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Impact of GST on Working Capital of MSMEs in Rajasthan

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Abstract

The Goods and Services Tax (GST) regime was introduced in India in July 2017, consolidating various indirect taxes into a single tax regime and allowing input tax credit (ITC) for eligible business purchases. But for Micro, Small and Medium Enterprises (MSMEs), the impact on working capital has been varied. While GST can help eliminate tax cascading and facilitate interstate goods flow, compliance costs, problems in accessing input tax credit, refund issues, and tax obligations prior to receipt of customer payments can cause liquidity pressures. The problems are applicable in the context of MSMEs in Rajasthan, which are engaged in manufacturing, textiles, handicrafts, engineering, touristic activities and trading. The relationship between GST and working capital of MSMEs has been analysed in the present paper which uses literature search, statutory provisions, and available sources of secondary data. The analysis reveals that GST's effects are influenced by the size of the firm, industry, digital preparedness, the number of payment cycles and the capacity to handle tax documentation. It finds that the benefits of GST will be more pronounced in the future if the system is made more user friendly and the following are put in place:

Keywords: Goods and Services Tax, MSMEs, working capital, input tax credit, liquidity, Rajasthan.

1. Introduction

Micro, Small and Medium Enterprises contribute to employment generation, local value chain and entrepreneurship which are important in regional economic development. Textiles, gems & jewellery, handicrafts, stone & marble industries, engineering, food processing, tourism and retail businesses frequently have limited financial resources in Rajasthan. They do not only need to be profitable, they also need to have the working capital necessary to buy materials, pay wages, keep a stock of materials, and pay their short-term bills.

Generally, working capital is the amount of money that is needed for day to day business activities. Current assets - current liabilities is the formula to calculate net working capital, and working capital management relates to the timing and coordination of cash, inventories, receivables and payables. If the customer takes a long time to pay even if the business is profitable, the business can face financial problems.

The aim of GST was to bring about a more integrated indirect tax system and to eliminate cascading of the tax burden. It introduces an input tax credit mechanism which enables the eligible registered businesses to claim the tax paid on business inputs as credit against the tax liability on business outputs, subject to certain conditions. However, availability of financing and tax payments can impact liquidity. The eligibility for input tax credit is mentioned in Section 16 of the CGST Act, which also includes the conditions for documents and reporting.

The important question is then not whether GST is good or bad, but how it can affect or limit working capital. In this paper, this question is explored in detail with specific reference to MSMEs in Rajasthan.

2. Review of Literature

Bhalla et al. (2023) conducted a study on the impact of the Goods and Services Tax (GST) on the performance of MSMEs in India, where a questionnaire survey was performed with 404 registered MSMEs. Their study found a generally positive association among changes of GST, adoption of technology, tax awareness and the performance of

the business. The authors also found that one outcome that was linked with improved GST practices was the reduction in the blockage of working capital. Their research indicates that how well companies are able to adjust to the digital and procedural requirements of the GST plays a part in determining its impact.

The study The Influence of Goods and Services Tax (GST) on Working Capital Management of Micro, Small and Medium Enterprises (MSMEs) in Rajasthan: An Empirical Study explicitly discusses the issue. The presence of it shows that working capital management of GST has been studied in the Rajasthan context. The publicly available listing does not include information at a detailed level; it can only be considered as an abstract level information and should not be interpreted as findings of the study without reading the full article.

Bhayani (2024) has critically examined the GST and MSMEs in Rajasthan and discussed all the possible advantages and remaining challenges. Simplified tax procedures and improved logistics are among the potential benefits mentioned in the paper, whereas compliance costs, lack of awareness and input tax credit issues are concerns. The work is presented as a research-paper manuscript, so its reported conclusions should not be considered as a substitute for evidence from a well-established, peer-reviewed body of research.

In general, the literature shows that the impact of GST is not the same for all businesses. Technology transition and tax knowledge are also highlighted, alongside improvements in operational efficiency and working capital, in studies that report improvements. On the other hand, companies that have less accounting capability may have more adjustment costs. The literature thus justifies a distinction between the structural benefits of GST and short-term liquidity effects of compliance and credit timing.

In the present paper, a secondary-data framework has been used for the state of Rajasthan in the framework of the above. It does not state that it has done any new survey of the firm level, nor have it made any statistical causal claim for the entire set of MSMEs in the state.

3. Impact of GST on Working Capital of MSMEs in Rajasthan

3.1 Input Tax Credit and Liquidity

One of the most crucial mechanisms for GST to impact working capital is through the input tax credit. The tax credit can be applied against its output tax liability, subject to certain conditions, when an enterprise buys eligible inputs and then sells its goods or services. This has the effect of minimizing the cascading of tax and can decrease the effective tax burden on business transactions.

But tax credit does not always give instant cash flows. An enterprise may need to pay its supplier in advance of the payment being received from its customer. Funds may not be available for wages, inventory, transport, or other operating expenses because they are not immediately available for use on those costs due to not being able to use input tax credit, or it may be pending a refund. Timing differences may be more important for smaller companies that have limited cash reserves.

3.2 Compliance Costs and Digital Readiness

Electronic registration, electronic invoicing, filing returns and matching records are heavily utilized in GST. The digital processes can increase accounting accuracy and transparency, but can also carry adjustment costs for enterprises that lack technological capacity. Costs for accounting software, professional services, employee training, and improperly filed paperwork can all cause a loss of cash flow.

The results achieved by Bhalla et al. (2023) showed that the transition to the technology and awareness were correlated with the performance of MSMEs, whereas the burden of compliance was correlated with the reduction of MSME performance. Their research suggests that a lack of resources and knowledge can make digitalisation counterproductive, but when companies have these in place, digitalisation can be helpful.

This difference is significant in Rajasthan as the size of enterprises and organization of their businesses ranges widely. A small handicraft unit or trader might rely on an external accountant, while a relatively established manufacturer may have a devoted accounts team. Different costs, then, can be associated with the same compliance requirement for different enterprises.

3.3 Receivables and the Timing of Tax Payments

A business may find itself in a situation where it's required to pay taxes before getting paid by customers, creating working capital pressure. For instance, an MSME can sell its products on credit to a distributor, and then wait for weeks or months for the distributor to pay up the invoice. At this time it is responsible for covering production costs, and other operating costs, with its own resources or borrowed money.
Delayed payment from the customer is a distinct and historic working capital risk, and is not the sole issue with GST. However, when taxes are paid at different times and bills are due, tax payment schedules can add to the strain. The Micro, Small and Medium Enterprises Development Act, 2006 sets out a system for the payment obligations towards micro and small suppliers, including a maximum agreed payment period of 45 days.

3.4 Sectoral Differences within Rajasthan

There is a possibility that the impact of GST can be different on various industries of Rajasthan. For example, a textile and garment manufacturer may have significant stock levels, and may buy the inputs at various stages of production. Businesses in the handicraft and gems & jewellery industry may experience fluctuation in demand, long and short supply chains and different payment dates for customers. The raw materials, equipment, transportation and storage costs for marble and stone businesses can be substantial. Even though service enterprises may require an inventory different from manufacturing firms, they are still impacted by receivables, compliance costs, and tax payment dates.

The examples are only analytical illustrations, not the results of a new survey of the sectors. They also show the reasons behind not considering the effect of the GST only in terms of total tax revenue or number of registrations. The enterprise's cash conversion cycle, inventory turnover, receivables period, credit availability and time used for taking advantage of eligible tax credits should be taken into account in a reliable assessment.

3.5 Positive Effects on Business Operations

Even under these limitations, GST can help in managing the working capital in a few ways. An indirect tax system that is more integrated could make it easier to transact across state lines, decrease tax doubling where credits are being offered, and incentivise consistent digital bookkeeping. Improved invoice records could enable enterprises to monitor receivables, determine a customer's credit worthiness and provide financial data for lenders.

These benefits are not automatically provided. They rely on precise bookkeeping, expertise with the regulations, prompt credit, and the capacity to collect payments from consumers. GST needs to be viewed, therefore, as a tax structure whose working capital impact will be influenced by business models and administrative effectiveness.

4. Data Analysis and Interpretation

4.1 Research Methodology

The paper is of descriptive and analytical type of research and uses secondary data. It is based on academic research published, the Central Goods and Services Tax Act and literature on GST's impact on the performance of MSME. The main avenues of impact of GST on working capital in the state of Rajasthan are evaluated.

For this paper, there was no original questionnaire, original financial data of the firms or a representative sample of Rajasthan. Thus, there are no reported "survey percentages," statistical significance, or causal estimates. The main mechanisms found in the literature and their probable effects on working capital are summarized in the following table.

Table 1. Analytical assessment of GST's working capital effects on MSMEs

GST-related factor	Potential positive effect	Potential working capital risk
Input tax credit	Reduces cascading taxation and eligible net tax liability	Credit may be unavailable or delayed when conditions are unmet
Digital compliance	Improves records and transaction transparency	Software, professional fees, and filing errors can increase costs
Tax payment timing	Provides a more structured tax-payment framework	Tax liabilities may fall due before customer receipts arrive
Interstate transactions	Can facilitate trade across state boundaries	Documentation and compliance requirements still demand resources
Refund processing	Refunds can release eligible funds back into the business	Pending refunds may restrict liquidity
Tax awareness and accounting capability	Improves compliance and credit utilisation	Limited expertise can increase dependence on paid consultants

Source: Author's synthesis of Bhalla et al. (2023)

4.2 Interpretation

Based on the analysis it has been proposed that GST has two general effects on working capital. The first is a liquidity channel, where input tax credit, refunds, tax-payment schedules and receipts from customers will dictate the amount of cash available for operations. The second is a compliance-cost channel, where accounting systems, professional fees, staff time and filing errors impact operating expense.

These channels can be used in reverse. The timely use of input tax credit and digital record keeping could have a positive impact on cash-flow management, whereas delayed input tax credits, extra compliance costs, or delayed customer payments can cause cash-flow problems. Overall, this impact is likely to differ across enterprise size, industry, digital capability and payment cycle.

The academic evidence considered is a mix of the above. Bhalla et al. (2023) found positive relationships between technological and knowledge enhancements to GST with MSME performance, but negative effects due to the compliance burden. The study specifically cited by Sharma and Modi (2025) is relevant to the context of the study in Rajasthan and it is advisable to use the results of the empirical study in their study with due consideration of the actual findings.

There is a need for a strong future study that will gather financial data from the MSMEs in the industrial centres like Jaipur, Jodhpur, Udaipur, Kota, Ajmer and other centres of the city. These measures would be current assets, current liabilities, days sales outstanding, inventory holding days, accounts payable days, compliance expenditure, credit utilisation and time between ITC eligibility and utilisation. These comparisons by enterprise size and by sector may help pinpoint the businesses facing the severest liquidity problems.

5. Recommendations

1. Improve timely utilisation of input tax credit and refunds. Documentation and reconciliation should be clearly guided by tax administration and refund should be processed as per the guidelines. Known processing can minimize uncertainty and aid companies in their cash planning.

2. Improve the awareness of GST among MSMES. State-level industry bodies, chambers of commerce, and MSME support institutions should conduct hands-on training sessions on an array of topics such as ‘Invoicing', ‘Returns', ‘Credit eligibility', ‘Reconciliation', and ‘Refund claims'. It is important that training is available for small businesses that may not have strong accounting knowledge.

3. Support low-cost computerised book-keeping. In the case of small enterprises, it is important to encourage low cost, proportionate, accounting and invoicing systems, which are linked to purchases and sales, receivables and tax records. Support must be geared towards both usability and training, not just technology adoption.

4. Enhance working capital financing. While developing short term credit facilities, banks and other eligible financial institutions should consider the cash-flow cycles of MSMEs. Firms also need to have cash-flow forecasts that take into consideration tax due dates, customer credit period and credit utilisation.

5. Minimize customer payments that are late. MSMEs should put in place written payment terms and monitor overdue invoices and utilise statutory provisions where applicable. Improving payment discipline will help ease the financing burden that exacerbates GST-related timing issues.

6. Build Rajasthan-specific evidence. The studies should be done sector-wise based on reliable firm-level data, and researchers and government agencies should do this. This would enable policy makers to tell the difference between short-term adjustment costs and long-term liquidity issues and determine how well current support measures are doing.

6. Conclusion

GST has impacted the working capital management of MSMEs in aspects of input tax credit, compliance process, digital accounting and timing of payments. It has a built-in tax structure which may minimize cascading taxation, and better records can enhance operational control, which can facilitate interstate business. Compliance costs, the challenges of accessing eligible credits, delayed refunds and tax reporting that falls short of customer receipts, however, can restrict cash flow, especially for businesses with limited cash resources.

The impact will not be consistent for MSME in Rajasthan. Whether GST related processes enhance financial efficiency or exacerbate short term cash-flow pressures could depend on the differences in the sectors, enterprise size, digital capability, inventory requirements and customer-payment cycles. The evidence examined indicates that the overall impact of the introduction of the GST has neither proved to be a indiscriminate rise in working capital or a fall.

The key focus point of the policy must be to make it more predictable and more accessible to comply with GST, and to enhance the credit utilisation, the tax awareness, digital capability, and discipline of payments. Representative financial

information at the level of states in Rajasthan needs to be studied in the future to quantify these effects and identify the best category of MSMEs that need the most support.

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