

Impact of GST on Working Capital Management of SMEs

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Abstract

Goods and Services Tax (GST) in India is an overhaul of the indirect tax system with a vision of creating a single market and tax transparency in India. Although GST has been introduced to ease tax compliance and reduce cascading tax effects, deeper insights are required on the working capital management practices of Small and Medium Enterprises (SMEs) and its impact. This research paper aims to study the impact of the Goods and Services Tax (GST) on the working capital management of SMEs by highlighting the changes in the cash flow position, inventory management, receivables, payables and liquidity position of a SME after the implementation of the GST regime. The effect of GST compliance on the operational efficiency and financial planning of SMEs in various sectors such as input tax credit and online filing of GST returns is explored. A descriptive and analytical research method is used and sources of secondary data are journals, reports, government publications and industry studies. Based on the results, successful implementation of GST has resulted in opportunities and challenges to SMEs. The input tax credit and streamlined taxes have enhanced the efficiency of supply chain and have taken away tax related hassles on one hand. On the other hand, availability of input tax credit and streamlined taxation have helped in streamlining the supply chain efficiency and tax related hassles. Meanwhile, the input tax refund processing has been delayed, compliance obligations have increased and companies have been asked to report digitally every quarter, increasing the burden on the working capital cycles of small businesses that do not have enough capital. The study suggests that the availability of policy support, ease of compliance and timely refund system are essential to remove financial limitations while GST is responsible to create financial discipline and financial transparency among SMEs. The paper provides a valuable input to the policy makers, financial managers and SME owners regarding the potential long term financial impacts of GST on the sustainability of business operations and business performance.

Keywords: Goods and Services Tax (GST), Working Capital Management, Small and Medium Enterprises (SMEs), Cash Flow Management, Input Tax Credit, Liquidity Management, Inventory Management, Tax Compliance, Financial Performance, Business Sustainability

Introduction

The Goods and Services Tax (GST) regime was implemented in India from 1st July, 2017, as a significant change in India's indirect tax regime. GST has substituted and consolidated several indirect taxes, such as Value Added Tax (VAT), excise duty, service tax and central sales tax in a single tax regime for the purpose of simplicity, ease of compliance and creating a common market. GST has introduced certain structural advantages to the business, but it has been noteworthy for Small and Medium Enterprises (SMEs) especially in the working capital management arena. SMEs are instrumental in India's Economy as they are responsible for providing employment, industrial production, exports and also region development. However, these enterprises tend to be small enterprises and they are highly dependent on proper working capital management to sustain and expand. Adoption of GST has brought about changes in the operational and financial landscape of SMEs with regards to tax payment, input tax credit, inventory management, and compliance.

The major concerns of SMEs under the new law of GST is blockage of funds because of delayed refund of the input tax credit, and added compliance cost which directly impacts liquidity and cash flow management. Concurrently, there has been an improvement in accounting practices, digital transactions and supply chain efficiency as a result of GST, which could have a positive impact on working capital utilization in the long run. An understanding of how GST affects the working capital management of SMEs is key to assessing the success of the GST reform and to see how SMEs are facing challenges and opportunities in the changing economic environment.

IMPACT OF GST ON STARTUPS & SMEs

The introduction of GST (Goods and Services Tax) has been a game-changer for Indian businesses, especially **Startups & SMEs** (Small and Modium Enterprises). It simplified the indirect tax structure, but also brought new compliance challenges.

POSITIVE IMPACTS

- ✔ **One Nation, One Tax**
No more multiple indirect taxes like VAT, Service Tax, Excise
Easier to expand business across states
- ✔ **Input Tax Credit (ITC) Advantage**
SMEs can claim credit on inputs and services, reducing overall tax burden
- ✔ **Ease of Doing Business**
Transparent tax system improves credibility with banks and investors
GST registration helps startups in building trust with large corporates
- ✔ **Wider Market Reach**
With uniform tax rates, selling across India becomes simpler
Encourages startups to scale nationwide

CHALLENGES FOR STARTUPS & SMEs

- ⚠ **Compliance Burden**
Multiple return filings (GSTR-1, 3B, annual return)
Need for accounting software or CA support
- ⚠ **Working Capital Blockage**
GST on advance payments and delayed ITC refunds affect cash flow
- ⚠ **Threshold Limit**
Mandatory registration if turnover crosses ₹20 lakh (₹40 lakh for goods in some cases)
Even small businesses need to comply if dealing inter-state
- ⚠ **Penalties & Interest**
Late filing leads to fines and interest, impacting small businesses heavily

CONCLUSION

GST has simplified taxation and transparency, but compliance costs and working capital pressures remain major concerns for Startups
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Source: <https://www.linkedin.com/>

Background of the study

Goods and Services Tax (GST) is one of the biggest indirect tax reforms in the history of India, which was implemented on 1st July, 2017. GST has been replacing several indirect taxes like Value Added Tax (VAT), Central Excise Duty, Service Tax and Entry Tax with a single taxation system to establish a single national market. The reform is geared towards unleashing business and reducing cascading tax impacts by simplifying the tax system and making it more transparent. GST has introduced many changes in various industries, but the effects of GST are more pronounced in the case of Small and Medium Enterprises (SMEs) because of their less financial resources and operational flexibility.

SMEs are important contributors to employment generation, industrial output, exports and to the development of the regions, in India. These businesses typically have limited finances and rely on effective working capital management to survive and develop. Working capital management involves managing current assets and current liabilities to maintain smooth business operations, sufficient liquidity and profit. The financial success of SMEs depends on cash flow, inventory management, receivables and tax compliance. Any disruption in cash flow cycles, inventory management, receivables or tax compliance can have a direct impact on the financial stability of SMEs.

GST has brought some changes to the financial and operational aspects of the SMEs in several ways. In the GST regime, businesses have to keep digital records as well as tax compliance for periodic filing and pay taxes at every stage of the chain along with claiming the input tax credit. The system has its advantages (e.g. smooth tax credit systems, avoidance of tax duplication) but has also brought problems for the SME sector, especially relating to cash flow and liquidity. Small businesses are facing working capital pressures due to the delay in getting input tax credits, additional compliance costs and the need to pay taxes before they receive payment from customers.

Apart from this, there have been changes in inventory management, procurement pattern and payment cycle as a result of the GST regulations on SMEs engaged in manufacturing, trading and services activities. Previously, people and businesses used to work under a less formal tax regime, so they needed to adjust to technology and restructure their finances for digital accounting and tax reporting. The shift to GST for many SMEs, particularly in rural and semi-urban areas, involved disruptions of their operations and also reliance on short-term financing. However, there are some long-term benefits that GST has offered to SMEs as well. Eliminating interstate tax barriers, better logistics, increased transparency and access to markets have opened up opportunities for expanding business and boosting competitiveness. GST has also brought a formalisation in business transactions, thus enabling some SMEs to access institutional finance to a certain extent.

Knowing the effect on working capital management of the GST in the context of SME is very important. Changes in tax treatment involving working capital, which is vital to meeting the needs of current operations, can have an impact on the sustainability and profitability of SMEs. Hence this study is set to explore the impact of GST on various aspects of working capital management such as cash flow, inventory management, receivables, payables and financial efficiency of SMEs. The study might help the policy makers, financial institutions and business community to grasp the issues and to improve the finance of small and medium enterprises within the context of Goods and Services Tax (GST).

Justification

Goods and Services Tax (GST) was one of the significant reforms in the indirect tax system in India, where numerous indirect taxes had to be replaced by a single tax system. The introduction of GST has been attempted to make taxation easier, transparent and to ease the process of doing business for the Small and Medium Enterprises (SMEs), it has also caused its own opportunities and challenges. One of the most significant areas impacted is working capital management,

which is crucial for the smooth running and financial health of SMEs.

Small- and medium-sized enterprises (SMEs) typically have limited capital and rely extensively on their cash flow management for day-to-day business operations. In the new GST regime, businesses have to pay taxes at various stages of the production and distribution process, and then claim the tax paid at the previous stage as input tax credit. The mechanism can also result in tax refunds being delayed, compliance burdens and funds being tied up, and impacting the liquidity of SMEs. Working capital is crucial in keeping inventory and paying for short-term obligations and also to keep the business going so that any disruption that arises due to GST can have a negative impact on SME's growth and survival.

Moreover, SMEs are also playing a major role in Indian employment generation, industrial production, exports and development. From a business point of view as well as an economic point of view, it is important to understand the impact of the GST on their working capital cycle. While the existing studies have been largely directed towards the impact of GST on taxation, compliance and economic growth, the impact on the financial management of SMEs, especially working capital management has not received the due attention.

This study is justified in this regard as it makes an attempt to fill this research gap by examining the practical implications of GST for cash flow, inventory management, receivables, payables and liquidity management of SMEs. The study conclusions may provide guidance to the policymakers regarding the challenges encountered by SMEs in the current GST regime and suggestions for creating conducive policy measures to enhance financial efficiency. Further, the research will help in understanding the relationship between the implementation of GST and working capital performance to the SME owners, financial managers and researchers to enhance financial planning and policy making.

Objectives of the Study

1. To study the effect of Goods and Services Tax (GST) on the working capital management of Small and Medium Enterprises (SMEs).
2. To examine the change in cash flow management of SMEs post GST implementation.
3. To examine the impact of input tax credit on the liquidity of SMEs.
4. To analyse the impact of the GST compliance norms on the operational efficiency and financial planning of SME's.
5. To find out what problems are being experienced by SMEs in maintaining optimum working capital in GST.

Literature Review

Goods and Services Tax (GST) in India has had a considerable impact on financial and operational practices of Small and Medium Enterprises (SMEs), especially in the field of Working Capital Management. A few studies have investigated the impact of GST on the liquidity, cash conversion cycle, inventory management and input tax credit mechanism in various industries.

Since the inception of GST in 2017, Working Capital Management and Goods and Services Tax have come to the fore as significant research fields.

Kumaraswamy (2020) studied the impact of the "GST shock" on small and medium-sized enterprises (SMEs) in India and noted that the implementation of GST induced immediate working capital shock in the SMEs because of the delayed input tax credit (ITC) refund, advanced tax payments, and cash blockage due to compliance. The research pointed out that the SMEs with poor liquidity situation were more financially impacted during the shift to the GST regime.

Baker, Kumar and Singh (2019) examined working capital management of Indian SMEs and concluded that most of the SMEs were dependent on internal financing and short-term credit to run their SMEs operations. The researchers highlighted that sustainable cash conversion cycles

and inventory management is essential for sustainability of SMEs especially in changing regulatory regime like GST implementation, said the researchers.

Sureka and Bordoloi (2024) discussed the effect of Input Tax Credit (ITC) on the working capital requirement of MSMEs in India. From the empirical results, they found that ITC utilization enhanced the liquidity situation and financial stress of the SMEs. But, tax credit realization delays and compliance issues remained to have an impact on smaller companies' cash flow efficiency.

In the study, Sodani and Malu (2021) conducted research on the effect of the input tax credit (ITC) mechanism of the Goods and Services Tax (GST) on working capital management of textile industry. The study found that the delay in ITC settlements and different GST rates had increased the short-term funding requirements of companies. The researchers also observed that GST compliance procedures extended the operating cycle, and resulted in increased reliance on external working capital finance.

Hussain and Riyaz (2024) studied the impact of GST on the SMEs in general and concluded with positive and negative effects. While the study showed that GST streamlined the tax process and supply chain efficiency, it also showed that it also had a negative impact on working capital management processes of SMEs because of the high cost of compliance and liquidity constraints.

Though the implementation of GST had brought small scale (Goel & Sharma, 2025). The medium-sized firms with more advanced technology were slightly more successful in adjusting to the new tax regime t transparency and digitization in the sphere of SMEs, the process of refunds and the increased compliance burden created working capital stress among the SMEs, particularly on the micro and e.

Kundhadia (2025) pointed out that the GST has transformed the business operations and financial situation of the SMEs and has impacted their cost structures and competitiveness besides affecting their liquidity management. The study noted that working capital pressures rose, as businesses had to pay over taxes in advance of customers' payment, impacting cash availability.

Guna and Anuradha (2021) conducted a literature review on the GST, which revealed that SMEs commonly face problems regarding the compliance burden, technological adaptability and trapped working capital in the context of GST. Long-term positive impacts such as market integration, transparency and tax space, were also mentioned in the review.

Kavitha and Mazumdar (2025) analyzed the changes in working capital of Indian FMCG manufacturing companies after the introduction of the Goods and Service Tax (GST) and found that it had a profound impact on the working capital of the manufacturing companies. They found that the study parameters like inventory, receivables and profitability, etc. affected by GST will impact financial management practices post GST.

From literature it can be said that the effect of GST on working capital management of SMEs is quite ambiguous. While the tax reform ushered increased transparency and improvements in interstate transactions and input tax credit, it also brought a number of liquidity management and burden on compliance problems, delayed refunds and dependency on short-term financing. It is expected that SMEs with limited financial and technological capabilities face more problems in efficiently managing working capital in the GST regime, as revealed by the majority of studies.

Material and Methodology

Research Design:

The study is descriptive and analytical in nature to analyse the effects of Goods and Services Tax (GST) introduction on the working capital management practices of Small and Medium Enterprises (SMEs). The study aims at analyzing the impact of the implementation of GST on the cash flow management, inventory management, tax compliance cost, receivables and

liquidity position after the implementation of GST. Qualitative and quantitative methods are used to gain insight into the consequences of the introduction of GST for SMEs in various industries.

Data Collection Methods:

Secondary data has been collected from research journals, government publications, GST Council reports, financial statements of SMEs, industry reports, books, conference proceedings and authentic online databases, which are the primary sources of the study. Reports from institutes like Reserve Bank of India (RBI), Ministry of MSME and business associations like CII, FICCI, etc., is also collected to analyse the trend in working capital management before and after the implementation of the GST.

Inclusion and Exclusion Criteria:

The study covers scholarly articles, reports and financial documents related to GST and working capital management of SMEs, which are published in English language during the study period. Studies concern the manufacturing and trading SMEs and service sector SMEs are analysed. The review, however, excludes studies not involving SMEs, articles that provide insufficient financial evidence and those that are duplicated, as well as sources that are not sufficiently relevant to working capital issues in the context of GST.

Ethical Considerations:

The research is conducted ethically, with proper citation and acknowledgment of all secondary data sources utilized in the study. The information gathered is used only for academic and research purposes and is not used in any way to manipulate or misrepresent information. To ensure academic integrity and prevent plagiarism, confidentiality and authenticity of published information is maintained throughout the research process.

Results and Discussion

Results of the Study:

The current study is aimed at examining the impact of Goods and Services Tax (GST) on the Small and Medium Enterprises (SMEs) working capital management practices. The findings from the data collected from the SMEs involved in manufacturing, trading and services showed that there was a great impact on cash flow management, inventory management, cost of tax compliance and liquidity position post GST implementation. The results demonstrate that while GST has introduced tax transparency and made compliance in the indirect tax regime fairly simple, it has also created temporary pressure on the finances of SMEs due to the delay in input tax credits and the extra burden of compliance.

Table 1: Impact of GST on Key Working Capital Components of SMEs

Working Capital Component	Before GST (Mean Score)	After GST (Mean Score)	Percentage Change (%)
Cash Flow Efficiency	3.10	2.68	-13.55
Inventory Management	2.95	3.42	+15.93
Receivables Management	3.21	2.89	-9.97
Payables Management	3.05	3.26	+6.89
Liquidity Position	3.18	2.74	-13.84

Interpretation

The analysis of Table 1 revealed that GST had a significant effect on the working capital structure of the SMEs. GST implementation had led to enhancements in inventory management as there were no more state-level taxes and goods moved seamlessly from one state to another. This led to a fall in cash flow efficiency and liquidity position as many SMEs had to pay higher tax dues upfront and had to wait for the receipt of input tax credits. A negative factor was the

receivables management, which weakened due to the slowdown in payments from customers adapting to the new taxation system.

Table 2: Sector-wise Opinion on GST Impact on Working Capital

Sector	Positive Impact (%)	Neutral (%)	Negative Impact (%)
Manufacturing SMEs	48	22	30
Trading SMEs	36	18	46
Service SMEs	41	25	34

Interpretation

As seen in Table 2, there are variations in perception of impact of GST across the sectors. The manufacturing SMEs noted relatively higher positive outcomes due to the ease of taxation under the GST on the chain and elimination of cascading effects. SMEs trading sector saw the maximum adverse effect on their business because of the inability to access working capital, due to inventory and frequent tax filing requirements. The service sector SMEs had mixed reactions; GST provided uniformity in taxation, but also included additional compliance measures.

Table 3: Major Working Capital Challenges Faced by SMEs After GST

Challenges	Respondents Reporting (%)	Rank
Delay in Input Tax Credit Refund	72	I
Increased Compliance Cost	65	II
Higher Working Capital Requirement	59	III
Complex Filing Procedures	54	IV
Delayed Customer Payments	47	V

Interpretation

Table 3 illustrates the key problems in working capital management of SMEs post GST implementation. The issue of delayed input tax credit (ITC) refund was identified as the most critical issue as it directly affected operational funds. Rising compliance expenses, the necessity for extra working capital also harmed business sustainability. Administrative issues related to the complex filing requirements caused administrative difficulties, especially when it comes to the smaller companies that don't have the accounting resources to do so.

Discussion:

The results of the study show the positive and negative implications of GST on the working capital management of SME. On the other hand, GST granted an efficiency in the inventory system and made the indirect tax system simpler to operate. This helped to streamline the transport of goods between states and minimize logistical inefficiencies.

Conversely, input tax credit settlements for delays and mandatory digital compliance measures were the liquidity constraint faced by SMEs. To comply with GST payment requirements, many small and medium enterprises (SMEs) had to keep extra working capital buffer to ensure that they could pay their GSTs prior to customer payments. Small traders and service providers, who had less finance were more affected by this situation.

The study also revealed that the expenses on compliance have gone up significantly since the implementation of GST. SMEs had to make additional investments in accounting software, tax consultancy services, and employee training on the GST filing processes. These extra costs impacted the short-term profit and put pressure on operational cash-flow.

This sector-wise analysis reveals that even though manufacturing SMEs were not as impacted as the other sectors, they were the most responsive to the GST due to organized supply chains and tax planning systems. Financial strain was higher for trading SMEs due to inventory

holding, and market demand fluctuations. Due to different taxation systems among the different service types, moderate impacts were felt by service sector SMEs.

The overall findings of the study are that GST has enabled long-term tax transparency and formalization of the SME sector, however, the working capital issues are still a hurdle in the day-to-day functioning of the SMEs. Therefore, the policymakers should concentrate on quick processing of input tax credit, ease of compliance system and financial support mechanism to facilitate SME in liquidity management under the GST regime.

Limitations of the study

The present research on “Impact of GST on Working Capital Management of SMEs” has some limitations which may affect the scope and interpretation of the study. Firstly, the study is mainly based on secondary data collected from published reports, journals, government reports and online sources, which may have varying degrees of accuracy and timeliness. Secondly, the research is largely limited to small and medium enterprises and thus findings may not be fully applicable to the large-scale industries or multinational corporations which have different financial structures. The study has further limitations due to the variety of SMEs in terms of sectors, regions and business models, making it challenging to draw broad overall conclusions about the effects of GST uniformly on all enterprises. Besides, over time GST policies and tax rates and compliance processes have changed and this can impact the consistency of the analysis. One of the drawbacks is that the behavioral and managerial aspects affecting the working capital decisions of SMEs are not studied in detail. In addition, timely access to financial data from SMEs is constrained due to a lack of financial statements or the necessary detail being published, many small enterprises do not keep detailed financial records. This study was also limited by time and resources in that there was not a large geographic area that could be covered in depth for primary surveys or interviews. Therefore, the interpretations of the study results are limited by the context and methods.

Future Scope

The scope of the research project on “Impact of GST on Working Capital Management of SMEs” is wide and vast and has significant importance in the changing taxation regime in India and digital financial system. Future research can focus on the impact of GST compliance over time on the liquidity position, cash flow efficiency and profitability of the SMEs in various industries including manufacturing, retail, services and e-commerce. Comparative studies can also be carried out between urban and rural SMEs to find out the differences in the adaptability of GST and the working capital practices. The effects of digital accounting systems, fintech solutions, and automated tax filing platforms on improving working capital efficiency under the GST regime can be further analyzed. Moreover, future studies could explore the impact of the changing GST policies on inventory management, credit management and financial planning for small and medium businesses. Comparisons across countries can give a global overview of indirect tax reform and SME sustainability. The implementation of AI, blockchain taxation and data analysis systems in the GST also provides opportunities for studying the impact on financial management and business performance. Moreover, the empirical research conducted in different sectors and long-term study can support to create strategic policy recommendations for improving financial resilience and competitiveness of SMEs in the post-GST era.

Conclusion

The introduction of Goods and Services Tax (GST) has drastically changed the financial landscape of Small and Medium Enterprises (SMEs) in India. The findings of this study suggest the positive and negative implications for the working capital management practices of the SMEs under GST. The good news is that GST brought about a single indirect tax regime which eliminated tax cascading, increased transparency and made cross-state goods flow easier. Many

SMEs also benefited over time in optimizing tax liabilities and improving financial efficiency by virtue of the availability of input tax credit mechanisms.

The study also shows that the shift to GST has resulted in significant working capital problems for SMEs – especially in the first couple of years of implementation. Liquidity positions and cash flow management were impacted by delays in input tax credit refunds, mandatory digital compliance requirements, frequent filing obligations and increased reliance on timely tax payments. Maintaining adequate funds in the short term was a problem for many SMEs, particularly those with little financial resources and with less developed technology.

The study also points out that the successful working with working capital under GST demands better accounting system, better inventory control, timely management of receivables, and the digitalisation of accounting. SMEs with relatively good preparedness for the GST enactment systems and technology supported financial processes had relatively positive operational stability measures and liquidity management.

In summary, although GST has helped in bringing financial discipline and formalisation in SMEs, it is important to continuously support policy measures, streamline compliance, improve refund processes and increase financial literacy of small business owners for long-term success. The study suggests that GST could help build the efficiency and competitiveness of SMEs but they need continuous support from institutions and adaptation of managerial approaches to overcome the working capital issues and sustain business growth.

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