURE 1. *The Laws that warrant more clarity with specific reference to MSME Debt restructuring – Overall response of Stakeholders.*

The study took the considerations of three categories of respondents who were directly or indirectly involved in the debt restructuring for the enterprises. Debt being a major source of financing the business the MSMEs opt for a debt based funding rather than equity based funding. The character and nature of the MSMEs differ largely from the larger enterprises. The founder of an MSME with the same nature of entity, for example a private limited company, if is also the founder and owner of a large corporate, one would deal with the laws and proceedings differently. It is understood that several factors influence the loan to be classified as NPA. These factors can be categorized as internal factors and external factors which are characterized by those that are in control of the entities' decision making are internal and those that influence the entities' decision making are external. Further the factors influencing were classified for better clarity into, financial and non-financial factors. Those factors like compliance and regulatory factors did not directly account for in the statement of accounts hence called non-financial factors.

The Study indicates that despite several legislative reforms that enable a seamless progression for the MSMEs and the better management of debt recovery and lowering of NPAs in Banking systems, the clause in an act or statute or regulation, should have the proviso or explanation be specific and clear in directions and intent of the statute to the context of the MSMEs being treated in each statute.

The significant findings of the study are that there are two enforcements in order one being the procedural enforcement and the other being the statutory enforcement. It is clear that the procedures are implemented properly if the law is clear and not ambiguous. Though the SARFAESI Act and the IBC are relatively new enforcements the provisions therein are contextual and objective to regulate the repayment of the debts. The regulatory authorities have been handling the law for a long time and hence their responses towards its amendment or specific enactment of laws are not aspired.

6 CONCLUSIONS

There are scientific studies which could be adopted for monitoring and reviving of any sick industries but the provisions of the law should take it up and bring it as a provision. More than making a new law or amending an Act in-force, it is found that it is the enforcement along with provisions for clear judicial interpretations that would enable a better restructuring of the debt to MSMEs. It is important to have sensitisation and awareness programs for all and the lead to be taken by the industrial representative bodies of MSME.