

Effect of GST on MSME Growth and the Financial Performance of Non-Banking Financial

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Abstract: *The introduction of the Goods and Services Tax (GST) in India marked a significant structural reform aimed at unifying the indirect tax system and promoting economic formalization. This study examines the impact of the Goods and Services Tax on the growth and operational performance of Micro, Small, and Medium Enterprises (MSMEs) and analyzes its effect on the financial performance of Non-Banking Financial Companies (NBFCs) in India. The research adopts a descriptive and analytical design using both primary and secondary data. Comparative analysis was conducted between pre-GST (2014–2017) and post-GST (2018–2023) periods. Statistical tools such as ratio analysis, paired t-tests, regression models, and panel data analysis were applied to evaluate changes in revenue growth, compliance costs, working capital management, loan disbursement, asset quality, and profitability indicators.*

The findings reveal that GST has contributed positively to MSME formalization, increased revenue transparency, and expanded interstate trade. However, compliance costs and working capital constraints increased during the transition period. For NBFCs, GST enhanced credit appraisal efficiency through improved availability of tax-based financial data, leading to increased MSME lending. Nevertheless, a temporary rise in non-performing assets was observed due to transitional stress among small enterprises. The study concludes that while GST has generated short-term operational challenges, it has strengthened long-term financial integration between MSMEs and NBFCs. Policy measures focusing on compliance simplification, faster input tax credit refunds, and fintech-enabled credit assessment can further enhance the positive impact of GST on economic growth and financial stability..

Keywords: GST, MSME, NBFC, Financial Performance

I. INTRODUCTION

The introduction of the Goods and Services Tax (GST) on 1 July 2017 marked one of the most significant indirect tax reforms in India's economic history. By subsuming multiple central and state taxes such as excise duty, service tax, VAT, and entry tax into a single unified tax regime, GST aimed to create a "One Nation, One Tax" system. The reform was designed to simplify the tax structure, eliminate cascading effects, enhance transparency, improve compliance, and promote ease of doing business. While GST has had economy-wide implications, its impact has been particularly pronounced on Micro, Small and Medium Enterprises (MSMEs) and Non-Banking Financial Companies (NBFCs), both of which play a vital role in India's economic growth and financial stability.

The MSME sector forms the backbone of the Indian economy by contributing significantly to GDP, employment generation, exports, and industrial output. MSMEs are highly sensitive to policy changes due to their limited financial resources, informal business practices, and operational constraints. The implementation of GST brought both opportunities and challenges for MSMEs. On one hand, GST reduced tax complexities, enabled seamless input tax credit, expanded market access, and encouraged formalization of businesses. On the other hand, compliance requirements such as digital return filing, invoice matching, and working capital blockages posed difficulties, especially



for small enterprises with limited technological and financial capacity. The shift from an informal to a formal tax structure compelled many MSMEs to restructure their accounting systems and adapt to new regulatory norms.

At the same time, the financial performance of Non-Banking Financial Companies (NBFCs) has been indirectly influenced by GST implementation. NBFCs serve as crucial financial intermediaries by providing credit facilities, especially to MSMEs and underserved sectors that may not have easy access to traditional banking services. The growth and stability of MSMEs directly affect the asset quality, loan demand, and profitability of NBFCs. If GST enhances MSME growth, it can increase credit demand and improve repayment capacity, thereby strengthening NBFC financial performance. Conversely, if compliance burdens negatively affect MSME cash flows, NBFCs may experience higher credit risks, rising non-performing assets (NPAs), and liquidity stress.

Furthermore, GST has influenced the operational framework of NBFCs through changes in taxation of financial services. Earlier, service tax was applicable to financial services, but under GST, the tax rate structure and input credit mechanisms were modified. Although NBFCs can claim input tax credit on certain services, restrictions on credit availability and increased compliance requirements have impacted their cost structures and profitability margins. Additionally, GST-driven formalization of the economy has improved financial transparency, enabling better credit assessment and risk management practices for NBFCs.

The interrelationship between GST, MSME growth, and NBFC financial performance highlights the importance of analyzing the broader economic implications of tax reforms. MSMEs rely heavily on NBFC financing for working capital and expansion, while NBFCs depend on MSMEs for credit demand and revenue generation. Therefore, any structural reform affecting one sector inevitably influences the other. Understanding this interconnected impact is essential for policymakers, financial institutions, and business stakeholders.

In the context of India's evolving economic landscape, studying the effect of GST on MSME growth and the financial performance of NBFCs becomes highly relevant. The findings of such a study can provide insights into whether GST has achieved its intended objectives of promoting formalization, improving credit access, and strengthening financial ecosystems. It can also help identify policy gaps and suggest measures to enhance tax compliance mechanisms, reduce operational burdens, and improve financial sustainability for both MSMEs and NBFCs.

Thus, this research aims to examine the extent to which GST has influenced MSME growth and how these changes have subsequently affected the financial performance of Non-Banking Financial Companies, thereby contributing to a deeper understanding of the economic impact of tax reforms in India.

II. REVIEW OF LITERATURE

Dwivedi & Agrawal (2024) examined the impact of GST on the financial performance and compliance behaviour of MSMEs in India. They found that although GST simplified the tax framework and improved formalisation, many MSMEs still struggled with increased compliance costs, digital adaptation issues, and working capital constraints in the post-GST era. The study highlights that the compliance burden and delayed refunds posed significant challenges for smaller enterprises, affecting profitability and operational efficiency. Rajeshkumar and Sunil (2024) conducted a comprehensive review of how GST provisions changed MSME operations. Their review revealed a dual effect: on one hand, GST unified the tax system, reduced cascading taxes, and improved operating transparency; on the other hand, it resulted in higher licensing costs and technological adoption burdens — especially for micro and small firms with limited resources. Policy support and capacity building were identified as key factors for future MSME competitiveness under the GST regime. Studies like Dhillon & Gautam (2022) and Garg et al. (2024) provided region-specific assessments (e.g., Punjab, Rajasthan), showing varied effects of GST on MSMEs across states. These works reported improvements in tax efficiency and interstate trade opportunities but also noted issues with input tax credit awareness, heightened compliance costs, and the need for targeted government support for smaller operators. Bhalla, Sharma, and Kaur (2023) empirically analysed the GST impact on MSME business performance using survey data from 404 firms. Contrary to some criticisms, their results indicated that GST resulted in overall improvements in ease of doing business, operational efficiency, and profitability. Their findings suggest that determinants such as tax awareness, technological



adaptation, and streamlined processes helped reduce working capital blockages and enhanced performance under the GST system. Reshma S (2023), The paper *Effects of GST on MSMEs* examines how the introduction of the Goods and Services Tax (GST) has influenced Micro, Small, and Medium Enterprises (MSMEs) in India, focusing particularly on manufacturing units. GST was implemented in India in 2017 as a unified indirect tax system, replacing multiple central and state levies. The study uses both primary data (survey of 151 entrepreneurs from manufacturing MSMEs in Thrissur district) and secondary data to assess the effects of this major tax reform. Reshma S (2023) The study aims to empirically evaluate the financial performance of selected Non-Banking Financial Companies (NBFCs) in India by analysing key financial indicators such as profitability, efficiency, leverage (debt), and turnover over a defined period. The author uses secondary data sourced from reputed financial databases (*PROWESS, CMIE, and Capitaline*), applying financial ratio analysis to measure profitability (e.g., returns, margins), leverage (debt levels), and efficiency. Ratios such as return on assets (ROA), return on equity (ROE), and leverage indicators are computed and compared across NBFCs. Differences in profitability and leverage suggest strategic and operational disparities across firms, underscoring the importance of effective financial management, risk control, and performance monitoring in sustaining competitiveness. The study offers valuable insights for investors, managers, and policymakers interested in the financial dynamics of the NBFC sector.

Objectives

- To examine the impact of the implementation of the Goods and Services Tax (GST) on the growth and operational performance of Micro, Small, and Medium Enterprises (MSMEs) in India.
- To analyze the effect of GST implementation on the financial performance of Non-Banking Financial Companies (NBFCs) in India.

III. RESEARCH METHODOLOGY

The present study adopts a descriptive and analytical research design to examine the impact of the Goods and Services Tax (GST) on MSME growth and the financial performance of NBFCs in India. Both primary and secondary data sources were utilized to ensure comprehensive analysis. Primary data were collected through structured questionnaires administered to selected MSME owners and financial managers, along with interviews conducted with officials from Non-Banking Financial Companies (NBFCs). A stratified random sampling method was adopted to select MSMEs across manufacturing, trading, and service sectors to ensure representation. For NBFC analysis, financial data were collected from published annual reports and regulatory disclosures.

Secondary data were obtained from reports of the Goods and Services Tax Council, publications of the Reserve Bank of India, Ministry of MSME reports, and peer-reviewed journal articles. The study period was divided into pre-GST (2014–2017) and post-GST (2018–2023) phases to facilitate comparative analysis. Statistical tools such as percentage analysis, ratio analysis, paired sample t-tests, multiple regression analysis, and panel data models were applied using SPSS and Excel software. Key variables analyzed included revenue growth, compliance cost, working capital turnover, loan disbursement growth, Gross NPA ratio, Return on Assets (ROA), and Net Interest Margin (NIM). The methodology ensured reliability and validity through pilot testing of questionnaires and cross-verification of financial data. The results were interpreted to assess both short-term transitional effects and long-term structural implications of GST implementation.

IV. DATA ANALYSIS AND INTERPRETATION

Comparative Analysis (Pre-GST vs Post-GST)

Particulars	Pre-GST (2014–2017 Avg)	Post-GST (2018–2023 Avg)	% Change
Revenue Growth (%)	8.5%	11.2%	+31.7%
Compliance Cost (% of Revenue)	2.1%	3.4%	+61.9%



Particulars	Pre-GST (2014–2017 Avg)	Post-GST (2018–2023 Avg)	% Change
Working Capital Turnover	4.2	3.6	-14.3%
Formal Registration (%)	62%	81%	+30.6%
Net Profit Margin (%)	9.8%	8.9%	-9.2%

(A) Paired Sample t-Test

To compare pre- and post-GST performance indicators.

Revenue Growth: $p < 0.05$ (Significant improvement)

Compliance Cost: $p < 0.01$ (Significant increase)

Profit Margin: $p > 0.05$ (Not statistically significant decline)

(B) Multiple Regression Analysis

Model:

$$MSME\text{Growth} = \beta_0 + \beta_1(GST\text{ComplianceCost}) + \beta_2(WorkingCapital) + \beta_3(Formalization) + \epsilon$$

Results Summary:

Variable	Coefficient	t-value	Significance
Compliance Cost	-0.42	-3.15	Significant
Working Capital	0.37	2.84	Significant
Formalization	0.51	4.02	Highly Significant
R ²	0.64		

Interpretation:

The regression analysis clearly indicates that formalization has a strong and statistically significant positive impact on MSME growth in the post-implementation period of the Goods and Services Tax. Increased formal registration under GST has improved transparency, credibility, and access to institutional finance, thereby enhancing revenue growth and market expansion opportunities for MSMEs. Formalization has also facilitated smoother interstate trade and better integration into organized supply chains, contributing positively to overall business performance.

To analyze the effect of GST on the financial performance of NBFCs in India

Key Financial Indicators

Loan Disbursement Growth to MSMEs

Gross NPA Ratio (%)

Return on Assets (ROA)

Net Interest Margin (NIM)

Liquidity Ratio

Comparative Financial Performance

Indicator	Pre-GST Avg	Post-GST Avg	% Change
MSME Loan Growth	12.4%	16.8%	+35.4%
Gross NPA Ratio	5.6%	6.9%	+23.2%
ROA	2.3%	2.0%	-13.0%
Net Interest Margin	4.5%	4.2%	-6.7%
Liquidity Ratio	1.28	1.15	-10.2%



(A) Ratio Analysis

Used to evaluate profitability, liquidity, and asset quality.

(B) Difference-in-Differences (DiD) Model

Compared:

NBFCs heavily exposed to MSME lending

vs

NBFCs with diversified portfolios

Result:

MSME-focused NBFCs experienced higher loan growth but also higher NPA increase post-GST. Did coefficient significant at 5% level.

(C) Panel Data Regression Model

$$FinancialPerformance = \beta_0 + \beta_1(MSMEExposure) + \beta_2(GSTPeriodDummy) + \beta_3(InteractionTerm) + \epsilon$$

Variable	Coefficient	Significance
MSME Exposure	0.29	Significant
GST Dummy	-0.12	Moderate
Interaction Term	-0.21	Significant
R ²	0.58	

Interpretation:

The findings indicate that higher exposure to MSME lending significantly contributed to credit growth among NBFCs in the post-implementation phase of the Goods and Services Tax. With improved financial transparency arising from GST filings, NBFCs were able to assess borrower cash flows more accurately, thereby expanding credit disbursement to MSMEs. Access to structured tax return data reduced information asymmetry and enhanced confidence in extending working capital and term loans to small enterprises. As a result, NBFCs with a greater concentration in MSME portfolios experienced relatively stronger loan growth compared to those with diversified lending structures.

V. DISCUSSION

The findings of the study indicate that the implementation of the Goods and Services Tax (GST) has produced a mixed but structurally transformative impact on the growth trajectory of MSMEs and the financial performance of NBFCs in India. From the MSME perspective, GST has significantly enhanced business formalization, improved tax transparency, and created a unified national market by eliminating cascading taxes. The data analysis reveals that post-GST revenue growth improved due to expanded interstate trade and input tax credit (ITC) benefits. However, the compliance burden increased substantially, especially for micro and small enterprises with limited digital infrastructure and accounting capabilities. Frequent return filings, e-way bill requirements, and delayed ITC refunds created working capital constraints, thereby affecting operational liquidity. These findings are consistent with reports by the Goods and Services Tax Council, which acknowledge transitional challenges faced by smaller enterprises during the early years of GST implementation.

With respect to NBFCs, the study finds that GST improved financial transparency of MSMEs, thereby strengthening credit appraisal mechanisms. Availability of GST return data (GSTR-1, GSTR-3B filings) enabled NBFCs to assess cash flows more accurately, reducing information asymmetry in lending decisions. As regulated by the Reserve Bank of India, NBFCs increasingly leveraged GST-linked data analytics for credit risk assessment. The analysis shows an increase in MSME loan disbursement post-GST; however, a moderate rise in Gross NPAs suggests short-term financial stress during the transition period. Profitability indicators such as ROA and NIM experienced marginal decline due to



increased provisioning and compliance costs. Overall, GST has strengthened long-term financial integration between MSMEs and NBFCs, though short-term adjustment costs were evident.

Implementation

The study suggests several strategic and policy-level implementations. For MSMEs, there is a need to simplify GST compliance procedures, especially for micro enterprises under the composition scheme. Strengthening digital literacy programs and providing subsidized accounting support can reduce compliance costs. Timely processing of input tax credit refunds is essential to mitigate working capital pressures and sustain operational performance. Further, expanding awareness initiatives through state MSME development agencies can enhance tax compliance efficiency and business competitiveness.

For NBFCs, integrating GST data with fintech-driven credit scoring models can significantly enhance credit appraisal efficiency. Development of cash-flow-based lending models using GST filings will enable more inclusive financing for small businesses lacking traditional collateral. Strengthening early warning systems for MSME stress using GST transaction trends can reduce future NPAs. Additionally, collaborative frameworks between NBFCs, fintech firms, and government platforms can promote data-driven lending practices.

At the macro-policy level, continuous review by the GST Council to rationalize return filing frequency and reduce compliance complexity is recommended. Strengthening coordination between the Ministry of MSME, financial regulators, and lending institutions will improve credit flow and financial stability. In the long run, GST-driven formalization is likely to enhance tax base expansion, improve financial transparency, and support sustainable economic growth through stronger MSME–NBFC linkages.

VI. CONCLUSION

The study concludes that GST has had a transformative yet dual impact on MSMEs and NBFCs in India. For MSMEs, GST has enhanced formalization, expanded market access, and improved transparency in financial reporting, thereby strengthening their integration into the formal economy. Revenue growth and interstate trade opportunities have improved in the post-GST period. However, increased compliance requirements, frequent return filings, and delays in input tax credit refunds created short-term working capital constraints, particularly for micro and small enterprises. Thus, while GST has positively influenced long-term structural growth, transitional challenges have moderated profitability and liquidity in the short run.

With respect to NBFCs, GST has improved credit assessment capabilities by enabling access to reliable transaction-level tax data, reducing information asymmetry in MSME lending. This has contributed to increased loan disbursement to the MSME sector. Nevertheless, a moderate rise in NPAs during the initial implementation phase reflects temporary financial stress among borrowers. Over time, improved data transparency and digital compliance are expected to enhance asset quality and profitability. Overall, GST has strengthened the financial linkage between MSMEs and NBFCs, promoting formalization, credit expansion, and sustainable economic development. Continuous policy refinement and compliance simplification will be crucial to maximize long-term benefits.

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