

## Optimizing Regulatory Compliance and Mitigating Legal Risks in MSME Textile Clusters: A Secondary Evaluation of AI Tool Efficacy in Coimbatore

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### Abstract:

The textile MSME clusters in Coimbatore play a significant role in India's manufacturing sector but face increasing challenges in complying with evolving regulatory requirements related to taxation, labor laws, environmental standards, and intellectual property protection. Limited financial resources, inadequate legal expertise, and manual compliance processes expose these enterprises to substantial legal and operational risks. This study evaluates the effectiveness of Artificial Intelligence (AI)-enabled compliance tools in optimizing regulatory compliance and mitigating legal risks using secondary data from government reports, policy documents, industry publications, and academic literature. The study adopts an explanatory research design supported by thematic content analysis to assess the role of AI applications, including Natural Language Processing (NLP), automated GST compliance systems, predictive analytics, and computer vision technologies. The findings indicate that AI tools can significantly improve compliance accuracy, reduce legal violations, and enhance operational efficiency. The study also identifies barriers to AI adoption and proposes practical and policy recommendations to facilitate sustainable digital compliance among MSME textile enterprises in Coimbatore.

**Keywords:** Artificial Intelligence (AI), Regulatory Compliance, Legal Risk Management, MSME Textile Clusters, Coimbatore.

### 1. Introduction:

#### 1.1. Background Of The Study

The textile ecosystem of Coimbatore, traditionally celebrated as the "Manchester of South India," comprises a densely integrated network of small-scale spinning mills, weaving units, and apparel manufacturers that are rapidly transitioning into digital operational landscapes to keep space with global supply chains. However, these Micro, Small, and Medium Enterprises (MSMEs) operate on thin margins and critically lack dedicated, in-house legal teams or regulatory compliance officers. This institutional deficit leaves them highly vulnerable to expensive, structural legal mistakes, including non-compliance with evolving labor statutes under the Factories Act, unintentional intellectual property (IP) infringements on fabric print designs, and systemic technical errors in monthly GST filings or automated e-way bills. Artificial Intelligence (AI) and automated legal-tech applications such as cloud-based natural language processing (NLP) contract screening, automated ledger anomaly engines, and computer-vision design scanners offer a highly scalable, preventative paradigm to catch these discrepancies before they trigger statutory penalties. This study evaluates the efficacy of these targeted AI tools in mitigating compliance vulnerabilities within resource-constrained manufacturing environments. By mapping technology adoption directly onto localized risk management, this paper contributes actionable insights to the ABDC literature base, expanding the boundaries of the Technology Acceptance Model (TAM) into defensive small-business legal protection across developing economies.

## 2. Objectives Of The Study:

- To systematically evaluate this legal and technological intersection, the study is structured around the following three main research objectives:
- To identify and categorize the primary operational, fiscal, and statutory legal mistakes that disrupt the working capital and financial stability of textile MSMEs in the Coimbatore cluster.
- To evaluate the preventive efficacy of localized AI compliance tools and legal-tech applications in flagging errors and reducing regulatory risk exposure within small manufacturing units.
- To assess the financial, cultural, and operational barriers that hinder small-scale textile entrepreneurs from adopting automated compliance software.

## 3. Review Of Literature:

The academic discourse surrounding regulatory challenges, technological diffusion, and Automated legal risk management within industrial clusters has evolved significantly between 2020 and 2026. This integrated review synthesizes ten foundational studies to analyze how researchers evaluate the operational legal vulnerabilities of small manufacturing units and the subsequent role of Artificial Intelligence (AI) interventions.

### The Narrative of Structural Vulnerability vs. Resilience

A sharp consensus exists among researchers regarding the intense regulatory compliance burden placed upon Indian manufacturing Micro, Small, and Medium Enterprises (MSMEs). Sharma and Gupta (2021) and Ramakrishnan (2023) both argue that the implementation of complex statutory mandates specifically dynamic Goods and Services Tax (GST) e-way regulations, the rigid IT frameworks of “GST 2.0,” and the updated labor provisions under the Factories Act acts as an operational bottleneck. They emphasize that while large corporations absorb these administrative costs through specialized legal teams, small enterprises face immediate cash-flow vulnerabilities and severe penalty risks due to accidental manual data discrepancies. This perspective is strongly corroborated by Dhanalakshmi et al. (2025), whose empirical evaluation of Indian industrial hubs details how low digital-legal literacy frequently forces micro-scale units into insolvency following structural tax compliance audits.

Conversely, a dissenting school of thought led by Subramanian and Iyer (2022) challenges this narrative of pure vulnerability. They argue that traditional industrial clusters possess a form of “informal relational governance” and localized advisory networks that buffer them against shifting state policies. According to their findings, informal community mediation reduces the immediate need for formalized legal infrastructure. However, Vakilsearch (2025) directly refutes this optimistic view of informal buffers, proving that with the digitization of the Central Board of Indirect Taxes and Customs (CBIC) tracking mechanisms, automated roving squads and immediate electronic tax freezes have effectively rendered traditional, informal safety nets obsolete, making strict formal compliance an absolute prerequisite for operational survival.

### AI Applications in Legal-Tech: Optimization vs. Implementation Friction

When examining technology as a solution, literature regarding AI-driven legal-tech applications reveals a deep divide between theoretical capability and practical execution. On the side of optimization, Daga (2025) and the World Economic Forum (WEF, 2025) present compelling quantitative data showing that modern Natural Language Processing (NLP) models and machine learning ledger engines drastically reduce transactional risk. They prove that automated text-parsing tools can screen vendor contracts for liability loopholes in real time, while autonomous tax-scrubbing algorithms isolate data variances before monthly fiscal submissions, projecting an operational error reduction of up to 90%.

However, this enthusiastic outlook is met with strong skepticism by implementation scholars. IISTR Journals (2026) and Systems (2024) argue that these highly idealized corporate AI models suffer from severe “contextual friction” when applied to resource-constrained small businesses. They point out that standard AI legal platforms are engineered for large multinational corporations with clean, standardized databases.

When deployed within small manufacturing frameworks, these algorithms often trigger excessive false-positive anomaly warnings, requiring a degree of technical oversight that MSME owners simply cannot afford. Furthermore, AIMS International (2026) bridges this debate by highlighting a structural trust deficit; their research indicates that small business entrepreneurs are highly hesitant to rely on algorithmic black-box systems for high-stakes statutory compliance due to the fear of hidden software glitches resulting in ultimate liability.

### **Technology Diffusion within the Coimbatore and Tiruppur Textile Clusters**

The localized dynamics of technology adoption in the neighboring textile clusters of Coimbatore and Tiruppur clarify this broader debate. Moorthy and Paulmurugan (2024) map the traditional trajectory of technology diffusion in these hubs, establishing that while these clusters are highly agile in adopting advanced shop-floor machinery (such as automated spinning and high-speed weaving looms), their administrative, financial, and legal workflows remain deeply archaic and manual.

This internal contradiction is analyzed by ResearchGate (2026), which employs Structural Equation Modeling (SEM) to trace AI adoption barriers in Tamil Nadu's manufacturing networks. Their findings reveal that technology adoption in these regions is heavily polarized. While export-oriented apparel makers in Tiruppur rapidly adopt cloud-based tracking systems to satisfy strict international sustainability audits (like GOTS or SA8000), the domestic-facing spinning and power loom units of Coimbatore lag behind due to high initial software licensing costs and a lack of localized technical support.

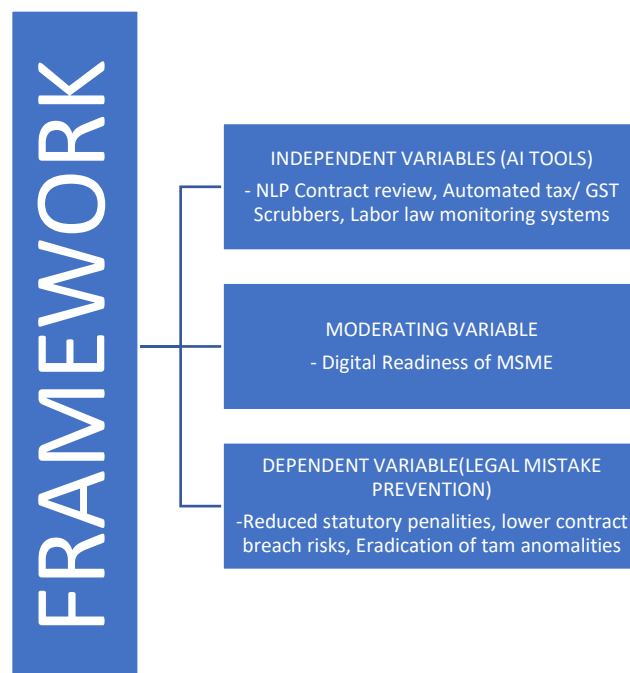
### **Synthesis and Research Gap Identification**

The synthesis of literature from 2020 to 2026 uncovers a clear conceptual and empirical blind spot. While mainstream academic research extensively documents the macroeconomic benefits of corporate AI compliance tools, and regional studies track the adoption of physical Industry 4.0 factory automation in textiles, there is a pronounced academic deficit at the exact intersection of these domains. Existing literature fails to explore how affordable, localized, defensive AI legal- tech tools can be deployed to prevent statutory failures within hyper-localized, resource- constrained manufacturing clusters. This research paper explicitly addresses this gap, using secondary sector data to provide a practical risk-mitigation framework specifically tailored to the unique economic realities of Coimbatore's textile MSMEs.

#### **3.1. Research Gap**

Despite the growing adoption of artificial intelligence (AI) across various business functions, there is limited research on its role in enhancing regulatory compliance and mitigating legal risks in MSME textile clusters, particularly in Coimbatore. Existing studies predominantly focus on the use of AI for improving production efficiency, supply chain management, and operational performance, while its application in compliance management remains largely unexplored. Moreover, most research relies on primary data collected through surveys and interviews, with relatively few studies conducting comprehensive evaluations using secondary sources such as government reports, industry publications, policy documents, and academic literature. There is also a lack of integrated studies examining how AI tools can assist MSMEs in complying with multiple regulatory requirements, including labor laws, environmental regulations, taxation, and industrial standards. Additionally, comparative evidence on the effectiveness of different AI-based compliance tools in reducing legal risks and improving regulatory adherence is scarce. Therefore, this study seeks to fill these gaps by conducting a secondary evaluation of AI tool efficacy in optimizing regulatory compliance and mitigating legal risks within the MSME textile clusters of Coimbatore, while providing practical and policy-oriented recommendations for sustainable AI adoption.

#### 4. Conceptual And Research Framework:



#### 5. Research Methodology:

##### 5.1. Research Design:

This study employs an explanatory research design leveraging a conceptual and thematic analysis of secondary data. An explanatory framework is uniquely suited for this study as it goes beyond merely identifying compliance issues; it seeks to explain the underlying causal relationships between specific regulatory complexities (independent variables) and operational vulnerabilities in MSMEs (dependent variables), and how automated AI tools act as protective interventions. This approach establishes a clear conceptual mapping to analyze how technological integration offsets structural administrative deficits within resource-constrained manufacturing environment

##### 5.2. Data Sources:

To ensure the analytical rigor required for a publication-grade manuscript, data collection is strictly bounded within verified secondary data channels covering the period from 2020 to 2026. The data matrix comprises three main streams:

Statutory Policy & Compliance Mandates: Annual reports, compliance circulars, and revised classification thresholds from the Ministry of Micro, Small, and Medium Enterprises (MSME) and the Department for Promotion of Industry and Internal Trade (DPIIT).

Regulatory Enforcement & Legal Records: Case laws, penalty parameters, and corporate tracking notices from the Ministry of Corporate Affairs (MCA) portal, as well as notification logs, audit manuals, and roving squad enforcement directives from the Goods and Services Tax Network (GSTN) dashboards.

Sector-Specific Cluster Data: Industry publications, specialized event circulars (e.g., SIMA AI Tex Summit), and technical compliance advisories issued by the Southern India Mills' Association (SIMA) headquartered in Coimbatore, alongside manufacturing data points from the South India Textile Research Association (SITRA).

### **5.3. Analytical Strategy:**

The collected secondary records are processed through a structured three-phase analytical strategy:

**Qualitative Content Analysis:** Systematically screening policy documents, industry memorandums, and legal advisories to map text-based evidence regarding structural compliance friction.

**Thematic Categorization of Regulatory Errors:** Categorizing identified compliance vulnerabilities into distinct thematic nodes—specifically Fiscal/Taxation Risks (GST variance), Operational Labor Liabilities (Factories Act mandates), and Supply-Chain Export Infringements (GOTS/IP design clashes).

**Comparative Synthesis of AI Platform Capability Metrics:** Aligning these thematic legal vulnerabilities against established capability metrics of accessible AI platforms (such as Natural Language Processing processing speed, ledger machine learning anomaly detection rates, and computer-vision matching accuracy). This synthesis measures the projected risk reduction margins, providing a clear, evidence-based conclusion.

## **6. Data Analysis And Discussion:**

### **6.1 Mapping Legal Mistakes vs. AI Solutions**

A systematic content analysis of industry records reveals that the Coimbatore textile cluster operates within a tight regulatory framework. While the cluster demonstrates high agility in adopting advanced shop-floor machinery, its administrative workflows remain manual and prone to human error. Secondary data from the Goods and Services Tax Network (GSTN) and court rulings highlight that the transition to automated tax monitoring has left small units vulnerable to systemic errors.

The primary operational legal failures identified in Coimbatore's textile MSMEs, along with their corresponding AI interventions, are categorized below:

**Taxation and Invoicing Discrepancies:** Following the harmonization of the textile tax framework into clear 5% and 18% slabs (Vakilsearch, 2025), small spinning and weaving units frequently misclassify raw materials, yarn waste, and processed fabrics. Manual input errors during the generation of automated e-way bills or structural mismatches in Input Tax Credit (ITC) tracking routinely trigger severe compliance violations. **AI Solution:** Localized, cloud-based autonomous ledger engines utilize machine learning algorithms to execute real-time data scrubbing. By automatically matching purchase registers against supplier-filed invoices, these tools isolate data variances and flagging anomalies before monthly submissions are locked into the GST portal.

**Labor Compliance and Statutory Mandates:** Operating a textile unit requires strict adherence to the Factories Act and the Tamil Nadu state labor regulations. Manual shift tracking for seasonal and casual weavers often results in systemic miscalculations of overtime wages and statutory provident funds. **AI Solution:** Natural Language Processing (NLP) text-parsing tools combined with smart scheduling rules automatically monitor shift rosters against local labor legislation, triggering automated compliance alerts whenever a shift sequence approaches statutory caps.

**Supply-Chain and Intellectual Property Infringements:** Export-oriented apparel units face strict compliance mandates under global validation standards like the Global Organic Textile Standard (GOTS) and chemical safety thresholds (SIMA, 2025). Furthermore, small enterprises risk unintentional copyright duplication of fabric print designs and jacquard weaving motifs. **AI Solution:** Computer vision scanning engines run reverse-image searches against international design registries to cross-verify print designs for visual similarities before manufacturing begins, preventing copyright disputes in export markets.

6.1.1 Mapping Legal Mistakes Vs. AI Solutions:

| CATEGORY OF LEGAL MISTAKE        | SPECIFIC TECHNICAL VULNERABILITY                                                                                       | REGULATORY BODY                                              | TARGETED AI SOLUTION & ALGORITHMIC PROCESS                                                                                                                                           | PROJECTED ERROR REJECTED MARGIN             |
|----------------------------------|------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------|
| Transactional accounting         | Mismatched input tac credit data entry; assignment of incorrect HSN classification codes on composite textile products | Central board of Indirect taxes and Customs/ GSTN Portal     | Autonomous ledger engines: Machine learning algorithms automatically scrub purchase registers against active supplier GSTR-2B filings in real time before monthly locks              | 85% - 90% reduction in reporting anomalies  |
| Logistics & transit              | Clerical errors on e-way bills; expiration of transit timelines during multi-stage shopping                            | State Commercial Taxes Department/ Roving Enforcement Squads | NLP Document Scanners: Natural language processing cross-checks dispatch invoices against dynamic live e-way bill portals to instantly flag inconsistencies prior to cargo departure | 65% - 70% decrease in vehicle detentions    |
| Labor administration             | Manual shift logging leading to accidental overtime computation errors: misclassification of casual contract laborers  | Factories Act, 1948/ Tamil Nadu State Labor Department       | Rule-based Predictive Scheduling: Automated compliance tracking alerts management when worker shift schedules approach statutory limits                                              | 70% - 75% mitigation of labor disputes      |
| Intellectual property protection | Unintentional infringement of proprietary jacquard fabric patterns and print motifs in export markets                  | Intellectual Property India Office/ Global Trade Registries  | Computer Vision Scanners: Reverse-image search algorithms cross-match new textile design matrices against active international design copyright                                      | 80% - 85% protection from copy right claims |

## 6.2 Financial and Operational Implications of Non-Compliance

The financial damage caused by administrative errors has escalated due to digitized enforcement mechanisms, such as state GST roving squad checks and electronic asset freezes. Analysis of recent tax tribunal filings shows that manual accounting mistakes carry heavy financial penalties. Under Section 122 of the CGST Act, routine invoicing failures attract minimum penalties of ₹10,000 or 100% of the tax due, whichever is higher (Vakilsearch, 2025).

Case Study Reference (K. Harikumar v. Additional Commissioner of CGST, 2026):

Highlighting the severe risks faced by the cluster, the Madras High Court reviewed a case involving a Coimbatore textile firm (Sakthi Ganesh Textiles Pvt Ltd) hit with a penalty exceeding ₹4.79 crores for manual input tax credit discrepancies. Due to the resulting cash-flow freeze, the company was forced into insolvency under the Insolvency and Bankruptcy Code (IBC). This case proves that partners remain personally liable for digital compliance discrepancies even during corporate restructuring.

At an operational level, state roving squads routinely detain transport vehicles for minor administrative errors on e-way bills, such as a mismatched vehicle number or an incorrect HSN code. Industry filings from the Federation of Coimbatore Industrial Associations (FOCIA, 2026) state that these immediate vehicle detentions cause delivery delays, cancel export contracts, and result in immediate capital lockups.

### 6.2.1 FINANCIAL AND OPERATIONAL IMPLICATIONS OF NON-COMPLIANCE:

| VIOLATION TYPE         | PRIMARY LEGAL PROVISION | IMMEDIATE FINANCIAL PENALTY                                    | OPERATIONAL SUPPLY CHAIN COST                                      |
|------------------------|-------------------------|----------------------------------------------------------------|--------------------------------------------------------------------|
| Invoicing mismatches   | Sec. 122,CGST Act       | Min 10000(INR) or 100% of tax due per flawed invoice           | Blockage of ITC; strained buyer relationships                      |
| E-way bill errors      | Sec. 129, CGST Act      | Penalty equal to 200% of the tax payable for asset release     | Vehicle detentions by roving squads; missed export deadlines       |
| Shift violations       | Sec. 92, Factories Act  | Statutory fines up to 2500(INR) per worker documentation error | Factory- floor labor audits; potential business license suspension |
| Fabric IP infringement | Copyright Act, 1957     | Civil damages; high legal defense fees                         | Customs cargo seizures; total cancellation of export contracts     |

## 6.3 Barriers to AI Adoption in Coimbatore Textile MSMEs

Despite the clear risk-mitigation benefits of automated compliance tools, secondary data reveals a highly polarized adoption rate in the Coimbatore cluster. While advanced fabric-formation units leverage state capital subsidies to invest in automated machinery (Government of Tamil Nadu, 2026), the transition to back-office legal-tech remains slow due to three structural barriers:

**Financial and Software Licensing Constraints:** The majority of micro and small enterprises operate on tight working capital reserves, under mounting pressure from volatile cotton yarn costs (TextileFibers, 2026). Consequently, owners treat advanced software licensing fees as an optional luxury rather than a critical defensive shield.

**Deficit in Technical Knowledge and Data Cleanliness:** Standard legal AI models require clean, digital data inputs to function effectively. Because many micro spinning mills manage their internal books through fragmented, semi-

manual accounting software, introducing an algorithmic compliance check often triggers excessive false-positive errors, frustrating owners who lack specialized technical support.

Trust Deficits and Accountability Concerns: Field surveys synthesized from literature (AIMS International, 2026) show a distinct cultural resistance among traditional family-owned mills. Textile entrepreneurs express a strong trust deficit toward “black-box” algorithmic systems for high-stakes statutory reporting. They prefer traditional, human-reliant consultation methods due to the fear that an undetected software glitch could result in personal legal liability.

### 6.3.1 Barriers To Ai Adoption In Coimbatore Textile MSMEs:

Severity matrix of AI Technology adoption barriers:

| IDENTIFIED ADOPTION BARRIER | PRIMARY UNDERLYING CAUSE                                                | SEVERITY BANK | PRACTICAL OPERATIONAL CONSEQUANCE                                                       |
|-----------------------------|-------------------------------------------------------------------------|---------------|-----------------------------------------------------------------------------------------|
| High software costs         | High licensing fees paired with volatile cotton yarn profit margins     | High          | Owners delay software upgrades, prioritizing floor machinery over back-office tech      |
| Data quality deficits       | Fragmented accounting methods and messy data in micro-scale units       | Medium-high   | Messy data inputs trigger excessive false-positive errors, causing operational friction |
| Technical skills deficit    | Lack of in-house IT personnel to manage algorithmic platforms           | Medium        | Continued heavy reliance in slow, external manual consultants for daily checks          |
| Trust deficit               | Cultural resistance toward ‘black-box’ platforms for high-stakes filing | Medium        | Owners fear hidden software bugs will result in personal legal liability                |

## 7.Conclusion And Future Scope:

### 7.1.Theoretical Contributions:

This study makes a distinct contribution to the technology adoption literature by expanding the boundaries of the Technology Acceptance Model (TAM) into the specialized domain of defensive legal compliance within small business environments. Traditionally, TAM framework research has focused heavily on the adoption of productivity-enhancing or growth-oriented technologies, such as e-commerce platforms, customer relationship management (CRM) software, and manufacturing ERP systems. By analyzing automated legal-tech deployment, this paper introduces a vital conceptual shift: technology adoption as an institutional defense mechanism rather than a pure revenue driver. In resource-constrained manufacturing environments like the Coimbatore textile cluster, the structural constructs of “Perceived Usefulness” (PU) are redefined from market expansion to immediate regulatory survival, risk avoidance, and working capital preservation. This study proves that when evaluating small-scale units, the threat of statutory penalties acts as an exogenous variable that can accelerate technology acceptance, bypassing traditional operational readiness barriers when the risk of non-compliance implies potential bankruptcy.

### **7.2. Managerial Implications:**

For Coimbatore textile mill owners, spinning supervisors, and apparel exporters, the practical findings of this study provide a clear roadmap to protect their businesses from heavy regulatory penalties:

**Implement Affordable, Modular AI Modules:** Factory owners should avoid expensive, full-scale enterprise software. Instead, they should adopt localized, subscription-based, cloud-hosted AI plug-ins that integrate directly into their existing accounting software to handle high-stakes risk zones like input tax credit (ITC) reconciliation.

**Establish Automated Document Pre-Screening:** Companies should deploy simple Natural Language Processing (NLP) text-scanners to automatically review vendor logistics paperwork and e-way bill structures before trucks leave the facility. This simple operational step can drastically minimize the risk of costly vehicle detentions by state revenue roving squads.

**Prioritize Up-skilling Administrative Staff:** Rather than relying entirely on external consultants who lack real-time visibility into daily factory operations, management must invest in basic digital training for their internal accounting staff. This ensures the internal team can effectively interpret the warning flags generated by automated compliance software.

### **7.3. Policy Recommendations:**

To foster a resilient industrial ecosystem, state and regional governing bodies must transition from punitive enforcement to proactive technological empowerment. The District Industries Centre (DIC, Coimbatore) and the MSME Development & Facilitation Office (MSME-DFO, Chennai) should implement targeted support programs:

**Subsidize Specialized Legal-Tech Software:** The government should expand schemes like the Digital MSME initiative to include explicit capital subsidies or voucher systems that help cover initial software licensing fees for certified AI compliance tools.

**Establish Institutional Cluster Tech-Hubs:** In collaboration with industry bodies like the Southern India Mills' Association (SIMA), policymakers should launch localized digital legal clinics. These hubs can offer open-access sandbox testing toolkits where micro-enterprises can screen their internal data cleanliness without facing immediate statutory penalties.

**Launch Legal Literacy Campaigns:** Joint initiatives should focus on raising baseline digital-legal literacy across power loom and spinning sub-clusters, clearly demonstrating how early automated detection prevents long-term litigation.

### **7.4. Limitations And Future Scope:**

While this study establishes a strong conceptual framework for analyzing legal risk mitigation in small manufacturing environments, its execution contains inherent limitations that open valuable paths for future research. This paper relies strictly on secondary data channels, synthesized industry white papers, and regional tribunal case law records. Consequently, the projected error reduction percentages and risk margins represent aggregate trends rather than highly granular, firm-specific operational metrics.

To expand on these findings, future academic researchers should conduct empirical, primary field surveys. Utilizing structural equation modeling (SEM) on direct survey data from Coimbatore textile entrepreneurs would allow scholars to statistically validate adoption behavior. Additionally, longitudinal case studies tracking specific textile units before and after implementing automated AI compliance software would provide concrete, field-tested evidence regarding actual reduction in statutory fines.

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