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IMPACT OF GOODS AND SERVICES TAX (GST) ON THE FINANCIAL PERFORMANCE OF SMALL BUSINESSES IN INDIA

A conceptual and empirical research framework

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ABSTRACT:



The Goods and Services Tax (GST), introduced in India on 1 July 2017, replaced a range of central and state indirect taxes with a destination-based tax framework. Its implementation has implications for small businesses through tax compliance, input tax credit, pricing, formalisation, accounting systems, working capital, and market access. This paper examines the channels through which GST may influence the financial performance of small businesses, with particular attention to profitability, liquidity, operating costs, sales, and cash-flow management. The paper adopts a mixed-method research framework: a review of published literature and official material, supported by a proposed structured survey of small-business owners and an analysis of selected financial indicators. Since no original field survey or firm-level dataset was supplied for this document, the empirical results section is presented as an analysis plan and reporting template rather than as fabricated findings. Existing research provides mixed but informative evidence: a survey of 404 registered MSMEs reported positive relationships between GST-related changes and business performance, while RBI analysis noted compliance costs and working-capital pressure, particularly where refunds and input tax credit were delayed. The paper concludes that GST's net effect is conditional on business size, sector, digital capability, tax awareness, input-credit eligibility, and the timeliness of refunds. Recommendations focus on accessible compliance support, cash-flow planning, digital accounting, timely credit/refund processing, and targeted capacity-building.

KEYWORDS: *Goods and Services Tax, GST, small businesses, MSMEs, financial performance, profitability, working capital, input tax credit, compliance cost, India.*

1. INTRODUCTION

1.1 Background of the Study

Small businesses are important to India's production, trade, services, employment, entrepreneurship, and regional development. They operate across manufacturing, retail, wholesale, food processing, transport, professional services, and numerous local economic activities. Many such firms work with limited capital, small management teams, and constrained access to specialised accounting and tax expertise. Consequently, changes in indirect taxation can affect them not only through the amount of tax payable but also through administrative requirements, cash-flow timing, pricing decisions, and the organisation of business records.

GST was introduced in India on 1 July 2017 as a broad reform of indirect taxation. It brought many supplies of goods and services within a common framework while retaining distinct central and

state components and specified rates, exemptions, and special procedures. The system includes registration rules, periodic returns, tax invoices, input tax credit subject to statutory conditions, and electronic processes. Its intended economic mechanisms include reducing cascading taxes, improving the movement of goods, supporting a common national market, and encouraging transaction formalisation.

For small businesses, however, the transition requires adjustment. Businesses may need accounting software, professional assistance, staff training, invoice discipline, reconciliation processes, and timely filing. Input tax credit can reduce tax embedded in eligible purchases, but its benefit depends on statutory eligibility, documentation, supplier compliance, and the timing of credit utilisation. A refund delay or mismatch between tax payments and customer collections can place pressure on working capital.

1.2 Statement of the Problem

The financial consequences of GST for small businesses are not uniform. A business with reliable digital records, eligible input credits, trained personnel, and regular customer payments may experience lower tax cascading and improved market reach. A small firm with limited digital skills, low margins, irregular sales, or dependence on delayed payments may face relatively high compliance costs and liquidity constraints. Therefore, the central problem is to assess how GST-related benefits and costs are associated with financial performance, and which business characteristics explain variation in those outcomes.

1.3 Significance of the Study

The study is relevant to small-business owners, accountants, tax practitioners, banks, policymakers, and commerce researchers. It organises the financial effects of GST into measurable dimensions and offers a practical framework for evaluating profitability, liquidity, working capital, and operating efficiency. It may also support local research in Maharashtra and the wider Marathwada region, provided that primary data are collected and analysed transparently.

2. REVIEW OF LITERATURE

2.1 GST and MSME Business Performance

Bhalla, Sharma, and Kaur (2023) examined the effect of the GST system on business performance using questionnaire data from 404 registered MSMEs. Their published study reported that GST-related change, technology transition, and tax awareness/knowledge were positively associated with business performance measures such as ease of doing business, operational efficiency, profitability, and working-capital outcomes. The study provides a useful model for examining technology and knowledge as mechanisms rather than treating GST as a single undifferentiated factor.

2.2 GST, Credit, and Working Capital

A Reserve Bank of India Mint Street Memo (Behera and Wahi, 2018) discussed MSME credit and export performance after the introduction of GST. It reported that GST implementation did not appear to have a significant impact on overall MSME credit in the period examined, while noting that compliance and operating costs increased for some businesses. It also highlighted how delayed refunds and input tax credit could affect working-capital requirements, particularly for exporters. These observations indicate that the timing of tax credits and refunds can matter as much as the nominal tax rate.

2.3 Formalisation and Administrative Capacity

GST relies on documented transactions and electronic compliance processes. Formalisation may improve the availability of transaction records and potentially support access to formal credit or larger supply chains. However, formalisation alone does not guarantee improved profitability. Benefits

depend on whether businesses can absorb compliance costs, maintain records, use credits lawfully, and translate wider market access into sales.

2.4 Research Gap

The reviewed literature provides useful national-level and survey-based insights, but a localised study can further examine differences across business sectors, turnover bands, years of operation, and levels of digital readiness. In particular, the interaction between GST compliance expenditure, payment delays, input tax credit utilisation, and cash-conversion cycles warrants attention. The present paper offers a structured framework that can be applied to a defined sample of small businesses in a selected district or region.

2.5 Research Contribution

The paper integrates financial performance measures with GST implementation variables and proposes a replicable survey and financial-ratio approach. It distinguishes the conceptual discussion and published evidence from primary findings that must be established through actual fieldwork.

3. OBJECTIVES OF THE STUDY

- To examine the relationship between GST implementation and the financial performance of small businesses.
- To assess the perceived effect of GST on profitability, operating expenses, sales, and pricing.
- To study the effect of GST compliance and input tax credit processes on working capital and liquidity.
- To identify challenges relating to digital filing, tax awareness, accounting costs, and refund/credit delays.
- To compare reported GST experiences across sectors and business-size categories.
- To suggest practical measures to improve GST compliance efficiency and financial planning among small businesses.

4. RESEARCH QUESTIONS AND HYPOTHESES

4.1 Research Questions

- How is GST compliance cost associated with the profitability of small businesses?
- Does timely utilisation of eligible input tax credit relate to improved liquidity and working capital?
- How do digital accounting capability and GST awareness relate to compliance burden?
- Do GST-related financial experiences differ between manufacturing, trading, and service businesses?
- Which GST-related factors are most frequently reported as constraints on business cash flow?

4.2 Hypotheses

H01: GST compliance cost has no statistically significant relationship with the profitability of small businesses.
H11: GST compliance cost has a statistically significant relationship with the profitability of small businesses.
H02: Timely utilisation of eligible input tax credit has no statistically significant relationship with liquidity/working-capital indicators.
H12: Timely utilisation of eligible input tax credit has a statistically significant relationship with liquidity/working-capital indicators.
H03: Digital accounting capability and GST knowledge have no statistically significant association with perceived compliance difficulty.
H13: Digital accounting capability and GST knowledge have a statistically significant association with perceived compliance difficulty.

The direction and magnitude of relationships should be determined from collected data; hypotheses should not be treated as established conclusions.

5. RESEARCH METHODOLOGY

5.1 Research Design

A descriptive and analytical design is proposed, combining a literature review with a cross-sectional survey and, where available, financial-statement analysis. The paper is suitable for adaptation to a district-level study in Maharashtra or another clearly specified geographic area.

5.2 Population and Sample

The target population is small businesses that are registered under GST or otherwise affected by GST-related transactions. A proposed sample is 100–200 businesses, selected through stratified sampling across manufacturing, trading, and services. The final sample size should be based on access, research resources, and an appropriate sample-size calculation. The researcher should state the study location, survey dates, eligibility criteria, and response rate in the final submitted version.

5.3 Sources of Data

Primary data: a structured questionnaire administered to owners, managers, or accounting personnel. Secondary data: audited or management financial statements where available; official GST and MSME publications; RBI publications; and peer-reviewed research. All financial data should be collected with consent and reported in aggregate.

5.4 Variables and Measurement

Dependent variables may include self-reported change in net profit margin, sales growth, operating cost, current ratio, cash-conversion cycle, and perceived financial performance. Independent variables may include compliance hours, annual professional/accounting cost, frequency of filing errors, GST knowledge score, use of accounting software, input tax credit utilisation experience, and refund/payment delays. Control variables should include sector, turnover band, age of business, number of employees, and location.

5.5 Proposed Questionnaire Scale

For perception statements, use a five-point Likert scale: 1 = Strongly Disagree, 2 = Disagree, 3 = Neither Agree nor Disagree, 4 = Agree, and 5 = Strongly Agree. Include factual questions separately (for example, business sector, years in operation, and whether accounting software is used).

5.6 Tools for Analysis

- Frequency and percentage analysis for respondent profiles and GST challenges.
- Mean and standard deviation for Likert-scale responses.
- Pearson or Spearman correlation, depending on measurement and distribution.
- Independent-samples t-test or ANOVA for suitable group comparisons, subject to assumptions.
- Multiple regression to examine associations while controlling for sector, turnover, and digital readiness.
- Financial ratio analysis where reliable financial statements are available.

The researcher should check missing data, outliers, scale reliability (for multi-item constructs), assumptions of statistical tests, and possible selection bias. Statistical significance should be reported with effect sizes and confidence intervals where feasible. Association should not be described as causation in a cross-sectional study.

6. CONCEPTUAL FRAMEWORK

GST-related factors (compliance cost, tax awareness, input tax credit experience, filing complexity, digital capability, and refund/payment timing) may influence intermediate business processes such as record quality, administrative time, pricing, inventory decisions, and working-capital availability. These processes may in turn be associated with financial outcomes including liquidity, profitability, sales, and operating efficiency. Sector, turnover, business age, and customer payment practices may moderate these relationships.

GST-related factors → Administrative and cash-flow mechanisms → Financial performance

This framework is a proposed model for empirical testing, not a claim that every factor has the same effect on every enterprise.

7. DISCUSSION: CHANNELS OF FINANCIAL IMPACT

7.1 Compliance and Accounting Costs

Registration, return preparation, invoice management, reconciliation, and record retention require time and expertise. A business may incur direct costs for accountants, software, internet access, staff training, or professional advice. For a small enterprise with low turnover, fixed compliance costs can represent a larger share of revenue than they do for a larger enterprise. The financial effect should therefore be assessed relative to turnover or operating expenses rather than only as an absolute amount.

7.2 Input Tax Credit and Cost Structure

Input tax credit, where legally available and properly documented, can reduce the cascading of eligible input taxes. The actual benefit depends on the nature of purchases, applicable restrictions, supplier documentation, and compliance with statutory requirements. Credit that cannot be used promptly may not provide immediate cash relief. Researchers should distinguish eligible credit claimed, credit utilised, credit pending, and credit disputed.

7.3 Liquidity and Working Capital

GST payments, customer collection cycles, supplier credit terms, and refund timing can affect short-term liquidity. A business may need to pay tax before receiving payment from a customer, depending on the transaction and applicable rules. Where cash is tied up in receivables, inventory, or pending credits, the enterprise may rely more heavily on overdrafts or informal borrowing. Relevant indicators include current ratio, quick ratio, debtor days, payable days, and cash-conversion cycle.

7.4 Profitability and Pricing

Profitability may be affected through compliance expenditure, input-credit benefits, changes in procurement, pricing adjustments, and changes in demand. Passing tax-related costs to customers may be difficult in competitive markets, especially where customers are price-sensitive. Conversely, better documentation and input-credit availability may improve cost visibility and supplier-chain participation. The net result is likely to vary by sector and business model.

7.5 Sales, Market Access, and Formalisation

A common indirect-tax framework can facilitate inter-state transactions and documented supply-chain participation, subject to applicable rules and logistics constraints. Formal invoices and consistent accounting may help firms serve larger customers. Yet market access must be converted into orders and timely collections before it improves financial performance.

7.6 Digital Readiness and Tax Literacy

Digital accounting, staff capability, and knowledge of GST procedures can reduce avoidable errors and administrative uncertainty. These capabilities require investment and continuing updates as

rules and portal processes change. Training and accessible professional support can help small enterprises improve the quality of filings and cash-flow forecasts.

8. EMPIRICAL RESULTS: DATA-REPORTING TEMPLATE

Important: No original questionnaire responses or company financial statements were provided for this paper. Therefore, no sample size, survey percentage, regression coefficient, or statistical result is invented here. The following tables are templates to be completed after fieldwork.GST has improved access to larger/inter-state customers	—	—

Table 3. Financial indicators (where statements are available)

Once data are collected, describe the sample and report the observed results before interpreting them. Compare groups only where sample sizes and assumptions support the analysis. Explain any contradictory findings and acknowledge that changes in demand, inflation, credit availability, pandemic-related disruptions, and other policy changes may also affect financial outcomes.

9. FINDINGS EXPECTED FROM THE FRAMEWORK

The following are propositions to be tested, not actual findings from this study:

- Businesses with higher compliance expenditure relative to turnover may report greater pressure on margins.
- Enterprises that understand and properly claim eligible input tax credits may report improved input-tax management, subject to credit utilisation and cash-flow timing.
- Digital accounting and tax awareness may be associated with fewer filing difficulties and lower perceived administrative burden.
- Working-capital pressure may be more pronounced where customer payments are delayed or refunds/credits remain pending.
- GST experiences may differ across manufacturing, trading, and service enterprises due to differences in input structure, margins, supply chains, and transaction patterns.

10. SUGGESTIONS AND RECOMMENDATIONS

10.1 Recommendations for Small Businesses

- Maintain separate, regularly reconciled records for sales, purchases, tax collected, eligible input tax credit, credit utilised, and tax payable.
- Prepare a rolling 8–13 week cash-flow forecast that includes expected customer receipts, supplier payments, tax due dates, and loan instalments.
- Use reliable accounting software or a qualified practitioner appropriate to the scale and complexity of the business.
- Train owners and staff in invoice requirements, record retention, return calendars, and lawful input-tax-credit conditions.
- Reconcile supplier invoices and purchase records periodically and resolve mismatches early.
- Track compliance expenditure as a percentage of turnover and review whether processes can be simplified without compromising statutory compliance.

- Seek professional advice for complex transactions, disputes, classification questions, and eligibility issues rather than relying on informal assumptions.

10.2 Recommendations for Policymakers and Support Institutions

- Continue practical, multilingual GST awareness and digital-literacy programmes for micro and small enterprises.
- Make official guidance and return-related instructions accessible and consistent, with clear updates when procedures change.
- Strengthen timely resolution of eligible refund and credit issues through transparent processes and grievance channels.
- Support affordable bookkeeping and compliance assistance through industry associations, chambers, and small-business facilitation centres.
- Evaluate compliance requirements with attention to the fixed administrative burden faced by very small firms.
- Encourage research access to anonymised, aggregated data so that policy impacts can be evaluated without exposing confidential business information.

11. LIMITATIONS OF THE STUDY

- This document is a research-paper draft and framework; it does not contain newly collected primary data.
- Without a defined geographic area and sample, the proposed conclusions cannot be generalised to all Indian small businesses.
- Self-reported financial performance may be affected by recall error or reluctance to disclose financial information.
- Cross-sectional survey results can identify associations but cannot establish causal effects.
- GST rules and administrative processes may change; researchers should verify provisions applicable during their data-collection period using official sources.
- Other economic conditions, including inflation, demand shifts, interest rates, credit conditions, and sector-specific shocks, may influence financial performance.

12. CONCLUSION

GST has changed the tax administration and transaction-recording environment in which Indian small businesses operate. Its implications for financial performance arise through several connected channels: input tax credit and tax cascading, compliance and accounting expenditure, digital adaptation, pricing and market access, and the timing of tax payments, credits, and customer collections. Published evidence indicates that GST-related technology and tax knowledge can be associated with improved business processes, while other official analysis highlights compliance and working-capital challenges, especially where refunds or credits are delayed.

Accordingly, GST should not be characterised as uniformly beneficial or harmful to all small businesses. The net financial outcome depends on enterprise size, sector, input structure, digital readiness, tax awareness, access to professional support, and cash-conversion practices. A robust empirical conclusion requires a clearly defined sample, actual survey responses or financial statements, transparent statistical methods, and careful treatment of confounding factors. The framework and instruments in this paper can be used to conduct such a study and produce evidence-based recommendations for small businesses and support institutions.

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