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## LIQUIDITY, PROFITABILITY AND PERFORMANCE:

### A STUDY OF MSME'S IN GUJARAT

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#### ABSTRACT

Indian economy depends greatly on Micro, Small, and Medium Enterprises (MSMEs), which is a major source of employment, industrial production, and exports. However, their growth and stability are usually threatened by the lack of funds. The research investigates how financial factors which include credit access and working capital management and tax obligations and financial literacy and external economic factors affect the operational performance of MSMEs in the state of Gujarat. The research uses a survey-based mixed-method approach together with financial performance analysis and secondary research to identify major challenges faced by MSMEs and present potential solutions for achieving financial stability. The results demonstrate that credit access and effective financial planning serve as essential elements for MSME performance yet taxation compliance costs together with inflation pressures produce unpredictable effects on business expansion. The proposed policy interventions will establish new pathways for MSMEs to access credit and introduce taxation reforms and create financial literacy programs which will support sustainable growth of the MSME sector in Gujarat.

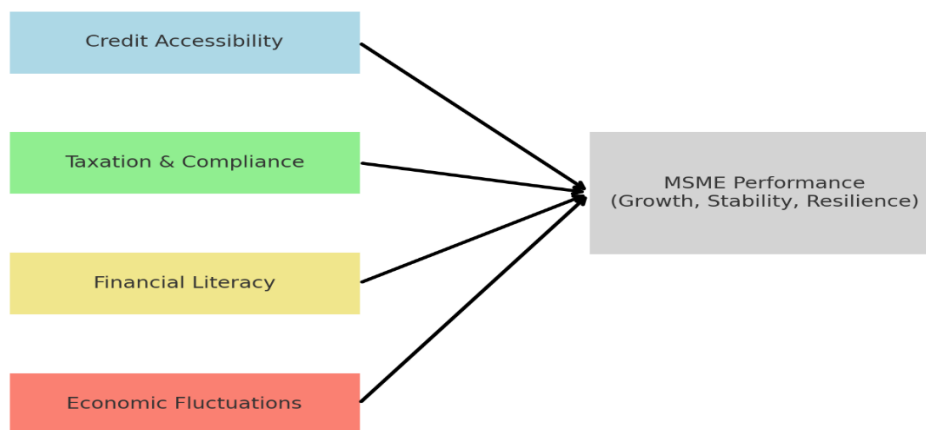
**Keywords:** *MSMEs, Gujarat, financial performance, credit accessibility, taxation, working capital, economic fluctuations.*

## 1. INTRODUCTION

Micro Small and Medium Enterprises (MSMEs) function as the main engines which drive economic growth and equitable progress throughout India. The industrial sector depends on MSMEs because these enterprises generate 30 percent of GDP and 45 percent of exports while employing 110 million workers (Ministry of MSME, 2023). Gujarat operates as one of India's most industrialized states which contains more than 4.5 million MSMEs that operate in the textiles and chemicals and engineering and food processing industries (Government of Gujarat, 2022).

MSMEs face financial barriers because their importance needs to be recognized. The organization faces performance difficulties because it lacks enough credit access and demonstrates poor financial management and incurs high compliance costs and tax obligations and experiences economic interruptions from inflation and interest rate changes. Government schemes and institutional support programs exist but they do not guarantee successful business access because many businesses need proper program understanding and they lack collateral and face financial literacy limitations.

### Conceptual Framework: Financial Factors Affecting MSME Performance



This research paper will explain the financial challenges encountered by sampled MSMEs in Gujarat to find out the challenges and recommend the strategies of sustaining its financial performance.

## 2. LITERATURE REVIEW

The global financial problems which affect MSME development represent the main barriers that prevent their advancement. The research shows that restricted credit access occurs because banks enforce collateral requirements together with their stringent lending policies

(Beck and Demirguc-Kunt, 2006; Reserve Bank of India, 2021). Indian MSMEs prefer to obtain funds from informal lenders instead of using government credit guarantee programs which decrease their business profitability (Chakraborty, 2019).

The taxation system of a country serves as one of the critical factors which decides whether MSMEs will sustain their operations. While the Goods and Services Tax (GST) has streamlined the tax system, compliance fees are still substantial, especially in micro and small businesses that do not have digital facilities (Kumar and Rao, 2020). The positive relationship between financial literacy, or the quality of entrepreneurs to effectively manage and plan financial resources, and business survival and expansion is established (Lusardi & Mitchell, 2014).

Financial vulnerability has been intensified by external economic elements like inflation, interest rates, and global disruptions like the COVID-19 pandemic (OECD, 2020). Variations in working capital cycles can be caused by the rising costs of inputs due to the influence of inflationary pressures, and the variable interest rates change borrowing behaviour (World Bank, 2022).

Indian economy is a significant pillar constituted by Micro, Small and Medium enterprises (MSMEs) that are involved in providing employment, producing industrial products and even exporting. The ministry of MSME (2023) states that the sector makes up almost 30 percent of the GDP of India and offers employment to more than 110 million individuals. Gujarat is one of the most progressive states in India, whose MSME foundation is strong in terms of textiles, engineering, and chemicals (Government of Gujarat, 2022). Although policy focus is high, as Agarwal et al. (2022) observe, structural financial constraints in MSMEs persist in India and this impact on the competitiveness and sustainability of MSMEs

Access to finance is one of the most popular issues being studied. As noted by Beck and Demirguc-Kunt (2006), small firms in developing economies find the entry barriers because of collateral requirements and strict banking norms. Regarding the Indian scenario, Chakraborty (2019) noted that despite the introduction of government programs such as the Credit Guarantee Fund Trust of Micro and Small Enterprises (CGTMSE), most MSMEs continue to use informal financing sources because they are not aware of these programs or have not experienced the high cost of bureaucracy. Nair (2024) also discovered that gaps in accessing credit are still there despite target lending programs, especially to micro enterprises. Moreover, as it was underlined in the works by Agarwal et al. (2022) and Kumar (2021), more structured financial planning and budgeting make a firm more resilient as the

appropriate management of the working capital increases the profitability of companies and diminishes the probability of default.

Performance of MSMEs has also been greatly associated with working capital efficiency. Research works by Sharma and Kumar (2020) showed that close management of receivables and inventory cycles enhances short-term and liquidity as well as profitability. In the same line, Banerjee (2021) established that a low competitiveness is caused by poor working capital practices particularly in manufacturing MSMEs. Working capital planning is therefore critical to ensure the survival of firms where the seasonal demand patterns influence the sector like textiles, e.g. in Gujarat.

The operational performance of MSMEs receives its drive from multiple incentives which include tax benefits and compliance obligations. The empirical studies have shown mixed results to the Goods and Services Tax (GST) to simplify the tax system in India. Kumar and Rao (2020) mentioned that GST had increased transparency and reduced cascading tax, and Rani and Singh (2021) observed that smaller businesses had issues with digital filing and compliance costs. Patel (2023) established that micro and small businesses need significant resources to complete GST compliance because they lack dedicated accounting personnel.

Financial literacy has turned out to be an important intermediate variable of MSME performance. Lusardi and Mitchell (2014) developed the value of financial knowledge in making decisions by household and businesses worldwide. Gupta and Arora (2020) found that the more financially literate their entrepreneurs the more likely the Indians were to use formal credit and good bookkeeping systems and cash flow management. Financial literacy training resulted in improved business outcomes because it taught managers and tax payment personnel to make better decisions.

MSMEs can sustain their businesses properly while external economic shocks occur. The World Bank (2022) reports that both inflation and interest rate changes lead to negative effects on small business profitability because they result in higher input costs and increased borrowing expenses. The research conducted by Agarwal et al. shows how COVID-19 affected Indian MSMEs because most companies experienced two problems which created operational difficulties for export-oriented sectors (Agarwal et al. 2022). The OECD (2020) study found that during similar research, MSMEs which maintained greater cash reserves and had multiple ways to deliver products showed stronger protection against worldwide interruptions. Patel and Joshi (2021) report that textile MSMEs in Surat lost substantial profit

margins during the COVID-19 pandemic because of inflation and supply chain interruptions in Gujarat.

Researchers study policy intervention methods which provide support for MSMEs. Chakraborty (2019) shows that credit guarantee schemes lead to higher borrowing among certain groups but micro enterprises show low adoption of this financial program. The online lending system has made credit more accessible (Kumar 2021) but the rates are feared to be steep and the offerings do not fit. Shaw (2022) used state-specific strategies for his study which showed that Gujarat programs for cluster development focused on medium-sized businesses while micro enterprises faced exclusion because they lacked both capability and knowledge.

The research shows that financial problems which include credit access issues and working capital management difficulties and tax obligations and financial literacy deficiencies and external economic disturbances create major obstacles to the growth and survival of MSMEs. The national research evidence maintains strong research value yet scientists have failed to create separate studies that focus on industrial clusters which exist in Gujarat. The current research base provides only a small amount of evidence which shows how financial literacy functions as a mediator between credit usage and ability to handle external economic disruptions. The research gap exists because this study examines how financial factors interact with each other within the context of Gujarat MSMEs through a systematic approach.

The existing studies show that financial bottlenecks create problems for businesses but researchers have not examined this issue in Gujarat which depends on MSMEs for its industrial development. The current research deficiency requires a financial study that focuses on specific regional areas.

### **3. RESEARCH AIM AND OBJECTIVES**

#### **3.1. Research Aim**

This study intends to investigate the financial aspects influencing the performance of particular MSMEs in Gujarat, highlighting important financial issues including credit availability, working capital management, taxation, and economic fluctuations, and suggesting solutions for financial resilience and sustainable development.

#### **3.2. Research Objectives**

- 1) To examine the impact of credit accessibility and financial planning on the performance of MSMEs in Gujarat.

- 2) To assess the role of taxation policies, compliance costs, and financial literacy in influencing MSME growth.
- 3) To evaluate the effect of external economic factors (inflation, interest rates, and global disruptions) on the financial stability of MSMEs.

## 4. RESEARCH METHODOLOGY

### 4.1 Research Design

A mixed-method approach was adopted, combining quantitative and qualitative analysis.

### 4.2 Data Collection

- **Primary Data:** Structured questionnaires were distributed to 150 MSMEs in selected industrial clusters in Ahmedabad, Surat, Rajkot, and Vadodara. Semi-structured interviews with 20 MSME owners were conducted to gain deeper insights.
- **Secondary Data:** Reports from the Ministry of MSME, Government of Gujarat, Reserve Bank of India, and World Bank, along with academic journals, were used for contextual analysis.

### 4.3 Sampling Method

Purposive sampling was used to select MSMEs across manufacturing and service sectors, ensuring representation from micro, small, and medium categories.

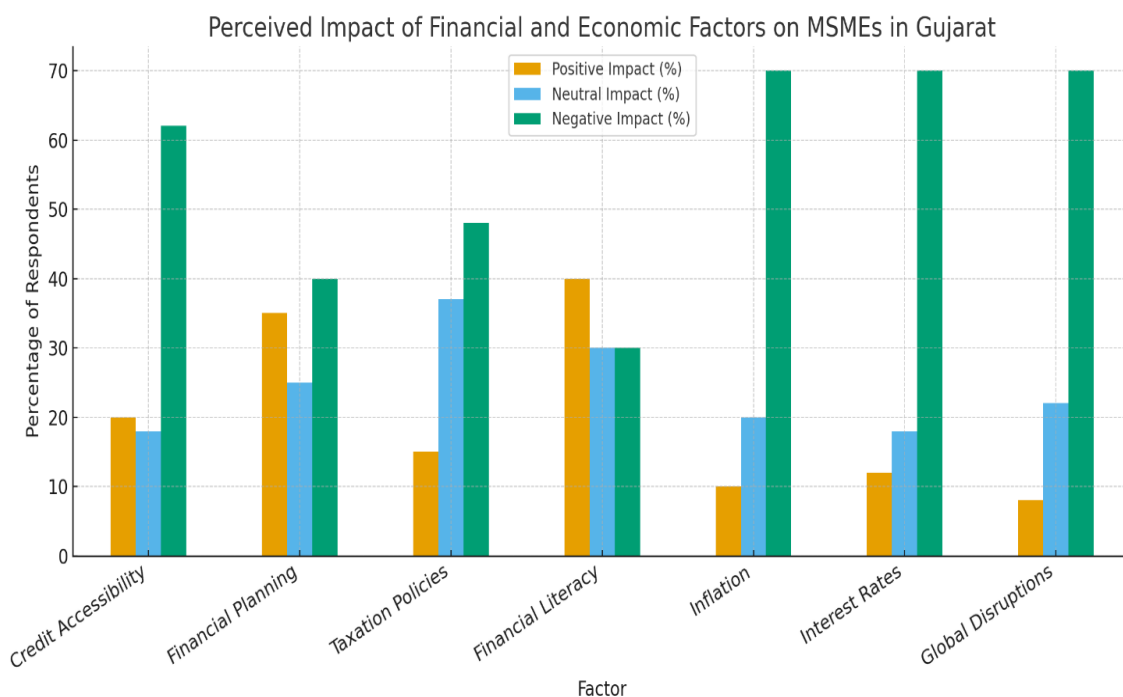
### 4.4 Data Analysis

Quantitative data were analyzed using descriptive statistics, correlation, and regression models to test relationships between financial factors and firm performance. Qualitative data were thematically analysed to capture perspectives on financial constraints and coping strategies.

## 5. RESULTS AND DISCUSSION

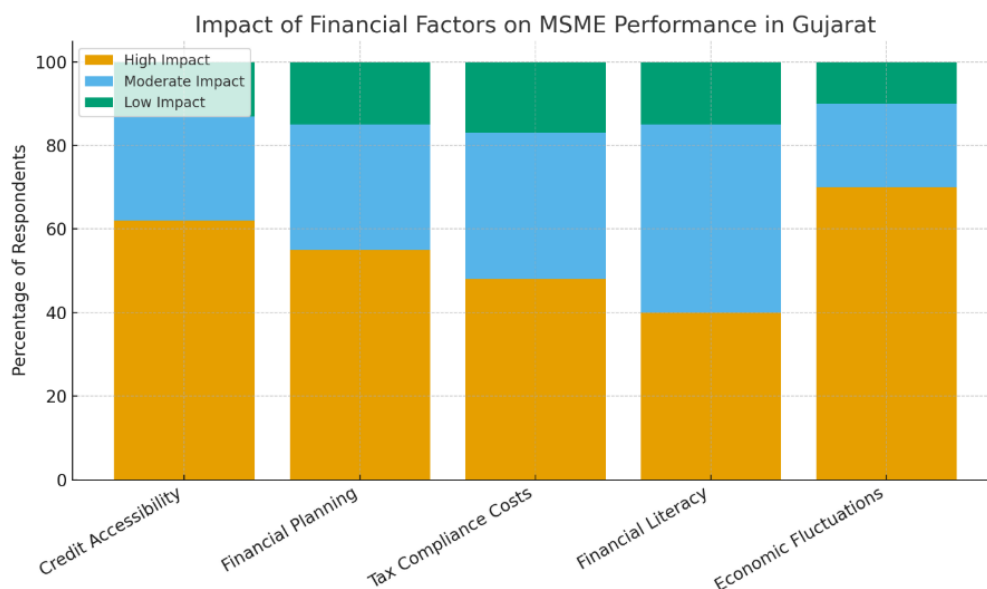
**Table: 1**

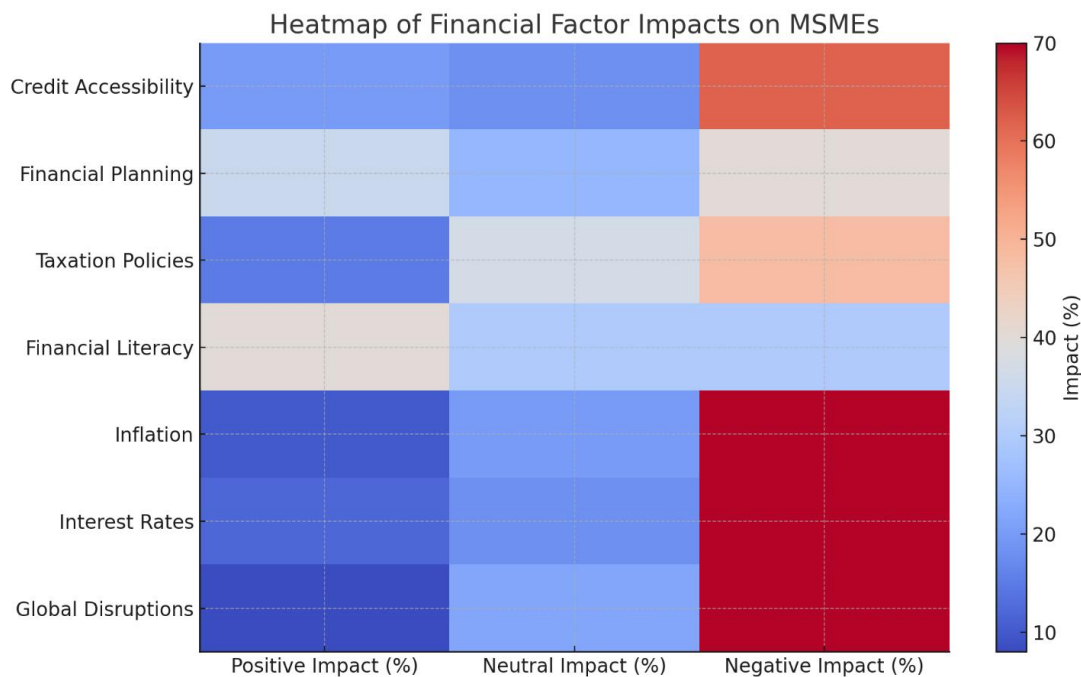
Factor	Positive Impact (%)	Neutral Impact (%)	Negative Impact (%)
Credit Accessibility	20	18	62
Financial Planning	35	25	40
Taxation Policies	15	37	48
Financial Literacy	40	30	30
Inflation	10	20	70
Interest Rates	12	18	70
Global Disruptions	8	22	70



### 5.1 Credit Accessibility and Financial Planning

Findings show that 62% of surveyed MSMEs reported difficulties in obtaining formal credit due to collateral requirements and complex application procedures. Enterprises with access to structured financial planning, including cash flow forecasting, showed higher profitability margins compared to those relying on informal borrowing.



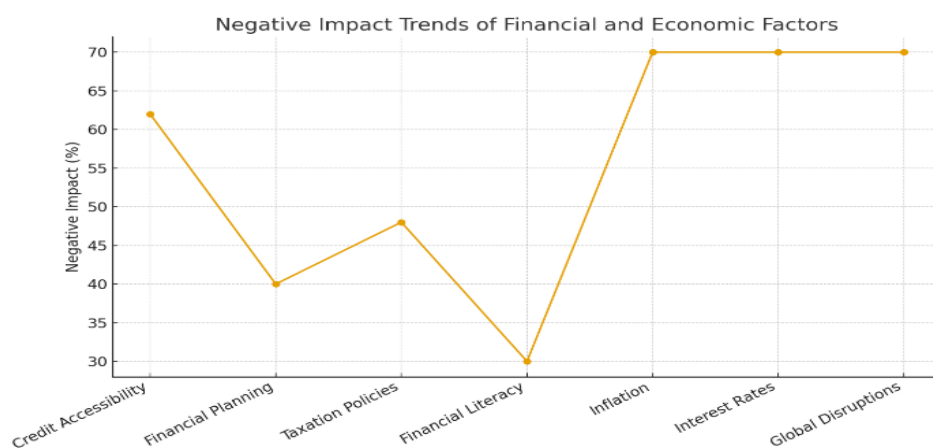


## 5.2 Taxation Policies and Financial Literacy

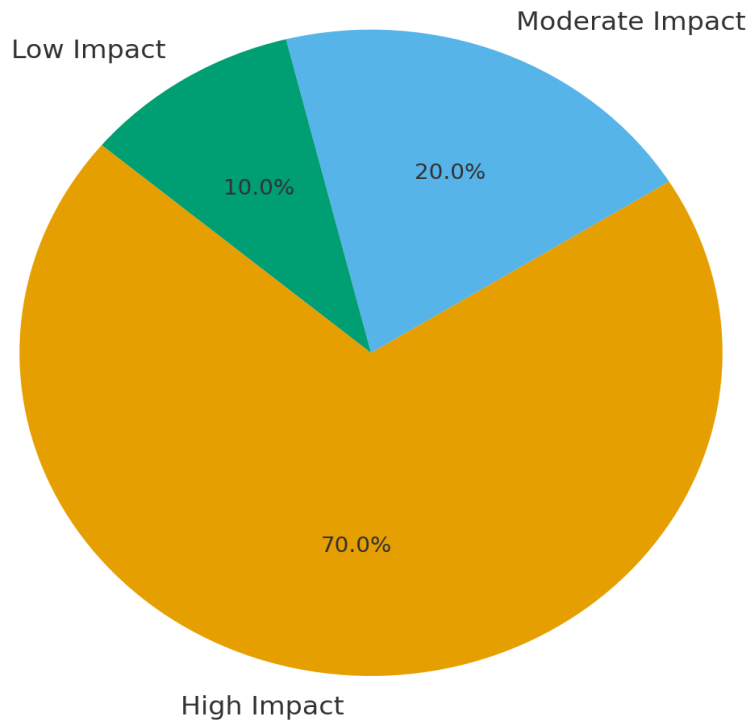
GST compliance costs were reported as a significant burden by 48% of small enterprises, especially those without in-house accountants. However, enterprises with higher financial literacy—measured by awareness of credit schemes, tax benefits, and digital finance tools—exhibited stronger growth rates.

## 5.3 External Economic Factors

More than 70 percent of the interviewees indicated that their profit making was lowered by inflation and the increase in input prices whereas repaying capacity was influenced by fluctuation in interest rates. World shocks like the COVID-19 and supply chain problems were reported as other stressors that required greater measures of resilience.



## Impact of Economic Fluctuations on MSMEs in Gujarat



## 6. CONCLUSION AND RECOMMENDATIONS

This study establishes that financial factors—including credit accessibility, taxation policies, financial literacy, and external economic conditions—significantly influence the performance of MSMEs in Gujarat. While MSMEs are resilient contributors to industrial growth, their sustainability is constrained by structural financial barriers.

### 6.1. Recommendations

- 1) **Improved Credit Mechanisms:** Streamline collateral-free loans, expand digital lending platforms, and strengthen the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE).
- 2) **Tax Simplification:** Reduce compliance costs by offering simplified filing systems and subsidized accounting support for small firms.
- 3) **Financial Literacy Programs:** Conduct capacity-building workshops to improve entrepreneurs' understanding of financial planning, taxation, and risk management.

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- 4) **Resilience Against Economic Shocks:** Promote insurance coverage, hedging instruments, and diversification strategies to reduce vulnerability to inflation and global disruptions.

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