



# Impact of Goods and Services Tax (GST) on the Financial Performance and Compliance Behavior of Micro, Small and Medium Enterprises (MSMEs) in India

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## ARTICLE INFO

## ABSTRACT

The implementation of the Goods and Services Tax (GST) in India marked a significant reform in the indirect taxation system. Designed to unify multiple taxes and streamline tax administration, GST has had varied implications across sectors—particularly on Micro, Small and Medium Enterprises (MSMEs), which form the backbone of the Indian economy. This study evaluates the impact of GST on the financial performance and compliance behavior of MSMEs in India using secondary data from government reports, industry surveys, and published research. The findings reveal that while GST has simplified taxation in theory, many MSMEs face challenges related to compliance costs, digital literacy, and working capital disruptions. However, the regime has also fostered greater formalization and transparency in business operations. This paper suggests policy-level improvements to reduce compliance burdens and enhance MSME adaptability to the GST framework.

**Keywords;** GST, MSMEs, Financial Performance, Tax Compliance, Indirect Tax, India, Business Reform

## 1. Introduction

The introduction of the Goods and Services Tax (GST) in India on July 1, 2017, was a landmark event in the history of Indian taxation. It replaced a complex structure of multiple indirect taxes with a unified, destination-based tax system. While GST aimed to simplify the tax process, reduce cascading effects, and increase revenue efficiency, its practical implications—especially for small and medium-scale businesses—have been multi-dimensional and sometimes contentious.

Micro, Small and Medium Enterprises (MSMEs) constitute over 90% of businesses and contribute nearly 30% to India's GDP and 48% to exports. Given their critical role, any major fiscal reform such as GST inevitably impacts their operational and financial dynamics. MSMEs, often constrained by limited financial resources and technological infrastructure, initially found the transition to GST challenging. Compliance with digital filing requirements, adapting to input tax credit mechanisms, and managing cash flows in the face of delayed refunds posed substantial difficulties.

On the other hand, GST has also brought certain long-term advantages for MSMEs, such as increased formalization, improved transparency, and access to broader markets. This paper aims to explore both the positive and negative aspects of GST's impact on MSMEs, focusing on two major dimensions: financial performance and compliance behavior.

## 2. Review of Literature

Several scholars and institutions have extensively studied the impact of Goods and Services Tax (GST) on the Indian business environment. Most of the existing literature focuses on GST's effectiveness in simplifying tax

structures, its influence on tax revenue generation, and the challenges encountered by different industrial sectors—particularly MSMEs.

Kumar and Sareen (2018) noted that although GST was introduced to eliminate tax cascading, its initial implementation resulted in confusion among small enterprises due to limited awareness and technological constraints. Singh & Reddy (2019) found that MSMEs experienced disruptions in their working capital cycles owing to delays in input tax credit refunds. They stressed the importance of training and hand-holding programs for GST compliance.

Dasgupta (2020) emphasized that GST has increased the formalization of the Indian economy, as more MSMEs are now brought under the tax net, thereby improving transparency and business credibility. Confederation of Indian Industry (CII, 2021) in a report observed that while GST has potential to simplify taxation, a large number of MSMEs still find the compliance cost too high, especially in rural and semi-urban areas.

### 3. Objectives of the Study

1. To analyze the financial impact of GST implementation on MSMEs in India.
2. To examine the compliance behavior and challenges faced by MSMEs under the GST regime.
3. To identify sector-wise disparities in GST compliance and adaptability.
4. To provide policy recommendations for making GST more MSME-friendly.

### 4. Research Methodology

This study is based on secondary data analysis. The sources include:

- Government reports from the Ministry of MSME and GST Council.
  - Publications and white papers by industry bodies such as CII, FICCI, and ASSOCHAM.
  - Research papers from reputed journals (2017–2024).
  - Statistical data from the National Sample Survey Office (NSSO), MSME Annual Reports, and GSTN analytics.
- The approach is descriptive and analytical in nature. Sector-specific impact is studied through qualitative insights, while general trends are interpreted using summarized financial indicators.

### 5. Analysis and Discussion

The analysis is structured around two key themes: financial performance and compliance behavior of MSMEs under GST.

#### 5.1 Financial Impact on MSMEs

- Turnover Trends: Post-GST, many MSMEs reported a short-term decline in turnover due to the initial confusion, disruptions in the supply chain, and time taken to understand the new tax structure. However, formal businesses with GST registration saw easier access to credit and increased market opportunities over time.
- Working Capital Stress: Input Tax Credit (ITC) refund delays affected the liquidity position of several MSMEs. Sectors such as textiles and handicrafts were hit harder due to their dependence on prompt cash flow.
- Cost of Compliance: Expenses related to hiring tax consultants, digital compliance tools, and ERP software increased. For small enterprises with limited resources, this cost burden significantly impacted net profit margins.

#### 5.2 Compliance Behavior of MSMEs

- Registration under GST: Many informal MSMEs were compelled to register due to the demand from B2B customers. This increased tax base but also pushed several micro-entrepreneurs into a compliance-heavy environment.
- Digital Literacy Gap: Filing of GST returns (GSTR-1, GSTR-3B, etc.) requires basic digital proficiency, which became a barrier for traditional and rural MSMEs.
- Fear of Penalties: The fear of heavy penalties for non-compliance discouraged several small businesses from regular filing, leading to cancellation of registrations in some cases.

### 6. Key Findings

1. Mixed Financial Impact: While GST improved market access and reduced tax cascading, MSMEs struggled with liquidity management and increased compliance costs.
2. Low Compliance Comfort: Most MSMEs, especially in rural areas, found digital compliance complex due to lack of training and infrastructure.
3. Increased Formalization: GST led to increased formalization of businesses, enabling better credit access and improved transparency.

4. Need for Tailored Support: Sector-specific challenges indicate that a uniform GST structure may not be effective for all MSMEs.

### **7. Suggestions & Policy Implications**

1. Simplification of Return Filing: Introduce a single quarterly return for small taxpayers with minimal documentation.
2. Faster Refund Mechanism: Streamline ITC refund processes to ensure uninterrupted working capital.
3. Capacity Building Programs: Government and GSTN should conduct regular digital training programs for MSMEs.
4. Compliance Support Centers: Establish district-level GST help desks for micro-enterprises lacking digital skills.
5. Differential Tax Rates: Consider lower GST slabs or exemptions for specific MSME sectors (e.g., khadi, handicrafts).

### **8. Conclusion**

The Goods and Services Tax (GST) reform was a significant step towards a unified tax regime in India. However, its implementation has posed notable challenges for MSMEs, particularly in terms of financial stress and digital compliance. While GST offers long-term benefits such as formalization and enhanced credit access, there is a clear need for targeted policy interventions to make the system inclusive and MSME-friendly. With focused reforms, GST can truly serve as a catalyst for inclusive growth in India's commercial ecosystem.

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