

Impact of GST and Demonetization on MSME

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Abstract: *The Goods and Services Tax (GST) and demonetization policies in India have resulted in notable transformations to the nation's economic environment, with a special focus on Micro, Small, and Medium-Sized Enterprises (MSMEs). With an emphasis on a number of areas, including taxation, the burden of compliance, financing availability, market competitiveness, and the general business environment, this document seeks to implement significant policy reforms for MSMEs. Using a combination of qualitative and quantitative research methods, such as surveys, interviews, and secondary data analysis, this study looks at the opportunities and problems MSMEs have when adjusting to the new monetary policies and tax structure. It investigates the impact of demonetization and GST on MSMEs' operations, future growth, and economic contribution to India.*

Key words: GST, Demonetization, MSME

Introduction

India has implemented major economic changes in the last few years with the goals of formalising the economy, promoting growth, and increasing transparency. The Goods and Services Tax (GST) and demonetization are two historic policy efforts that have attracted a lot of attention due to their potential to drastically alter the economic landscape of the nation. Although the long-term goals of these changes have been praised, discussions over their immediate effects have also been started, with a focus on MSMEs, a vital sector of the Indian economy that greatly contributes to GDP growth, innovation, and the creation of jobs. A complicated web of central and state taxes was replaced with a single tax system with the introduction of the Goods and Services Tax (GST) in July 2017, signalling a significant change in India's indirect tax policy. The GST's supporters contended that it would improve efficiency and competitiveness by streamlining taxes, doing away with cascading effects, and establishing a single national market. Due to their lack of resources and experience in navigating



complicated regulations, MSMEs, who make up a sizable sector of the informal economy, faced difficulties throughout the transition to the new tax regime. For MSMEs trying to stay competitive in the face of shifting market dynamics, compliance costs, technology adaption, and operational modifications become critical considerations.



Implementation of GST

Wide-ranging backhanded taxes like VAT, administrative taxes, and extract obligations would be replaced by the GST. Taxes must be paid on the value added and, in a sense, utilised. The household consumers bear the whole burden of the tax. The following are some of the challenges that the GST Council is facing despite the government's reported implementation of the GST beginning on July 1st, 2017:

- It is hoped that the GST will have low tax rates and be straightforward. Everyone is in favour of a straightforward GST, but the states are afraid they may lose money. Assigning a rate slab for commodities is problematic, and at the moment, each state has its own priorities. For instance, biscuits are considered a luxury item in Bihar yet a necessary commodity in Kerala. It would be challenging to assign a rate slab to anything..
- Bringing all of the indirect taxes under one roof is the largest challenge of the GST implementation. A few states have opposed the inclusion of purchase taxes, and other states are hesitant to put alcohol and tobacco products under the Goods and Services Tax. This is because these products account for a sizable portion of state revenue..

- Although transportation services are available everywhere, the location of consumption and sale may differ. It is challenging to proceed with revenue allocation in light of this.
- A crucial first step in making sure the GST is successful and beneficial to the people and government is determining the GST rates.

Review of literature

(Dubey et al., 2020) Studied “A Study on the Effect of GST and Demonetization on the Growth of the MSME” It discovered that two noteworthy decisions made by the Indian government to address current problems and identify emerging ones that gradually surface in the country's economy are GST and Demonetization. It's likely that Demonetization and GST would be presented as two key benefits of the Indian economy. Organizations would be required by GST to reorganise their production network systems and structure, in addition to filing grievances. Demonetization, however, is forcing an end to cashless instalments.

(Geeta et al., 2019) Studied “Impact of GST on MSME and discovered that indirect taxes play a major role in India's tax system. Before tax changes were implemented in the 1990s, indirect tax revenues constituted the primary source of tax revenue. The main defence of a high reliance on indirect taxes is that expanding the direct tax base has built-in constraints. Indirect taxes cause poor productivity and slower economic growth because they are cascading and distorting taxes on the production of goods and services. This is the fundamental characteristic of indirect taxation. The Indian tax system consists of numerous indirect taxes imposed by both the Central and State governments. On July 1, 2017, the Goods and Services Tax (GST), an indirect tax, was implemented nationwide in India. Several cascading taxes imposed by the federal and state governments have been replaced by the GST. As the name suggests, GST will be applied to all goods and services.

(Ahmed & Sur, 2021) Studied Effects of Demonetization, GST & Covid-19 Pandemic in the Adoption of Digitalization by Rural MSMEs in India I discovered that there are only two options in the tumultuous times brought on by the recent unclear events: give up or fight through. That has been the MSMEs' experience in India thus far. The introduction of demonetization and GST, as well as the limitations resulting from the pandemic, are three developments that altered the business environment. For firms, survival became the only factor that mattered. This paper delves further into these three occurrences and how they affected MSMEs' embrace of digitization in rural India.



(Dhillon et al., 2022) Studied A Critical Assessment of the Impact of GST on MSMEs in the state of Punjab and discovered that the indirect taxation system in India underwent a paradigm change on July 1, 2017, when numerous Central and State taxes were combined under a single Goods and Services Tax (GST) statute. GST affects all businesses, regardless of industry. But compared to major enterprises, the impact on small and medium-sized businesses has been more severe. Consequently, considering their small size and smaller margins, MSME resilience to this substantial tax and infrastructure overhaul needs to be examined. In this regard, a few relevant questions must be addressed, including how the introduction of GST has affected MSME in terms of various costs, including implementation, compliance, and non-compliance costs; additionally, any challenges posed by the development and alignment of new software systems with GSTN, human resource training, and problems related to the new accounting system.

(Nathan, 2020) Studied GST Impact on Micro Small and Medium Business Research discovered that the Micro, Small, and Medium-Sized Enterprises (MSMEs) benefited greatly from the implementation of the Goods and Services Tax (GST) by way of compliance reliefs such as threshold exemptions, composition levy schemes, and quarterly filing of the GST reports, to name a few. The GST Council boosted the tax exemption threshold to Rs. 40 lakh in yearly turnover, which is a significant relief to MSMEs. In a similar vein, the GST composition scheme's turnover threshold—which enables companies to pay a flat tax on goods and services—was increased to Rs. 1.5 crore. The action is intended to ease small dealers' fears. The GST exemption cap for hilly and northeastern states has been increased to Rs. 20 lakh.

(Ahmad, 2021) Studied Impact of Demonetization and Goods and Services Tax (GST) on India's Economic Growth: A Critical Review It discovered that the abrupt removal of currency notes from circulation and the hurried introduction of the Goods and Services Tax (GST) in the economy had an impact on India's economic growth. Demonetization paralyses the small-scale and informal sectors of the economy in addition to slowing economic growth. The rise of services slowed down, industrial output faltered, and eventually economic growth began to decline. Every sector of the economy is harmed by demonetization, including the real estate, healthcare, wedding, and tourism industries. However, every industry and its supply chain is being impacted by the introduction of the Goods and Services Tax (GST).

(Deepa et al., 2019) Studied Impact of GST on MSMEs” It discovered that MSME's are essential to the nations' economic development; hence, the introduction of GST has had a



significant impact on their ability to remain in the market. While some businesses found it useful, most have trouble implementing it. With the implementation of the Goods and Services Tax (GST), the tax structure for already-existing businesses was streamlined, the market was united, and all MSME operational efficiencies were enhanced. As a result, unorganised MSMEs grew faster than organised ones due to minimization. Additionally, the GST made the tax system transparent and made the entities responsible for paying taxes. This essay highlighted problems and difficulties faced by MSME entrepreneurs. 158 MSME entrepreneurs in Tamil Nadu's Sivaganga District were chosen for the study utilising the Cluster Random Sampling Technique in order to determine the influence on several aspects such as applying for GST, creating the registration for taxation, and High Compliance load.

IMPACT OF DEMONETISATION

The Indian economy is transitioning to a cashless one with the government of India's announcement on November 8, 2016, regarding the demonetization of the country's current 500 and 1000 rupee notes and the introduction of new ones. India's development rate is lowered by the IMF for the current financial year from its previous estimate of 7.6 percent to 6.6 percent because of the "impermanent negative utilisation stun" caused by demonetization. It is anticipated that the rate of development will decline further in 2017–18, with development expected to drop to 7.2 percent compared to the benchmark of 7.6 percent. This is attributed to a lack of financial accessibility in real estate-related industries including assembly and land. In fact, the previously rapidly expanding automobile industry saw a compression in the October–December quarter of 2016. The financial crunch has negatively impacted obtaining the intensity of clients. With India, more than 90% of transactions take place in actual money, with advanced transactions accounting for the remaining 10%. Additionally, banks have been focusing on the one task of withdrawals and shops. These results have had a negative impact on their essential major potential to provide breakthroughs.

Due to withdrawal restrictions, current record clients who require large sums of money quickly have not been able to access funds or credit. As far as we can tell, the small and medium-sized enterprise (SME) sector accounts for a significant portion of the economy, contributing 8% of the GDP and employing more than 18 people on average. Due in large part to the fact that the labour remuneration in this section is paid in real money, the demonetization has negatively impacted earnings. Low pay lead to a low labour force, which in turn causes a low interest rate



on goods and ultimately results in unemployment. In addition to the fact that the majority of payments in the areas are made in cash, other sectors such as transportation managers and restaurants have also suffered as a result of the financial exercises terminating. The demand for vegetables at discount stores has been decreasing, and the prices of food items have drastically decreased, making it impossible for ranchers to produce these yields. The one industry where all transactions are made with actual money is farming. Due to the pressure placed on the Mandis by the elimination of outdated currency notes, ranchers are finding it difficult to sell their produce at the market. Furthermore, as there is a severe shortage of rupees 500 group notes, vegetable and natural product vendors are unable to efficiently exchange change for the high division Rs 2000 notes. This has an extra impact on how the chaotic division is occupied. The demonetization of currency has negatively impacted the employment age, easing consumer interest and thus leading to a drop in mechanical creation. In fact, even the assembly line is experiencing a lull, which is indicative of the highest calibre of work produced by brilliant and semi-gifted individuals; it also occurs at a higher rate and produced fewer jobs. Approximately 4 lakh people have, on average, either lost their jobs or momentarily skipped work due to nonpayment thus far, and this figure is only going to rise as long as the financial crisis persists.

Impact of GST on MSME

Currently, 14.5 lakh crore is the total amount of taxes collected in India, of which 34% is indirect tax. Help tax, stump obligation, customs obligation, VAT, and other indirect taxes are examples of circuitous taxes. It indirectly refers to the range of taxes levied by the Indian government. The portion of the indirect tax is higher than the immediate tax in most developing countries. However, the percentage of the indirect tax is far lower in the developed world. As a result, the government will be able to exert more control over taxpayers thanks to the new GST usage. This should be appropriate for advancing the entire tax system. For a considerable amount of time, small and medium-sized enterprises (SMEs) have been regarded as the primary engine of economic development in India. The fact that 3 million SMEs in India currently account for 42% of the country's total GDP and nearly half of its industrial produce further supports this point. SMEs have emerged as the primary sector for job creation in India, a developing country with a very diverse population, and they have contributed to segment-specific advancement. We ought to investigate potential GST effects on small and medium-sized businesses [6]. Since all of the consistency systems under the GST, including registration,



payments, refunds, and returns, will now only be available through online portals, SMEs won't have to worry about collaborating with division officials to complete these compliances, which are currently thought to be a headache in the current tax system.



Impact Of Demonetization on MSME

Small- and medium-sized enterprises (MSME) account for a significant portion of the economy, employing more than 80 million people annually and contributing to the GDP by 8%. The majority of SMEs are often family-owned and operated businesses. There are two main types of market participants in this area. One group of companies was founded on the premise that its sponsors were able to see the opportunity early on and take advantage of it, quickly growing into powerful enterprises. While the impact of demonetization on the general populace has received a lot of attention, independent businesses may face significant short- to medium-term challenges due to the sudden nullification of 86% of Indian currency. It is impossible to overstate the importance of Micro, Small, and Medium-Sized Enterprises (MSMEs). The segment generates around 46 million units, or about 100 million jobs, according to estimates from the Ministry of MSME.

Due to their more notable reliance on hard money, it is reasonable to predict that MSMEs will be more affected by demonetization than the rest of the economy, with estimates ranging from 50bps at the lower end to 300bps at the better quality. Their money-only cost base serves as the foundation for their ethical money cycle. At that time, this helps the firm start earning actual money as well. The effects of demonetization on the SME sector are as follows:

- **Impact on Receivables from Customers**

The majority of MSMEs observed a decline in the demand for their goods and services. The effects differed across urban and rural regions. Due to the availability of more cash, a smaller network of bank branches, and the lack of digital payment methods, the rural population was impacted even more severely than their urban counterparts. Because MSMEs lack the leverage to negotiate better prices with big business clients, their receivables have been growing. Additionally, many MSMEs struggle to manage their working capital due to the need to collaborate with major corporates in order to obtain bulk orders and enhance scalability.

- **Impact on Credit**

One sector of the economy that faces credit constraints is the MSME sector. MSMEs receive about 17% of bank loans. This sector of the economy, which employs more people than organised manufacturing, could have access to more credit if the economy's potential for credit increases. Put another way, there could be a lot of beneficial knock-on effects if this segment's credit availability could be increased. If all of this segment's transactions shift to a digital format, lending institutions will have access to proof of creditworthiness, which could improve their access to formal sector financing. But before they can obtain credit, the transactions must go digital for this. Stated differently, the banking industry would not profit from the increase in available credit unless it is investigating riskier asset classes.

- **Impact on Employment**

Due to the micro, small, and medium-sized company (MSME) sector bearing the brunt of the reduced currency in circulation, demonetization has had a negative effect on the creation of jobs in the economy. MSMEs with a focus on infrastructure projects reported a revenue loss of 45% and a reduction in employment of 35%. Export-oriented industries, which include international businesses, reported a 40% decline in income and 30% loss of jobs. Medium-sized and large-scale manufacturing enterprises reported a 20 percent decline in revenue.

- **Impact on Operations**

Because the withdrawal limits were low, MSMEs had to temporarily halt operations in order to find supplies and pay their employees—especially those who worked on a weekly basis. The MSMEs sector has been severely impacted because it is primarily driven by workers on a contract or daily basis, and the majority of the mobile workforce does not have bank accounts at the location where they work. This has resulted in a lack of sufficient currency in the market, which is necessary for these units to operate efficiently and smoothly and requires a lot of working capital. Demonetization has a widespread effect on prices for the majority of goods.



Even the fundamental operations of the units were impeded by the restrictions on cash withdrawal. Units found it challenging to cover their transportation costs and pay salaries.

GST and Demonetisation Will Change Indian Economy

Prime Minister Narendra Modi's demonetisation initiative and the Goods and Services Tax (GST) provided the government with clear financial advantages. With regard to the Center, GST will ensure increased taxes, as well as higher taxes for the states. Following the government's assault on raising restrictions, all concerns about the Indian economy suffering as a result of demonetization were later disregarded. Head of State Modi has established a new national standard in which monetary exchanges will be conducted primarily through computer systems instead of cash. Long-term currency fluctuations will effectively result in an extension of both the GDP and the tax base. Demonetization is a huge step forward in replacing 86% of the nation's currency. It turns out that the hidden currency also includes counterfeit money, money used by psychological militant associations, and money used to carry out crimes. The Indian government made a very serious decision when it implemented the demonetisation measure. The government's progression has strengthened the banks. The banks' ability to support the economy in the existing circumstances was dwindling. We thus used budgetary contributions to strengthen the banks.

Conclusion

Innovation, development, and policy interventions will continue to create an MSMEs-friendly environment. GST will likely expand the taxpayer base, including MSMEs, and weight their consistency and expenses. GST will make MSMEs more aggressive over time by levelling the playing field with large companies. Recently, the government created a unique panel to address GST challenges faced by MSME. The business should proactively address the foregoing difficulties and receive help before GST is implemented, as the division's chances of respite are slim. However, de-adaptation only affects small and medium projects. Since most exchanges in this area are money-based, a liquidity shortage will likely stall monetary activity. Idealism has a medium- and long-term explanation. The inflow of stores should consider decreased financing costs, boosting interest in this segment. The transition toward cashless exchanges will help such undertakings recruit and benefit from central and state initiatives. A



significant shift to a computerised and cashless economy should also increase access to little effort money. GST will establish an almost unbreakable chain of transactions from the raw material to the buyer. Again, demonetization resets the parallel economy, forcing lawbreakers to start over. It's like sending certain sprinters back to the starting line because they won using unfair techniques. These sprinters can use the same strategies again and run faster. Obstacles are the main things that slow sprinters. GST will also be a major issue. GST has only promoted "One Nation One Tax" so far. Something to kill a complex tax structure that has been in place for years and replace it with a business-friendly, buyer-friendly one. This is true, but GST deserves more credit. The biggest future impact of demonetization will be that when someone stores a lot of money, tax authorities are frightened and he can stay on the radar later. GST, like demonetization, would cause short-term pain for long-term gain. So we could expect the usual suspects to raise many GST and Demonetization objections to slow it down.

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