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Impact of GST on MSMEs Growth and Competitiveness in India

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Abstract

The "Goods and Services Tax (GST) is a comprehensive indirect tax reform that replaced a complex web of indirect taxes, including excise duty, service tax, value-added tax (VAT)", and others, with a unified tax structure. On July 1, 2017, India embarked on a historic journey by implementing the GST, aimed at simplifying the tax regime, fostering economic growth, and promoting a seamless flow of goods and services across state borders. "The GST structure comprises Central GST (CGST) and State GST (SGST), levied by the Central and State governments, respectively, along with Integrated GST (IGST) on inter-state transactions. Micro, Small, and Medium Enterprises (MSMEs) form the backbone of the Indian economy, contributing significantly to employment generation, GDP growth, and export earnings." These enterprises play a crucial role in promoting entrepreneurship, fostering innovation, and ensuring regional development. MSMEs encompass a diverse range of industries, including manufacturing, services, and agribusiness, catering to both domestic and international markets. With a vast number of MSMEs operating across India, their collective performance directly impacts the overall economic health of the nation. This research study investigates how the Goods and Services Tax (GST) would affect the operations of Micro, Small, and Medium-Sized Businesses (MSMEs) in India. It aims to analyze the effects of GST on various aspects of MSMEs, such as financial performance, competitiveness, compliance burden, and overall business environment.

Key Words: Goods, Services, Tax, Micro, Small, and Medium, financial, performance.

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Introduction

The "Goods and Services Tax (GST) is a comprehensive indirect tax reform that replaced a complex web of indirect taxes, including excise duty, service tax, value-added tax (VAT)", and others, with a unified tax structure. On July 1, 2017, India embarked on a historic journey by implementing the GST, aimed at simplifying the tax regime, fostering economic growth, and promoting a seamless flow of goods and services across state borders. "The GST structure comprises Central GST (CGST) and State GST (SGST), levied by the Central and State governments, respectively, along with Integrated GST (IGST) on inter-state transactions.

Significance of the research: For a variety of stakeholders, including politicians, company owners, investors, and scholars, this study is very important. Understanding the impact of GST on MSMEs is essential for policymakers to fine-tune the tax system and create an enabling environment for MSME growth. Business owners will gain valuable insights into the challenges and opportunities arising from GST implementation, enabling them to make informed decisions. Investors will also benefit from understanding how GST affects the performance and attractiveness of investing in MSMEs. Lastly, researchers can use the findings as a basis for further exploration and to contribute to the existing body of knowledge.

In the Indian economy, MSMEs form the backbone of production and employment. Evidence based policy literature highlights the sector's large macro footprint, about 110 million jobs, around 29 per cent contribution to GDP, and a substantial share of exports, while also noting that the sector spans manufacturing, services, and trade and includes a very large number of small, often rural, firms. This size and diversity matter: the same GST feature (for example, return filing frequency, invoice matching, or ITC timing) can become either an efficiency gain for a digitally ready, formalized medium enterprise, or a heavy compliance shock for a micro enterprise with limited accounting infrastructure.[1]

Importance of MSMES In The Indian Economy

Micro, Small, and Medium Enterprises (MSMEs) form the backbone of the Indian economy, contributing significantly to employment generation, GDP growth, and export earnings." These enterprises play a crucial role in promoting entrepreneurship, fostering innovation, and ensuring regional development. MSMEs encompass a diverse range of industries, including manufacturing, services, and agribusiness, catering to both domestic and international markets. With a vast number of MSMEs operating across India, their collective performance directly impacts the overall economic health of the nation.[2]

Objectives of the study

To assess the impact of GST implementation on the financial performance of MSMEs in India: The study will analyze key financial indicators of MSMEs, such as profitability, liquidity, and solvency, comparing their performance before and after the introduction of GST. This analysis aims to reveal the extent of changes in financial health post-GST implementation.

GST Implementation and MSME Impact

Empirical research on GST's impact reveals mixed outcomes. Sharma (2017) argued that consolidating multiple indirect taxes into GST would benefit MSMEs through reduced cascading effects and simplified interstate trade. Franco and Chellammal (2018) specifically highlighted GST's potential to reduce borrowing costs for MSMEs by lowering interest rates from exploitative levels (20-100%) charged by informal lenders to the GST rate of 18% when accessing formal credit for tax payments.

Conversely, Agarwal et al. (2018) documented substantial transition costs in their study of Rudrapur and Malappuram markets, finding that MSMEs faced significant challenges adapting from VAT systems to GST's digital infrastructure. Vidit Mohan and Salman Ali (2018) reported that while 70% of Raipur MSMEs demonstrated GST awareness, smaller enterprises (annual turnover below ₹1.5 crore) exhibited considerably lower understanding and preparedness. Joseph and Jacob (2019) developed a conceptual framework linking taxpayer awareness, knowledge quality, satisfaction levels, and demographic factors to GST compliance behaviour, highlighting that compliance extends beyond mere awareness to encompass system satisfaction and perceived fairness.

The GST frameworks enable businesses to analyze customer demographics, footfall patterns, and purchasing behaviours, translating compliance data into strategic intelligence. This literature suggests that MSMEs overcoming initial implementation challenges can leverage GST's data requirements for competitive advantage through improved business intelligence and customer relationship management.[3]

Policy implications and recommendations

Synthesizing research findings, the study reveals that GST has a significant impact on MSMEs in India. It affects various aspects of their operations, including financial performance, sales, tax compliance, and logistics. To maximize GST's positive impact on MSMEs, the following policy recommendations are suggested[4]

1. Simplify GST Procedures for MSMEs: The government should streamline GST compliance processes for MSMEs to reduce the administrative burden. This

could include simplified tax return filing, user-friendly online portals, and accessible assistance for small businesses.

2. Provide Training and Awareness Programs: Conduct regular training and awareness programs to educate MSME owners and employees about GST regulations, compliance requirements, and potential benefits. This will enhance their understanding and improve compliance.
3. Encourage Digital Adoption: Promote the adoption of digital technologies and accounting software among MSMEs to facilitate easy recording and reporting of transactions, leading to better compliance and increased efficiency.
4. Customized Support for Micro-Enterprises: Recognize the unique challenges faced by micro enterprises and provide tailored support to help them transition smoothly into the GST regime. This could include targeted financial assistance and personalized advisory services.
5. Expedite GST Refunds Timely processing and disbursement of GST refunds are essential for MSMEs, as it can improve their working capital and cash flow, enabling them to invest in growth and expansion.
6. Encourage MSME Exporters: Offer incentives and benefits to MSME exporters to boost their global competitiveness and promote exports, thus contributing to economic growth and job creation.

Suggestions

1. Threshold Exemption: Consider raising the annual turnover threshold for mandatory GST registration for MSMEs to allow smaller enterprises to operate without the burden of compliance until they reach a certain revenue level.
2. Composition Scheme: Expand and simplify the composition scheme for eligible MSMEs to provide them with a reduced compliance burden and fixed tax rates, encouraging voluntary compliance.
3. Single Unified GST Return: Introduce a single, simplified GST return for MSMEs to reduce the complexity of compliance and minimize errors in reporting.
4. Regular Compliance Audits: Conduct periodic compliance audits in collaboration with industry associations to identify common compliance issues and provide guidance to MSMEs for corrective actions.

Future Prospects for MSMEs Under GST in India

India has brought about significant changes and benefits for Small and Medium-sized Enterprises (MSMEs). This new tax system has simplified the complex tax structure of the country by integrating multiple indirect taxes into a single unified

tax, which is expected to have a positive impact on the future growth prospects of MSME.

One of the major advantages of GST for SMEs is the ease of doing business. Under the previous tax regime, small businesses had to comply with various state-level taxes, leading to high compliance costs and administrative burden. With GST, all indirect taxes are now subsumed into one single tax, making it easier for MSME to understand and comply with taxation laws. This has reduced their time and effort spent on tax-related matters, allowing them to focus more on their core business activities.

India has been a major economic reform, aiming to streamline the indirect tax system by replacing multiple state and central taxes with a single unified tax. While this was expected to bring about significant changes across various sectors, its impact on Small and Medium Enterprises (MSMEs) has been a subject of great interest. MSMSEs play a crucial role in driving economic growth and creating employment opportunities, making it essential to understand how they have been affected by GST.

Conclusion

The research findings indicate that the implementation of GST has a significant impact on the performance of MSMEs in India. While GST offers benefits such as streamlined logistics and elimination of multiple taxes, it also brings challenges related to compliance and financial management. Policy interventions should focus on simplifying compliance procedures, promoting digital adoption, and providing tailored support for micro-enterprises. Encouraging MSME exporters and expediting GST refunds are crucial steps towards enhancing the positive impact of GST on the sector. Future research may take into account a broader geographic reach and investigate sector-specific impacts. Additionally, the study relied on self-reported data, which may introduce response biases. Future research could use objective data sources to validate the findings further. Finally, the research examined the short-term impact of GST; conducting longitudinal studies could shed light on the long-term implications on MSMEs' sustainability and growth. Overall, the impact of GST on SMEs is best characterized as dual and uneven: it offers systemic efficiency gains and formalization advantages, but it also creates transitional compliance and liquidity challenges that are most acute for micro and small enterprises.

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