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Research Article

Impact of GST on Small and Medium Enterprises in India: A Critical Empirical Analysis

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<p>Abstract</p> <p>The implementation of the Goods and Services Tax (GST) in India on 1 July 2017 marked a transformative shift in the country’s indirect taxation framework. By subsuming multiple indirect taxes into a unified structure, GST aimed to enhance transparency, reduce cascading effects, and create a common national market. Small and Medium Enterprises (SMEs), constituting the backbone of the Indian economy, have been significantly influenced by this reform. SMEs contribute nearly 30% to India’s GDP and employ over 110 million people, making them a critical component of economic growth and employment generation.</p> <p>This paper provides a comprehensive analysis of the impact of GST on SMEs using secondary data from government reports, academic studies, and policy documents. The study evaluates the impact across multiple dimensions, including compliance burden, cost structure, working capital management, digital transformation, formalization, and competitiveness. The findings reveal that while GST has generated long-term structural benefits such as improved tax transparency, supply chain efficiency, and market integration, it has also imposed significant short-term challenges, particularly in terms of compliance complexity and liquidity constraints. The study concludes with policy recommendations to enhance the effectiveness of GST for SMEs.</p>	<p>Manuscript Information</p> <ul style="list-style-type: none"> ▪ ISSN No: xxxx-xxxx ▪ Received: 13-03-2026 ▪ Accepted: 12-04-2026 ▪ Published: 14-04-2026 ▪ IJCRP: 5(1); 2026: 19-22 ▪ ©2026, All Rights Reserved ▪ Plagiarism Checked: Yes ▪ Peer Review Process: Yes <p>How to Cite this Article</p> <p>Ramakrishna R Reddy. Impact of GST on Small and Medium Enterprises in India: A Critical Empirical Analysis. Int. J. Creative Res. Publ. 2026;5(1): 19-22.</p> <p>Access this Article Online</p> <div style="text-align: center;">  <p>www.jcrp.in</p> </div>
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KEYWORDS: Goods and Services Tax-GST, Compliance Burden, Transformation, Share in GDP

1. INTRODUCTION

The Goods and Services Tax (GST) represent one of the most significant fiscal reforms in India’s post-independence economic history. Prior to GST, India’s indirect taxation system was fragmented, consisting of multiple central and state taxes such as excise duty, service tax, value-added tax (VAT), entry tax, and octroi. This multi-layered structure resulted in inefficiencies, tax cascading, and increased compliance costs for businesses.

GST was introduced with the objective of establishing a “One Nation, One Tax” system, thereby simplifying taxation and improving ease of doing business. It is a destination-based tax levied at each stage of value addition, with provisions for input tax credit (ITC) to eliminate cascading effects.

Small and Medium Enterprises (SMEs), also referred to as MSMEs in India, play a pivotal role in the economy. They contribute significantly to industrial output, exports, and employment. However, due to their limited financial and technological capabilities, SMEs are particularly sensitive to structural economic reforms such as GST.

The implementation of GST has fundamentally altered the operational environment for SMEs by introducing digitized compliance systems, restructuring tax liabilities, and changing supply chain dynamics. This paper seeks to critically analyze these impacts using empirical evidence.

2. OBJECTIVES OF THE STUDY

1. To examine the structural changes introduced by GST in the SME sector.
2. To analyze the impact of GST on compliance, cost, and working capital.
3. To evaluate the role of GST in promoting formalization and digitalization.
4. To assess the overall effect of GST on SME competitiveness and growth.

3. RESEARCH METHODOLOGY

The study is based on secondary data analysis, collected from:

- Government reports (Ministry of MSME, GST Council)
- Policy institutions (NITI Aayog, RBI)
- Academic journals and research papers
- Industry reports and economic surveys

The analysis follows a thematic approach, categorizing the impact of GST into key dimensions such as compliance, liquidity, and market integration.

4. Role of SMEs in the Indian Economy

The SME sector is a vital engine of economic growth in India. It contributes:

- Around 30% to GDP
- Nearly 45% of exports
- Employment to over 110 million people

These enterprises operate across diverse sectors including manufacturing, services, and trade, and play a crucial role in regional development and poverty alleviation.

Table 1: Contribution of SMEs in India

Indicator	Contribution
Share in GDP	~30%
Share in Exports	~45%
Employment	110+ million
Share in Total Enterprises	Over 90%

Source: Compiled from government and research reports

5. Positive Impact of GST on SMEs

5.1 Elimination of Cascading Taxation

One of the most significant benefits of GST is the removal of the cascading effect of taxes. Under the previous system, businesses paid tax on tax, increasing the overall cost of production. GST allows seamless input tax credit across the supply chain, reducing the tax burden and improving efficiency.

Studies indicate that GST has enhanced tax transparency and reduced hidden costs embedded in production processes.

5.2 Creation of a Unified National Market

GST has eliminated interstate tax barriers, enabling free movement of goods across states. This has reduced logistics costs and improved supply chain efficiency.

For SMEs, which often faced difficulties in expanding beyond local markets, GST has opened new opportunities for interstate trade and market expansion.

5.3 Feralization of the Economy

GST has encouraged businesses to register under the tax system to avail input tax credit benefits. This has led to increased formalization of the SME sector.

The transition from informal to formal operations has improved access to credit, as financial institutions increasingly rely on GST data to assess business performance.

5.4 Digital Transformation

GST is inherently technology-driven, requiring online registration, return filing, and invoice matching. This has accelerated digital adoption among SMEs.

Digitalization has improved transparency, record-keeping, and financial discipline, enabling SMEs to integrate into modern supply chains.

6. Negative Impact of GST on SMEs

6.1 Increased Compliance Burden

One of the most widely reported challenges is the increased compliance requirement. SMEs are required to file multiple returns, maintain detailed records, and adhere to strict timelines.

Research indicates that compliance complexity has disproportionately affected micro and small enterprises, which often lack technical expertise.

6.2 Working Capital Constraints

GST requires businesses to pay tax at the time of supply, even if payments from customers are delayed. Additionally, delays in input tax credit refunds have created liquidity issues.

Recent reports highlight that delayed refunds and ITC mismatches continue to impact SME cash flow and operational stability.

6.3 Technological Challenges

The GST system requires digital literacy and access to technology. Many SMEs, especially in rural areas, faced difficulties in adapting to online compliance systems. Technical glitches in the GST portal during the initial implementation phase further aggravated these challenges.

6.4 Sector-Specific Challenges

Certain sectors have been adversely affected due to structural issues such as inverted duty structure. For example, industries where input tax rates are higher than output tax rates face working capital blockages.

7. Impact on Cost Structure and Profitability

GST has had a mixed impact on cost structures:
Positive Impact: Reduction in logistics and tax cascading costs
Negative Impact: Increased compliance and administrative costs
 For larger SMEs with better resources, GST has improved profitability. However, smaller firms have experienced increased operational costs.

8. Impact on Competitiveness

GST has enhanced competitiveness in the following ways:

- Improved supply chain efficiency
- Better integration into national markets
- Increased transparency

However, small enterprises with limited resources have struggled to compete with larger firms that are better equipped to handle compliance requirements.

9. GST and Working Capital Dynamics

Working capital management has emerged as a critical issue under GST.

Table 2: GST Impact on Working Capital

Factor	Impact on SMEs
Input Tax Credit Delay	Liquidity constraints
Advance Tax Payment	Increased financial pressure
Invoice Matching	Compliance complexity
Refund Mechanism	Cash flow disruption

Source: Synthesized from research studies

The requirement to pay GST before receiving payments from customers has increased financial stress, particularly for SMEs operating on thin margins.

10. GST and Financial Inclusion

GST has indirectly improved access to finance:

- Banks use GST return data to assess creditworthiness
- Increased transparency reduces information asymmetry

- Fintech lending models rely on GST data
 This has created new opportunities for SMEs to access formal credit.

11. Discussion

The impact of GST on SMEs is **dualistic in nature**:

- **Short-term impact:** Increased compliance burden, liquidity constraints
- **Long-term impact:** Formalization, efficiency, and growth opportunities

The extent of impact varies across enterprises depending on their size, sector, and digital readiness. Micro enterprises have been the most affected due to limited resources, while medium enterprises have benefited from improved market access and operational efficiency.

12. Policy Implications

To enhance the effectiveness of GST for SMEs, the following measures are recommended:

1. Simplification of compliance procedures
2. Faster processing of GST refunds
3. Reduction in filing frequency for small businesses
4. Capacity-building programs for digital literacy
5. Rationalization of tax rates and slabs

13. CONCLUSION

GST has fundamentally transformed the business environment for SMEs in India. While it has introduced challenges related to compliance and liquidity, it has also created opportunities for growth, formalization, and competitiveness. The success of GST in the SME sector depends on continuous policy refinement and support mechanisms. With appropriate reforms, GST has the potential to significantly enhance the contribution of SMEs to India’s economic development.

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