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GST Rate Cuts & Their Cash-Flow Impacts for the Pharmaceutical Industry

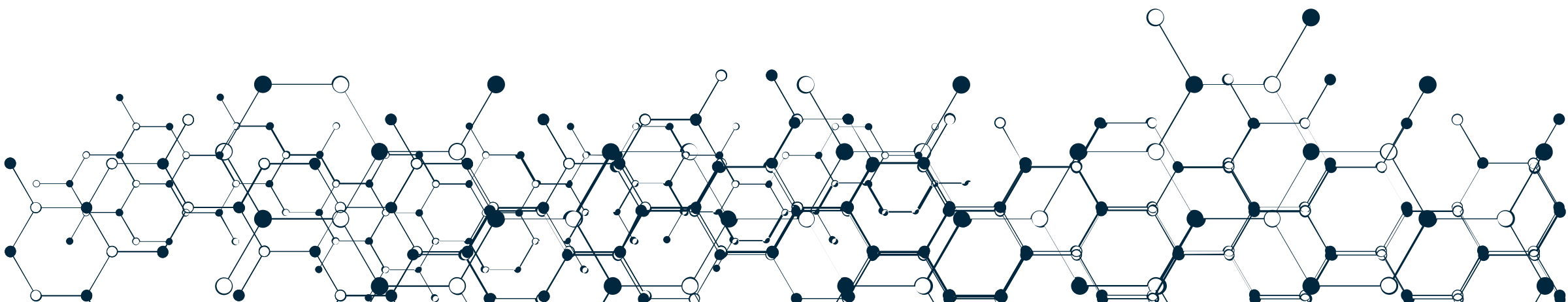
How GST rate reductions affect cash flow, why re-pricing & cash forecasting are critical, and how a Virtual CFO helps navigate the transition.

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Executive Summary

On 03 September 2025, the GST regime in India was revised. Most medicines and medical devices saw their GST reduced (notably many formulations moved to 5%), creating immediate pricing and compliance changes for the pharmaceutical sector. While lower GST rates reduce end-consumer prices, they also create input-output tax rate inversions for manufacturers whose raw materials and APIs continue to attract higher GST rates—this can cause significant input tax credit (ITC) accumulation, refund bottlenecks, and short-term cash-flow strain. This eBook explains every major cash-flow impact, outlines how to re-price and re-model costs, shows forecasting and transaction structuring remedies, and details risk mitigation strategies a Virtual CFO can implement.





POLICY

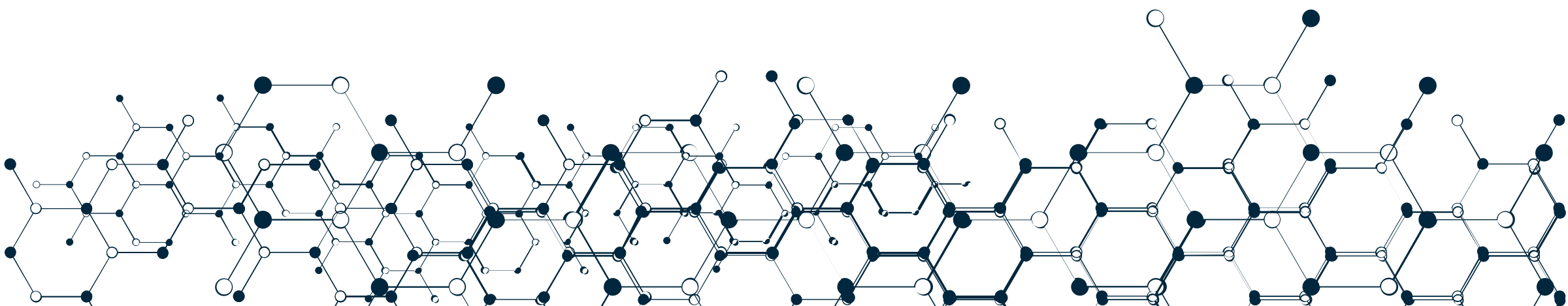
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The Policy Change: What Happened?

Effective Date: 22 September 2025.

What changed: GST rates on most medicines / drug formulations reduced (many items moved from 12%/18% to 5% / Nil); certain medical devices also moved to lower slabs. Government agencies (including NPPA) directed drugmakers to revise MRPs to pass on benefits.

Why this matters: Immediate requirement to re-price MRPs, update invoices and systems, adjust contracts with distributors, and manage the accounting/cash-flow consequences of an inverted duty structure (inputs taxed higher than outputs).



What “Rate Cut” Means Practically for Pharma Cash Flow

1. Lower collectable GST on sales → lower statutory tax liability, but also lower outward GST collected and remitted.
2. Higher ITC accumulation (rate inversion) → inputs [Active Pharmaceuticals Ingredients (APIs), Key Starting Materials (KSMs), services] may still attract 18% while finished goods attract 5% → ITC on inputs cannot be fully offset, leading to “blocked” credits or refunds waiting.
3. Refund bureaucracy & delays → refund claims for excess ITC may take time, creating working capital gaps.
4. Mandatory MRP revision / price pass-through → regulators (NPPA) require passing benefits to consumers; companies may have to cut MRPs and absorb margin changes until they restructure costs.

Net cash-flow effect: possible short-term negative cash shock (due to blocked credits and slower refunds) even as demand may increase over medium term due to lower consumer prices.





Key Takeaways by NPPA post Council meeting

- National Pharmaceutical Pricing Authority (NPPA) **mandates passing benefits** for medicines; non-compliance risks penalties and reputational damage. Plan the pass-through carefully while minimising cash pain using trade structuring.
- On 15 September 2025, NPPA issued an **order** under the Drugs (Prices Control) Order, 2013 (DPCO):
 - It **fixed MRPs** for several important combination drugs (for pain relief, diabetes, etc.), specifying the prices exclusive of GST.
 - NPPA clarified that manufacturers may add GST if payable, but **retail prices set are before GST**.
 - Manufacturer / marketer must **notify updated price lists** to NPPA, State Drug Controllers, and dealers through the Integrated Pharmaceutical Database Management System (IPDMS). Retailers/dealers must display the new MRPs prominently. Violations will lead to recovery of overcharged amounts + interest under the Essential Commodities Act.





Detailed Cash-Flow Impact Areas (Breakdown)

A. Margin Squeeze Due to Fixed MRPs

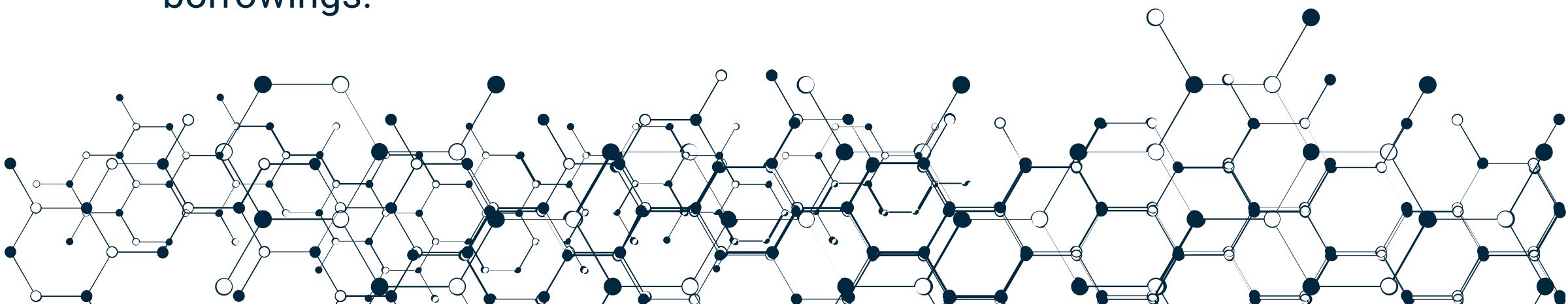
Since MRPs are now fixed before GST, manufacturers may have less flexibility to adjust final selling prices, especially if input costs (including those taxed at higher GST slabs) remain unchanged or increase.

B. Impact on GST-inclusive Pricing and Cash Collections

Though MRPs are exclusive of GST, GST still has to be collected (if payable). Invoices and billing systems must clearly show GST over and above the fixed MRP. Delays or errors in this may lead to disputes or non-compliance costs.

C. Working Capital Pressure:

Receivables cycle unchanged, but margins compress. Same receivable days but lower cash inflow. Slower refunds mean cash stuck in GST credit balances; companies must fund operations via internal cash or borrowings.





Detailed Cash-Flow Impact Areas (Breakdown)

D. Inventory Valuation & Transition Stock:

Stock produced or procured before 22nd Sep must be handled under transitional rules (credit notes, tax invoices). Transition stock revaluation and accounting adjustments create timing differences that affect cash;

E. Pricing & Distributor Margins:

Downward MRP revisions require renegotiation with distributors/retailers (who may request higher trade margins or compensation), causing short-term cash commitments.

F. Compliance & Systems Costs:

Updating ERP/tax engine, reprinting labels, relabelling inventory, and training distribution teams are direct cash outflows.

G. Cost Escalation for Inputs/Services:

Some input services (e.g., transport, job work, certain services) may attract higher GST under the new structure – increasing non-recoverable service costs and reducing available ITC.





Need for Re-pricing & Cost Model Review

When to Re-price: Immediately after regulatory notice and before dealers start selling as per new MRPs (NPPA required effect from 22 Sep 2025).

How to re-price properly:

1. **Map current MRP components:** base price, manufacturing cost, trade margin, GST, distribution charges;
2. **Recompute MRP** with new GST slab (5% vs prior 12%/18%);
3. **Forecast demand elasticity** (price drop → potential volume increase) and quantify net revenue change.

Why cost modelling is essential: Without accurate cost models you may either under-price (lose margin) or over-price (non-compliance/consumer backlash). Re-pricing must preserve cash viability while complying with NPPA directives.





Forecasting: How to Predict the Cash Impact

Key inputs to forecast:

- Expected change in MRP & estimated pass-through to consumers.
- Sales volume uplift/downturn estimates by SKU after price revision.
- Receivables days (DSO) and any change due to distributor negotiation.
- Expected timing of GST refunds (historic averages).
- Extra one-time transition costs (relabeling, IT updates).
- Financing costs if debt is required to bridge the gap.

Recommended outputs:

- Weekly net cash position;
- Cash runway;
- Breakeven price per SKU;
- Break-even point for absorbed margin scenarios.





Transaction Structuring to Reduce Cash Strain

- 1. Supply contract clauses:** renegotiate payment timings, consider staggered payments or early payment discounts, push certain costs upstream if possible.
- 2. Distributor agreements:** temporary support schemes (rebates vs. margin guarantee) to ensure retailers accept lower MRP and maintain distribution momentum without demanding extra cash.
- 3. Input procurement:** bulk buy discounts vs timing to avoid paying higher GST on inputs; consider supplier credits or deferred payment arrangements.
- 4. Service contracts:** assess if certain services (e.g., logistics) can be renegotiated or converted into pass-through reimbursables.

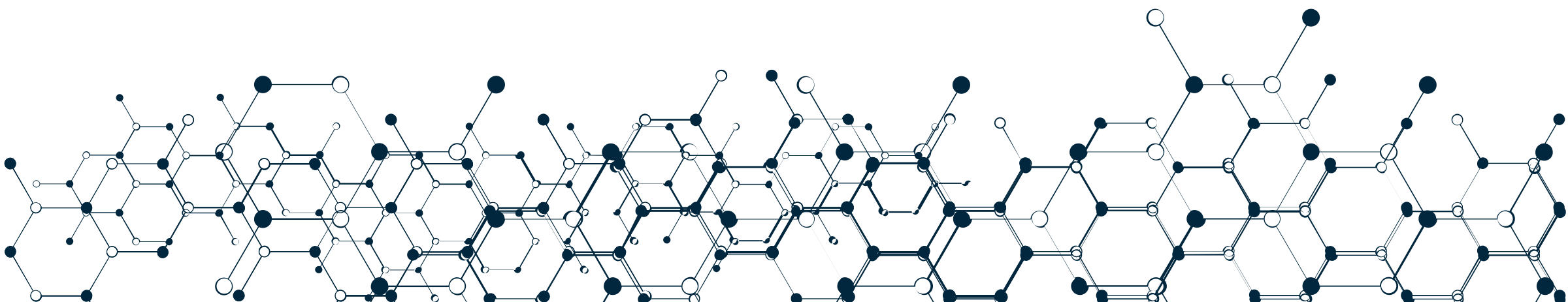
These structural changes preserve cash and distribute transition costs across supply chain partners instead of the manufacturer alone.





Managing ITC & Refunds

1. **Reconcile supplier invoices** immediately for ITC claims; **prioritize** clearing supplier discrepancies to avoid refund rejections.
2. **Segregate inputs:** (e.g. APIs taxed at 18% vs finished drugs at 5%) and prepare detailed mapping to support refund claims and legal positions.
3. **Prepare clean refund claims:** use accurate invoices, reconcile GSTR-2B / 2A mismatches proactively; pre-file due diligence to reduce queries.
4. **Tax credit planning:** determine whether to claim refunds or to use alternative mechanisms (e.g., transfer of ITC under prescribed rules, if available).
5. **Liaison with authorities:** maintain document trail and follow up proactively—refund timelines can be shortened with accurate submissions and representations.



Risk Mitigation Strategies (Four Pillars)

Pillar A – Liquidity Management:

- Maintain an emergency buffer (3 months fixed costs).
- Negotiate short-term working capital lines pegged to receivables or validated refund claims.

Pillar B – Operational Controls:

- Tighten receivables collection (credit policies, incentives for early payments).
- Reassess credit limits for distributors.

Pillar C – Legal & Compliance:

- Document MRP changes, maintain NPPA communications, and maintain compliance evidence to avoid penal consequences.

Pillar D – Strategic Hedging:

- Stagger purchases of APIs or use hedging contracts if global prices or forex impacts are material; explore supplier diversification.





Case Study (Hypothetical but Based on Industry Patterns)

Company: Mid-sized drug manufacturer (annual turnover ₹350 Cr)

Problem: New GST revision moved finished formulations to 5% while key APIs remained at 18%; refund backlog and distributors demanded compensation.

Intervention by Virtual CFO:

- Performed a 7-day Rapid Impact Assessment; identified ₹18 Cr short-term cash gap.
- Implemented rolling weekly cash forecast and negotiated short-term overdraft of ₹12 Cr against receivables.
- Introduced minimum order quantity to distributors, renegotiated payment terms with key suppliers, and ran an incentive program for early collections.
- Result (3 months): Cash runway stabilised, required borrowings minimized to ₹5 Cr, refunds processed for core SKUs, and MRP revision accepted across key distributors.



Thank You!



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