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IMPACT OF G S T ON MSMEs - A GROWTH INDICATOR OF INDIAN ECONOMY

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ABSTRACT

Micro, Small and Medium Enterprise (MSMEs) constitute over 90 percent of total enterprises in most of the economies and are credited with generating highest rate of employment growth and also account for a major share of industrial production and exports gained attention of policy makers due to its potential of generating large output from a lower investment. This labour intensive sector has the capacity of reducing regional imbalances through income and employment generation, economic independence of rural folk and helps in sustainable development. Numerous registered and unregistered enterprises are mushrooming in India but there are also spatial inequalities too. In India, states like Tamil Nadu, Uttar Pradesh, Gujarat and West Bengal are the leading states in MSME sector. MSMEs in India are very much heterogeneous, the sector is critical in meeting the national objectives of generating employment, reducing poverty, and discouraging rural-urban migration. These enterprises help to build a thriving entrepreneurial eco-system, in addition to promoting the use of indigenous technologies. The sector has exhibited consistent growth over the last few years, but it has done so in a constrained environment often resulting in inefficient resource utilization. Tax cascading effect becomes more prominent as the chain grows and used to have major impact till the goods reached the consumer. Value added tax structure is the solution to this cascading of tax. Apart from cascading the sales tax system had varied tax rates for various goods and it also varied from state to state making this difficult to administer and was also leading to unhealthy competition between states for more revenue. Of the many challenges impeding the growth and development of MSMEs, inadequate access to financial resources is one of the key bottlenecks that make these enterprises vulnerable, particularly in periods of economic downturn. The Indian MSME sector is poised for rapid growth and integration with major global value chains. Government must also take sustained initiatives in order to educate MSMEs about the various provisions and compliance requirements under GST for timely policy intervention and due support promptly rendering the Indian MSMEs to be globally competitive.

KEY WORDS: Micro, Small and Medium Enterprise, Industrialization, Operational Capital Requirement, G S T, Value added tax structure.

INTRODUCTION

Indian Micro Small and Medium Enterprises (MSME) sector has emerged as a highly vibrant and dynamic sector of the Indian economy over the last decades. SMEs not only play crucial role in providing large employment opportunities at comparatively lower capital cost than large industries but also help in industrialization of rural areas. The MSME sector plays a significant role in the Indian economy for socio-economic transformation of the country, the sector is critical in meeting the national objectives of generating employment, reducing poverty, and discouraging rural-urban migration. These enterprises help to build a thriving entrepreneurial eco-system, in addition to promoting the use of indigenous technologies. The sector has exhibited consistent growth over the last few years, but it has done so in a constrained environment often resulting in inefficient resource utilization. MSMEs are complementary to large industries as ancillary units and this sector contributes enormously to the socio-economic development of the country. The Sector consisting of 36 million units, as of today, provides employment to over 80 million persons. The Sector through more than 6,000 products contributes about 8% to GDP besides 45% to the total manufacturing output and 40% to the exports from the country. The MSME sector has the potential to spread industrial growth across the country and can be a major partner in the process of inclusive growth. MSMEs also play a significant role in Nation development through high contribution to Domestic Production, Significant Export Earnings, Low Investment Requirements, Operational Flexibility, Location Wise Mobility, Low Intensive Imports, Capacities to Develop Appropriate Indigenous Technology, Import Substitution, Contribution towards Defense Production, Technology Oriented Industries, Competitiveness in Domestic and Export Markets thereby generating new entrepreneurs by providing knowledge and training. Despite their high enthusiasm and inherent capabilities to grow, MSMEs in India are also facing a number of problems like sub-optimal scale of operation, technological obsolescence, supply chain inefficiencies, increasing domestic & global competition, working capital shortages, not getting trade receivables from large and multinational companies on time, insufficient skilled manpower, change in manufacturing strategies and turbulent and uncertain market scenario. To survive with such issues and compete with large and global enterprises, SMEs need to adopt innovative approaches in their operations. MSMEs that are innovative, inventive, international in their business outlook, have a strong technological base, competitive spirit and a willingness to restructure themselves can withstand the present challenges and come out successfully to contribute 22% to GDP. Indian MSMEs are always ready to accept and acquire new technologies, new business ideas and automation in industrial and allied sectors.

India has been trying to implement the Goods and Service Tax (GST) for last few years but due to political and state government autonomy issues the federal government has been unable to make it a law. Intention to implement this was declared in 2008 and it was supposed to be in existence from April 2010. 85 percent of the revenue of state governments is generated from the indirect taxes on goods and services and sales tax alone accounts for 61percent of the total revenue. Introduction of state level value added tax in 2005 led to uniform tax rates and eliminated cascading tax rates but it is still a step towards more comprehensive reforms as that of

GST. (Kavita Rao 2008) Indian federal government initiated the VAT in 1986 for excise duty by introducing the MODVAT for some of the goods. This later developed into CENVAT (central VAT) which included most of the goods. In 2005 Indian federal government amended the constitution to tax the services and this tax was also included into the CENVAT. The federal government intensified its efforts to convince the states for VAT tax structure in mid-nineties and focused on the harmonization of sales tax structure through implementation of uniform floor rates of sales tax. The continuous persuasion and discussion lead to a great success in reaching at a consensus for uniform floor sales tax rates. After this procedures were initiated for systematic introduction of state level VAT. Indian states had the sales tax system till 2005 when VAT was introduced after about 10 years of deliberations. In sales tax system the inputs for manufacturing were taxed for sales tax and when the product was produced than again whole of the selling value was taxed. So there was cascading of

tax because of tax on the tax. This cascading effect becomes more prominent as the chain grows and used to have major impact till the goods reached the consumer. Value added tax structure is the solution to this cascading of tax. Apart from cascading the sales tax system had varied tax rates for various goods and it also varied from state to state making this difficult to administer and was also leading to unhealthy competition between states for more revenue. Of the many challenges impeding the growth and development of MSMEs, inadequate access to financial resources is one of the key bottlenecks that make these enterprises vulnerable, particularly in periods of economic downturn. Exclusive credit Plans for Micro Small and Medium Enterprise entails providing lower rate of interest for growing business units and offering them access to banking services at low rate of interest, quick processing and servicing. Indian context they can be considered as the backbone of national economy. In each stage of development a different set of factors is critical to the firm's survival and success. The Churchill Lewis model gives an insight into the dynamics of MSME growth, including the distinguishing characteristics, problems and requirements of growing MSMEs and explains business growth. Indian comprise three sub-sectors: 1. Predominantly rural based, traditional household industries 2. Small and medium industries, functioning with relatively obsolete technologies 3. Modern small and medium enterprises, which are owned and operated by techno entrepreneurs, operating in new industries such as software and bio-technology. Being pillars of economy, the MSMEs continue to face several problems in their day-to-day operations, that is, in production and marketing of their products. They find it difficult to sell their output at remunerative prices and cannot spend much on advertising, marketing research, etc. They also face stiff competition from large firms. Inadequate infrastructural facilities and access to credit are other major problems. MSMEs are often unable to procure adequate financial resources for the purchase of machinery, equipment and raw materials as well as for meeting day-to-day expenses. Further, they find it difficult to recruit and motivate skilled managerial and technical personnel. They are mainly reluctant to adopt modern methods of organization and management constituting more than 80 % of the total number of industrial enterprises and supporting industrial development, many MSMEs in India have problems such as suboptimal scale of operation, technological obsolescence, supply chain inefficiencies, increasing domestic and global competition, fund shortages, change in manufacturing strategies and turbulent and uncertain market scenario.

MSMEs is facing the challenge of available work force. Moreover the initiatives are addressed for skill development of unskilled labour that might be inconsistent in any job offer and bargains for higher wages and demands conveniences that MSMEs could not afford. Thus losing the worker to a competent entrepreneur. The competency in most cases is addressed based on the ability to fund the workers sustainability at the unit. Other than this the Women entrepreneurs still find the social perception and attitude could not transform as easy as the schemes, policies and frameworks which hinder the growth of women entrepreneurs in the State Majority of the banks consider lending to MSMEs an unattractive venture due to a range of factors including information asymmetries and consequently high transaction costs, collateral requirement, financial products not meeting MSME sector requirements in medium to long term Information asymmetries due to inefficient legal system and weak governance structures of SMEs result in higher transaction costs on the supply side. On the demand side we find most of the SMEs tend to shy away from formal modes of financing due to the high cost of credit, lengthy procedures, collateral requirements and lack of awareness about the benefits of corporate governance.

POSITIVE IMPACT OF GST ON MSMEs

Low Rates Taxes : With the application of GST, industries having a turnover between Rs.10 and 50 lakh have to pay levies at lower rates, thereby, getting an enormous relief from tax burdens.

Reduction in Logistics Cost and Time : GST enactment reduced time and money required for Interstate movement as their duties got eliminated. Also, this diminishes costs of retaining large stocks due to ease in free movement of goods.

Creating a Uniform Platform : GST levies taxes on stock transmissions and neutralizes the impact of contributed taxes through the input credit too, thus, removing all tax differentiation and bringing small and medium businesses to par with large-scale industries.

Increased Reach to Customers Presently, the Central Sales Tax (CST) on sales between states restricts small and medium businesses to reach their potential customers across India, which surges the acquisition charge of products for the consumers. The implementation of GST will prevent that.

NEGATIVE IMPACT OF GST ON MSMES

Burden of Lower Threshold : GST bill has improved the threshold limit from 10 lakh to 20 lakh generally and from 4 lakh to 10 lakh for North-eastern states, due to which any service provider or retailer is subject to the tax levy. Earlier, the central expunge threshold was INR 1.5 crore. Now, as the threshold is low, most MSMEs have to pay a lump sum of their investment towards tax in the near, foreseeable future.

Lack of Tax Differentiation for Luxury Items and Services : The GST implementation has the function of tax neutrality, which though beneficial in other areas, does not differentiate between luxury and normal items and services. Unlike earlier, when the state and central government levied greater duties on luxury goods and services, the GST tax requires all goods and services to have the same tax. This leads to an increase in the financial gap between the rich and the poor and is not a model situation for MSMEs to compete and flourish against large industries.

Selective Tax Levying : GST tax is not applicable to alcoholic liquor for human consumption as well as petroleum and oil based industries, which is a contradiction of the policy of the 'unified market' philosophy of GST.

Extra Operational Capital Requirement: Taxes on stock transmission primarily affect the functioning capital necessities. This, in fact, varies with factors such as stock reversal time at depository, credit sequence to the consumer, etc. A greater sum of Capital Prerequisites increases the interest charge, which finally increases the rate of Completed Merchandises.

GOVERNMENT POLICY SUPPORT

1. As per the Public Procurement Policy, all Central ministries and PSUs will have to ensure that a minimum 20 per cent of all their total annual purchases of products or services are from MS Es, and within this limit, 4 per cent of the orders should be placed to the SC/ST entrepreneur.
2. Offset under defense purchases are suitably focused to support the MSMEs in the country, in upgrading their capacities, capabilities & technology.
3. Micro & Small Enterprises Cluster Development Programme .
4. National Manufacturing Policy targeted to increase manufacturing sector growth of 12-14% over medium term to increase share of manufacturing in GDP from 16% to 25%.
5. Credit Linked Capital Subsidy Scheme (CLCSS) meant for technology up gradation of Micro and Small Enterprises are existing. The scheme provides 15% Capital Subsidy (limited to maximum Rs. 15.00 lakh) for purchase of Plant & Machinery.
6. The Technology Upgradation Fund Scheme (TUFS) provides for interest reimbursement/capital subsidy/margin money subsidy for textile units seeking credit for technological up gradation.
7. The 10 component schemes under the NMCP targeted at enhancing the entire value chain of the MSME sector are at various stages of implementation by Ministry of MSME.
8. The strategy also recommended some sub-sectors for immediate focus such as Textiles and Garments, Leather and Leather Products, Auto Components, Drugs & Pharmaceuticals, Food Processing and IT Hardware.
9. Credit Guarantee Fund Scheme for Micro and Small Enterprises (CGTMSE) launched particularly micro enterprises, for loans up to Rs. 100 lakh without collateral/ third party guarantees.

10. Implementation of Platforms in Stock Exchanges for providing general purpose equity to MSMEs, separate platforms for SMEs were set up in 2012 in the Bombay Stock Exchange (BSE) and National Stock Exchange (NSE).
11. Priority sector lending by the commercial banks to ensure sufficient credit availability are the major constraints of SMEs finance for initial capital and working capital, Line of credit from the suppliers, new technology to produce quality products/ give service, ability to hire qualified and professional staff for production, service and marketing .

CONCLUSION

Micro Small and Medium Enterprises (MSMEs) are crucial for the economic growth and stability of any country and play a vital role especially for developing countries as they facilitate economic activity and provide employment thus contributing to poverty reduction. SMEs can be considered as the backbone of national economy and as a significant solution for our development issues as they Provide resilience in the economy and foster an entrepreneurial culture , Creates jobs , Contributes to exports, Reduces poverty, Provide more employment at lesser capital costs compared to large enterprises, Reduces inequalities in the economy by contributing in distribution of wealth. and facilitate learning across the sectors as well as geographically .Although the GST implementation aims to upsurge the taxpayer base, largely SMEs into its opportunity, it presents a problem of compliance and related charges for them. Nevertheless, GST will make the MSMEs more competitive in the long run and will make the playing arena level between big enterprises and them. Additionally, the Indian MSMEs would be able to compete with the international market goods and competition coming from cheap price epicentres such as China, Philippines, and Bangladesh and actually thrive in the world market scenario. With the Goods and Services Tax (GST) making rapid progress over the last few months, the technology leveraged, unified indirect tax regime is all set to be introduced by 1 July. While the MSME sector is likely to benefit from the far-reaching tax reform, there are some concerns regarding its various clauses and processes. Government policies focus on investment and tax incentives. However, these policies are not effective in the long run and do not meet the expectations of the businesses. Such efforts tend to support unprofitable activities and are inefficient. On the other hand, governments can create an environment which will be effective in the long run such as improving education, training and development of SME clusters. A complicated compliances system and a rigid taxation regime place added limits on the growth potential of small enterprises. Uncertainty about claiming the Input Tax Credit (ITC), multiple registrations and returns, transference of tax liability, complex procedures, etc are some of the problem areas for MSMEs. To build technical literacy in MSMEs to make optimal use of the technology-enabled platform for GST, enhance awareness amongst MSME another attempt to ease the compliance burden for small traders, the Government announced the Composition/Compounding Scheme. which decided that traders with gross turnover cut-off of `50 lakhs will pay 1-2%, which is much lower than the GST rate. The benefits of GST will be lost on Indian industry if it is not accompanied by a set of simple procedures to reduce the compliance burden on businesses, especially MSMEs. The Government must also take sustained initiatives in order to educate MSMEs about the various provisions and compliance requirements under GST for MSMEs through seminars, conferences, training sessions, etc. This will go a long way in enhancing their preparedness for swiftly transitioning to this new tax regime, and avail of its various benefits on the Indian industry measures raising the business confidence MSME interventions for a larger share of global business which presents opportunities for MSME integration in almost all industry sectors. The Indian MSME sector is poised for rapid growth and integration with major global value chains for global competition.

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