

The Role of GST in Shaping the Growth & Challenges of SME's: A Policy and Economic Perspective

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Abstract

The study analyzes the impact of the July 2017 GST rollouts in India on small and medium-sized enterprises (SMEs), focusing on financial performance, operational efficiency, and strategic decision-making. It highlights discrepancies in SME tax compliance between the current and projected GST regime.

The Sustainable Development Goals (SDGs) and the Goods and Services Tax (GST) are closely linked, with GST potentially boosting economic activity by simplifying tax laws and reducing the cascading effect of taxes. A progressive GST system could feature lower rates for needs and higher rates for pleasures, reducing inequality and promoting strong institutions and effective governance. Study on SMEs' GST adjustment revealed challenges like increased compliance costs and cash flow disruptions, but benefits from reduced tax cascading and transparent structure.

The study suggests that governments should ensure proper use of GST income and an equitable tax structure, contributing to ongoing discussions on tax policy and economic expansion.

Key words: Business Economics, Goods and Services Tax, Profitability, Small and Medium Enterprises, Strategic Decision, Sustainable Development Goal

Introduction

Small and medium-sized enterprises, or SME's, play a major role in India's economic growth by boosting industrial output, generating employment, encouraging balanced development, and boosting exports and foreign exchange profits. As of 2018, 36 million MSMEs were creating about 80 million job opportunities, accounting for 33% of India's total manufacturing output and 8% of the country's GDP (Gross Domestic Product). (**MSME Annual Report 2017-18**)

GST has been introduced in around 160 countries (**Countries Implementing GST or VAT,2017**), posing issues for small and medium-sized businesses. Scholars have studied compliance challenges for small and medium enterprises in Malaysia (**Ramli et al.,2015**), New Zealand (**Buchan et al., 2012**), Australia (**Isle et al.,2014**), and Canada (**Zu & Y, 2018**). Some have questioned the benefits of small businesses, while others have debated where to draw the line. Our study is geared to the Indian market, taking into account the unique characteristics of each country's small business operations.

The implementation of GST has changed the tax landscape in many nations, supporting a unified tax system by replacing a slew of indirect taxes. While major organisations frequently have the means to adapt to such changes, small and medium-sized enterprises (SMEs) may struggle with compliance, budgetary constraints, and operational adaptations.

The mobilization and effective use of existing resources is a cornerstone to achieving sustainable development. Taxes are a crucial budgetary resource for the government and a powerful tool to help finance achievements of the SDGs. The government earns revenue by taxing the wealthiest classes of society according to their capabilities, which it then spends on community-wide services. The results of the interviews highlight the main dangers and concerns regarding the GST's adoption and how it would affect SMEs. The primary conclusions drawn from the survey state that: increased government involvement is required in the form of setting up the necessary training programs to strengthen the GST owners of SMEs, greater GST awareness among SMEs could result in an increase in their operational and financial performance, improved government support, and raised Standardizing the work procedures of SMEs would be aided by increased awareness among their owners.

The study highlights the difficulties faced by SMEs as well as the function and significance of training offered to them by government agencies in order to integrate them into the mainstream market. This has suggestive implications for policymakers regarding how and where to support SMEs in the GST domain.

Although taxation plays a very important role in supporting national growth, the efficiency of taxation ultimately hinges on how various tax types and structures are chosen.

Literature Review

1. Impact of GST on MSMEs

Mastering the lessons their recommendations through the Goods and Services Tax (GST) Rule, while Indians considered the concept of economic protection for MSMEs against imports. Monachan et al. (2024) grew GST induced compliance which is still a far-fetched expectation as many MSMEs are burdened with registration, return filing and payment procedures hurting revenue and profits of the MSMEs. Likewise, Kumari (2017) stated that, though the GST intends transformation and transparency, it is harming MSMEs, as MSMEs account for sizable contribution to 7 per cent of manufacturing GDP, 31 per cent of services GDP and 46 per cent of the nation exports.

GST was a major tax reform with its changed approach of "One Nation, One Tax." The introduction of technology and digitalisation is the key to the transition but it also requires a behavioral shift of businesses from traditional systems to digital platforms (Pandit, 2017). Though useful for creating a unified market, Siddiq and Prasad (2017) highlighted that SMEs face the burden of compliance, as manufacturers with turnovers over Rs 20 lakh are subject to excise duty compliance through online portals. They also noted challenges including tax neutrality, which requires SMEs to compete directly with larger enterprises.

2. Challenges in GST Implementation

The process of implementing GST has been marred with resistance and skepticism. Resistance from states such as Punjab, Haryana and Maharashtra was underscored by Kumari (2017), especially as their powers to impose taxes on goods and services are limited by the Constitution. On the other hand, Lourdunathan and Xavier (2017), using exploratory research, emphasizes that GST education, workshops, and training programs are essential in resolving problems such as credit processing and filing of returns in a human-free manner.

Das then (in 2023) delves into GST issues facing the FMCG industry, bringing up issues such as unsuitable impact on tax calculations, taxation on promotional activity and ambiguity in GST rates to the general public. These issues highlight the need for continued mentorship and improved policy mechanisms to facilitate success.

3. Economic and Social Implications of GST

The repercussions of GST go beyond MSMEs to the larger economy as well. The empirical analysis of India's tax structure and its effect on income inequality spanning over forty years (1980–2019) was conducted by Muduli, Rout and Khan (2022). Their study found that customs duties do indeed increase income disparity, but higher top marginal tax rates can reduce it. This suggests that tax reforms must be balanced in accordance with social needs.

According to Siddiq and Prasad (2017), GST can help to lower fiscal deficits, speed up growth in GDP and facilitate ease of purchasing capital goods. However, its success hinges on a consensus around tax rates and integrated implementation. Additionally, Monachan et al. (2024) further emphasized the significance of GST on supplier relationships and customer behavior, affecting MSMEs' market dynamics.

4. GST and Sectoral Performance

In their study, Das (2023) studied the effect of the GST in the fast-moving consumer goods (FMCG) sector, wherein a reduced multi tax system was noted to have positive sector performance. But those with some nuance about tax rates, profit clarity, and promotional activity remain. According to Lourdunathan and Xavier (2017), GST plays an important role in achieving economic efficiency as long as the implementation of GST is parallel with proactive government interventions and awareness initiatives.

5. Global Perspectives and Behavioral Shifts

It placed the Indian experience in the global context (in which GST was implemented in multiple countries at the same time) and emphasized that it was more of a behavioral change than a tax change (Pandit, 2017). The digitisation of taxation processes requires rapid adjustment, particularly for MSMEs used to conventional systems. Role of Digital Platforms in GST Compliance | Another area of GST where MSME owners needs tech upskilling, much needed is from the perspective of digital platform as communicated by Siddiq and Prasad (2017).

Summary of Literature Gaps

While existing literature provides insights into GST's challenges, opportunities, and economic implications, limited studies explore sector-specific impacts beyond MSMEs and FMCG. Additionally, the behavioral transformation required for GST compliance and its role in income inequality remain underexplored. Further research is needed to analyze the long-term effects of GST on different sectors, regional disparities, and social outcomes.

Research Objectives

- a) Assess the impact of GST on the financial performance and operational efficiency of SMEs
- b) Identify sector-specific challenges faced by SMEs under the GST regime
- c) Examine the relationship between GST implementation and Sustainable Development Goals (SDGs)

Methodology

Finding out how the recent GST implementation has impacted the Indian SME sector is the main objective, as mentioned earlier. We started by interviewing taxpayers of SME's in semi-structured open-ended conduct to better understand the issue. Following discussions with business owners and chartered accountants, a survey questionnaire is used to conduct interviews.

Qualitative Interviews

In-person, semi-structured interviews were performed with SME's taxpayers in Delhi NCR, India. This exercise aimed to examine how owners perceive and interpret the GST rollout. We aimed to gather comprehensive information about Practices, judgments, attitudes, perceptions, and experiences related to GST. We centered our queries on the following themes:

- Tax compliance behavior
- Influence of the composition levy.
- Level of satisfaction and acceptance
- Effect on margins or profitability
- Technical details and the registration process

Quantitative Survey

A systematic questionnaire on paper is designed and we are in process of getting responses from SME's owners in Delhi NCR, India. Participants were asked to select a response from a list of five-point Likert scale answers in closed-ended questions on the questionnaire.

- 1) Strongly disagree
- 2) Disagree.
- 3) Neutral
- 4) Agree
- 5) Strongly agree.

The questionnaire was tested using correlation analysis prior to implementation.

We make certain that the participants have a correct understanding and interpretation of the material.

Relevance to Small and Medium Enterprises

Small and medium-sized firms (SMEs) play an important role in economic growth, employment creation, and innovation. GST's influence can be separated into two parts: positive and negative, as explained below:

Positive Impacts of GST on SMEs

- 1. Simplified Compliance**
- 2. Market Growth**
- 3. Input Tax Credit**
- 4. Reinforcement of the Economy**

Negative Impacts of GST on SMEs

- 1. Compliance Load**
- 2. Enlarged Costs**
- 3. Input Credit Deferrals**

Under the GST regime, SMEs confront a number of challenges unique to their sector specific.

These challenges hinder SMEs' growth and viability under the GST regime by posing operational and financial issues. The following few are discussed below:

- 1. Complicated Compliance Procedures:** It can be challenging for small and medium-sized businesses (SMEs) to stay current with the constantly changing GST legislation and the numerous filings required for various tax forms and states.
- 2. Higher Working Capital Requirements:** Cash flow and working capital management are impacted by SMEs' frequent delays in obtaining Input Tax Credits. In addition, they may have financial difficulties due to upfront taxes on products or services.
- 3. Costs associated with IT Infrastructure:** Due to high costs or a lack of experience, SMEs find it difficult to invest in digital systems for filing returns and upholding compliance.

4. **Classification and HSN Codes:** It can be difficult for SMEs in a variety of industries to correctly classify products under the Harmonized System of Nomenclature (HSN) codes, which can result in mistakes and fines.
5. **Interstate GST compliance:** Managing several state GST compliances presents difficulties for SMEs involved in interstate transactions, which adds to their administrative load.
6. Service providers and exporters SMEs focused on exports frequently experience delays in obtaining GST refunds, particularly for exports, which can have a detrimental effect on their liquidity.
7. **Sector-Specific Rate Discrepancies:** The profit margins and pricing tactics of SMEs are impacted by disparities in the GST rates in particular industries, such as handlooms and textiles.
8. **Lack of Awareness and Knowledge:** Many SMEs find it difficult to understand the complexities of GST, especially in rural areas or smaller towns, which makes compliance more difficult.
9. **Reverse charge complexity:** SMEs have trouble managing transactions that are liable for reverse charge, which increases their tax burden and complexity.
10. **Seasonal and Small-Scale enterprises:** As they struggle to maintain submitting regular monthly files during the off-season, seasonal enterprises and smaller SMEs continue to face a significant compliance burden despite their best efforts.

These challenges hinder SMEs' ability to operate, which has an effect on their ability to expand and survive under the GST system.

Relationship between GST implementation and Sustainable development Goals (SDGs)

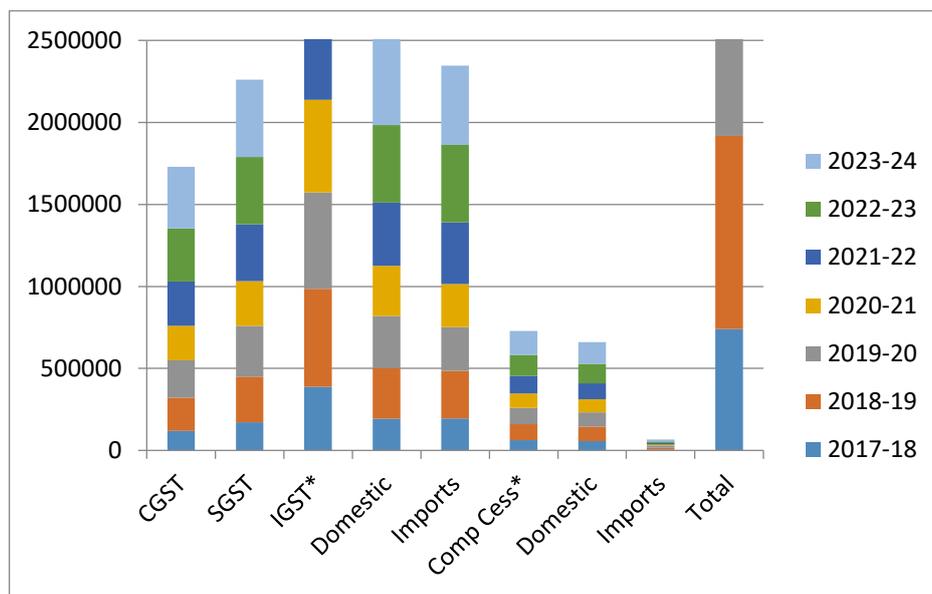
The Goods and Services Tax (GST) is a multi-stage, indirect tax imposed on the supply of goods and services in India. By combining numerous indirect taxes at the central and state levels, the GST seeks to streamline the tax system, prevent tax cascades, and advance the common economy. Collections from GST will not only help the government towards the growth of economy but also towards the achievement of Sustainable Development goals of UN Nations. An analysis of GST collection since its incorporation till Mar'24 has been done so as to understand the economic perspective.

07 Years of GST, Payments since July'17 to March'24

(Figures in crores)

| Month | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 | 2023-24 |
|-------------------|---------------|----------------|----------------|----------------|----------------|----------------|----------------|
| CGST | 118876 | 202444 | 227442 | 209916 | 270701 | 323923 | 375710 |
| SGST | 171803 | 278817 | 309231 | 272827 | 346186 | 410251 | 471195 |
| IGST* | 387355 | 598739 | 586698 | 565720 | 763632 | 945220 | 1026789 |
| Domestic | 193092 | 308244 | 319422 | 303947 | 386676 | 473421 | 543704 |
| Imports | 194264 | 290496 | 267277 | 261773 | 376956 | 471799 | 483085 |
| Comp Cess* | 62614 | 97369 | 98745 | 88338 | 107708 | 128286 | 144555 |
| Domestic | 56319 | 87289 | 88304 | 79153 | 98918 | 117390 | 132639 |
| Imports | 6294 | 10079 | 10443 | 9185 | 8790 | 10896 | 11915 |
| Total | 740648 | 1177369 | 1222116 | 1136801 | 1488227 | 1807680 | 2018249 |

*Note: IGST/Cess includes payments on both domestic supplies and imports
(Source: <https://www.gst.gov.in/download/gststatistics>)



From the above table, we can see that GST payments has been on increasing trend since 2017, however in 2020-21 , it decreased from previous year due to corona pandemic, which hits the world economy. Post pandemic, recovery can be seen in both domestic as well as imports payment. The more the collections more will be spending towards sustainable activities. Increased figures is also an indication that government is initializing the activities to smooth line the GST Compliance procedures so that it will turn out to be more reliable source of income for central as well as state government.

GST not only drives the country's economic growth but also ensures environmental sustainability. It encompasses eco-tourism, organic farming, electric vehicles, green construction, and renewable energy. The GST's reduced rates and exemptions for renewable energy sources help to stabilize the economy by moving the attention away from polluting firms and toward environmentally beneficial ones.

GST incentives for the transition to electric mobility, renewable energy expansion, energy efficiency, etc., directly enable climate change mitigation.(SDG 13 Climate Change). GST exemptions for renewable energy combined with compensation cess on coal and petroleum aid the progress of SDG 7(Affordable & Clean Energy). GST induces responsible consumption patterns by making environmentally harmful products more expensive through higher tax slabs. It also incentivizes businesses to adopt sustainable designs and green manufacturing processes through concessional rates, SDG 12 (Responsible consumption and Production). The government may utilize the proceeds from the GST and environmental cess levied on polluting enterprises to pay cleanup initiatives. Similarly, money earned by the GST on commercial mining and forestry can be used to support wildlife conservation and afforestation activities that align with SDGs 14 and 15.

Findings & Conclusion

Findings

The businesses of SME are contracted, affecting their profit margins significantly. The imposition of GST has significantly reduced their profit margins, with a growing tendency. Maintaining correct documentation has led to increasing workload and regulatory expenses for SMEs (Yong & S, 2006). Documentation often contributes significantly to administrative expenditures. This might necessitate building a value chain-wide integrated communication channel(Suhartanto et al., 2018). In order to assist SMEs in some ways, the entire value chain must be integrated under the GST framework. (Directorate General of Taxpayer Services, 2017).

Several obstacles faced by SMEs and chartered accountants in adopting GST include its high cost and time commitment. In summary, chartered accountants and owners of small and medium-sized businesses (SMEs) identified several significant obstacles to the implementation of GST, including:

- Compliance costs are significant due to extensive staff effort and documentation requirements.
- The complicated GST system would force many small enterprises to close..
- GST has impacted profit margins.
- Extensions in return filing dates and slab rate modifications are required.
- Connectivity concerns, especially in remote regions. Consider providing offline return filing options, especially for places with limited connection or distant locations.

- No modifications allowed after submitting/filing returns/invoice data.
- No feedback system in place.
- Clients face penalties even after getting confirmation of file completion.
- The composition levy benefits small stores but has no negative impact on larger firms.

Implications for Research

The study contributes significantly to understand the **economic, policy, and social dimensions** of GST on SMEs. It also influences public attitudes toward formal economic systems, emphasizing their role in improving livelihoods, reducing inequality, and supporting sustainable growth.

Economic Impact of GST on SMEs: The study examines the impact of GST implementation on profit margins, cash flow, and operational costs, and its potential long-term economic implications on SME growth, employment, and market competitiveness.

Compliance Burden and Policy Challenges: The study examines the impact of GST compliance requirements on SMEs' resource allocation and administrative costs, while also exploring simplified tax processes for SME sustainability and compliance stress reduction.

GST and SMEs' Financial Inclusion: The study evaluates the effect of GST on SMEs' formalization, access to credit, financial resources, and its role in enhancing transparency and facilitating supply chain integration.

Role of Technology and Digitalization: The study investigates the effectiveness of digital tools and GST software in GST compliance and assesses the digital divide's influence on rural and urban SMEs.

Policy Innovation: The study explores potential tax policy frameworks or rebates to tackle GST-related issues faced by small and medium-sized enterprises.

Conclusion

In this study, we used qualitative interviews and quantitative survey to observe the influence of the recent GST implementation on SME's. The in-depth in-person semi-structured interviews assisted us in identifying actual concerns and challenges encountered by SME's owners in the implementation of GST. Some flaws are also pointed in the structure that requires official intervention. The subsequent questionnaire poll indicated that government initiatives and training on GST awareness for SMEs and its impact on profitability were necessary.

Being the first of its type, the study offers insightful information to policymakers, practitioners, and researchers alike. Given the current situation, some things need to be fixed right away, while other things can wait. Important results were obtained from our study approach, which involved analysing modern phenomena through qualitative interviews and a quantitative survey. We think that our work will lay the groundwork for further in-depth and focused studies on the subject in the future, enabling researchers to ask more insightful and pertinent questions. The study's conclusions have significant implications for small business owners. Due to the study's substantial finding that business profitability and GST awareness are correlated, SME owners are encouraged to invest time and resources.

The study's conclusions also point out a number of operational issues and structural flaws with the GST implementation that need institutional attention. In order to integrate SME owners into the GST and improve compliance, policymakers should give priority to training and awareness campaigns. This will raise the state's tax revenue.

A thorough analysis of the business economics of the GST's effects on SMEs uncovers a complicated web of opportunities and difficulties. Even though GST has more upfront expenses and compliance requirements, its long-term advantages—such as streamlined procedures, increased cash flow from input tax credits, and access to markets—can provide SMEs with significant benefits. Moreover, SMEs' contribution to the achievement of sustainable economic development can be strengthened by matching GST policies with the SDGs. In order to successfully develop support programs and ensure that SMEs can prosper in a GST framework, policymakers must have a thorough grasp of this impact. This will allow policymakers to effectively contribute to both national and global economic objectives.

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