

# Demonetization and its Effect on Small and Medium Business Group

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**ABSTRACT:** Demonetization has negatively impacted job creation by hurting small and medium enterprises (SMEs). Demonetization is the act of stripping a currency unit of its status as legal tender. It is a process of removing a currency unit from general usage or circulation of money in a country. Demonetization is an act where the old unit of currency gets retired and replaced with a new currency unit. It can also be considered as withdrawal of a specific currency from market. The review is based on secondary data collected from different newspapers and online sources, mentioned in references. India's previously booming economy has now ground to a halt. All indicators sales, traders' incomes, production, and employment are down. Small producers, lacking capital to stay afloat, are already shutting down. India's huge number of daily wage workers can't find employers with the cash to pay them.

**KEYWORDS:** Demonetization, currency, market, small, medium, enterprises, employers, cash, traders, capital

## I. INTRODUCTION

Demonetisation - a move which was initially seen as a "masterstroke" in Indian political history that would have eliminated a parallel black economy in India, has rendered itself to be a volatile, fruitless and almost fatal for most MSMEs in the country. It has been a year of economic chaos after Prime Minister Narendra Modi's speech November 8, 2016 led the nation into uncharted water. What we have today at the end of the year is evidence about how agriculture, banking, budget were all affected by the move and also how it did nothing to curb the black economy or control terrorism. [1,2]



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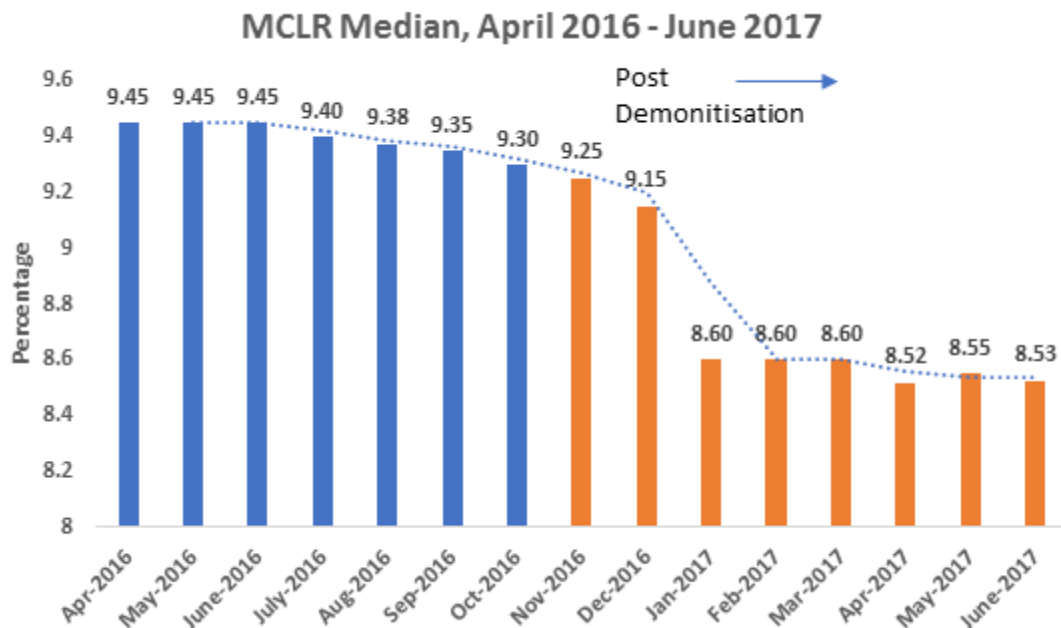
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The worst sufferers of this move, however, were the micro enterprises of the country. "While demonetisation brought many small industries closer to digitalisation, the micro industries had to go through an unstable phase. They were neither prepared for it, nor were they a part of the black economy to begin with. A dholwala at a wedding, a dhaba owner at the roadside, a plumber, or a daily wage earner - all of them earn in cash and are not familiar with credit cards, phone and net banking. Demonetisation brought a huge lull in their businesses." Estimates suggest SMEs in India constitutes 45% of the country's output and employs 60 million people. These businesses worth under Rs 10 crore in terms of investment in plant and machinery are mostly businesses run by families as a legacy. Most of their labour force is workers who have migrated from the interiors of the country to the cities. Coping with demonetisation was almost impossible for them.

Most of the workers in the micro industries went back to the villages. The bicycle industries in Ludhiana, the brass industry in Moradabad, the diamond industry in Surat, were all devastatingly impacted by demonetisation. Many such businesses shut down because there was no cash to pay the workers. About 1,000 units in Jamshedpur that operated as a small scale ancillary unit to big industries were closed. The unorganised sector consists 45% of GDP. According to the Indira Gandhi Institute of Development Research, sale of rice to rural mandis in the country had dropped to 61% and in many places winter crops last year could not even be sold because there was no cash to buy seeds.[3]

At the heart of the demonitisation was the penchant to convert the informal sector into the formal sector. In a speech in London this February, Finance Minister Arun Jaitley said "Demonetisation was a move to change the Indian normal... a new normal had to be created."



A predominantly cash economy has now to be substituted with a digital economy, which will bring more money into the banking system and lead to better revenue generation; the integration of the informal economy with the more formal

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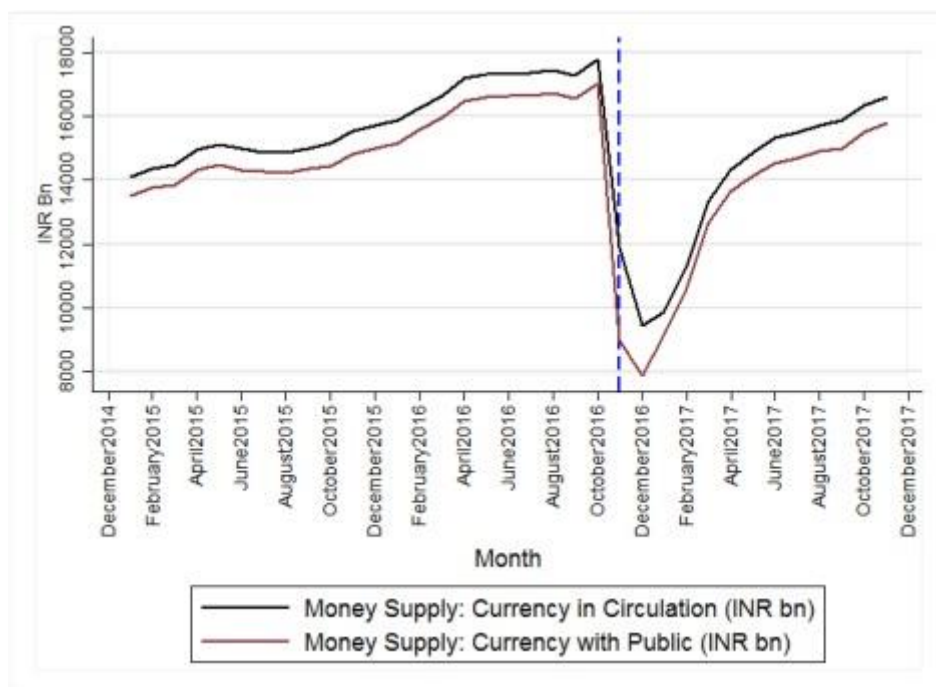
one is now taking place." According to International Labour Organization (ILO) some of the characteristic features of employment in the informal sector are lack of protection in the event of non-payment of wages, compulsory overtime or extra shifts, layoffs without notice or compensation, unsafe working conditions and the absence of social benefits such as pensions, sick pay and health insurance. It would then seem alright for the Finance Minister to want businesses to move from informal to the formal sector.

However, economics is rarely that simple and the informal sector may not be bad. There is evidence that suggest the informal sector is very important when it comes to riding out economic slowdown. When a slowdown strikes, the informal sector acts a cushion. The World Bank in one of its report has laid out the issue quite succinctly.

### III. DISCUSSION

SME sector witnessed slowdown post demonetisation, resulting in fall in production, wages and employment, according to a study by the India Development Foundation. However, there has been no "discernible impact" on prices and supply of agriculture commodities, the research foundation said.

In the study, India Development Foundation (IDF) assessed the impact of demonetisation on agriculture and the informal sector that rely heavily on cash transactions and also provide employment to majority of population.[4] "Our analysis shows that there has been no discernible impact of demonetisation on agricultural prices and quantities in the immediate aftermath," IDF Fellow Arijit Das said while releasing the study. He said the long term impact on agriculture, which was measured through the quantities of various inputs applied, is mixed.



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On the impact on SME sector, IDF said: “Unlike the agriculture sector, the SME sector seems to have suffered a negative impact of demonetisation”.

“Production activity is reported to have fallen in the last quarter of 2016 compared to the last quarter of 2015. This has been accompanied by fall in employment and wages and job losses in the two months after demonetisation,” it added. The study has been based on secondary sources of data and a perception survey in 48 districts across nine states.

Over 250 respondents took part in the survey. Over 74 per cent of the respondents said that production activity in SME sector has fallen, while 71 per cent said that labour employed during this period declined. Nearly 40 per cent of the respondents were of the view that wages paid to labour have decreased.

On job losses, 20 per cent said that “not many” employees have been fired in the last two months. As much as 54 per cent said “some” employees have been fired, while 26 per cent said “quite a few”. However, IDF said “given that both investments demand and consumption demand have slowed down before demonetisation, it is difficult to attribute the entire effect to it”.[5]

The study said that people reported significant job losses in cities and reverse migration to villages that increased demand for employment under NREGA. “Again, as noted for the SME sector, this could be due to the secular downward trend in the aggregate demand quite independent of demonetisation,” IDF said.



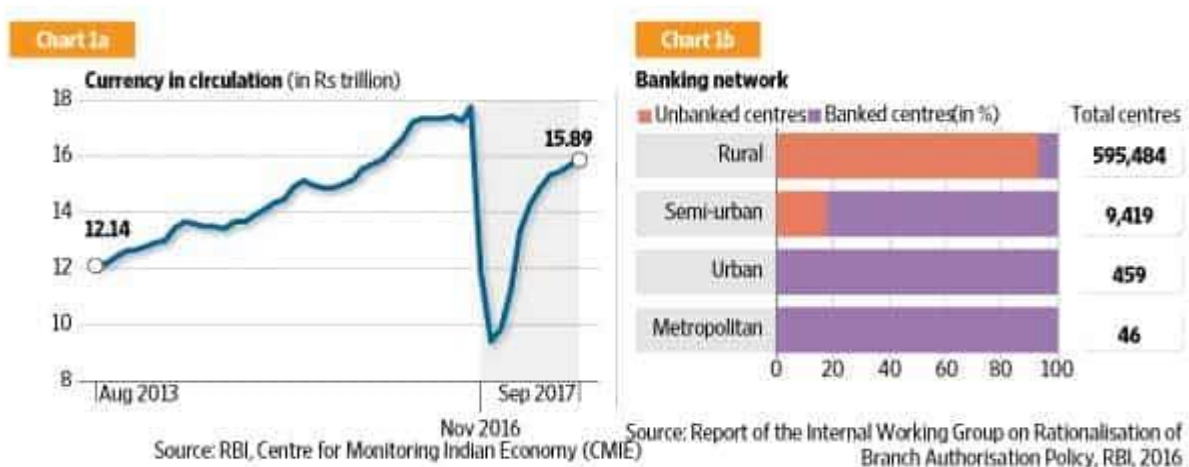
To answer this question there are multiple reasons why nations demonetize their local units of currency. Some reasons include combating inflation, to combat corruption, and to discourage a cash system.

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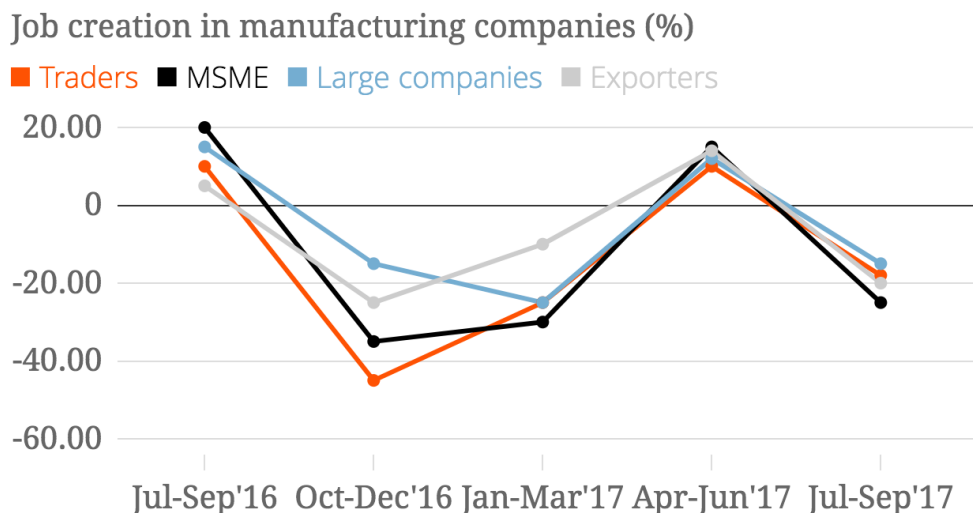
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In 2016, the Indian government decided to demonetize the 500- and 1000- rupee notes to eradicate counterfeit currency, fight tax evasion, eliminate black money gotten from money laundering and terrorist financing activities, and promote a cashless economy for small and marginal businessman. By making the larger denomination notes worthless, individuals and entities with huge sums of black money gotten from parallel cash systems were forced to convert the money at a bank which is by law required to acquire tax information from the entity. If the entity could not provide proof of making any tax payments on the cash, a tax penalty of 200% of the tax owed was imposed. Two times in 1946 and 1978 demonetisation happens in India and 500, 1000 and 10000 Rs. note have been demonetised and after some years of demonetisation 10000 Rs.note was again launched in market. Same in 1978 during the time of Janta government led by PM morarji desai this step was taken.500, 1000, 10000 Rs. notes were demonetised. After which 10000 Rs was totally stopped in market.[6]



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Data: All India Manufacturers' Organisation

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a) Importance of study: The present study is so important to know the psychology of small entrepreneurs to demonetization of high value currency in India, after the courageous decision of our honorable Indian Prime Minister Sri.Narendra Modi on 8th November 2016 that the demonetization of Rs. 500 and Rs.1000 and substituting with introduction of Rs.2000 new currency in India.

b) Statement of the problem: Today though India experienced two demonetizations in past but the present situation is quite different from the past historical situation in size of demonetization currency in circulation, peoples consent about currency in circulation, present problems of small businessmen, hoarding of wealth, corruption, fake currency etc. The present study is concentrated on the problems of demonitisation on small and micro entrepreneurs in India.

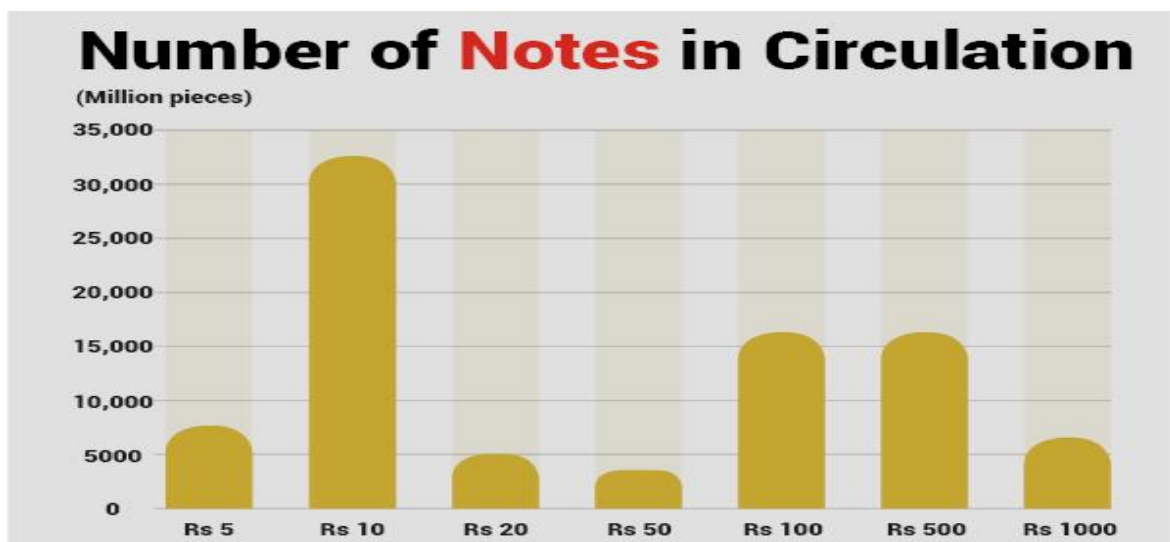
c) Objectives: India has experienced three times in 1946, 1978 and on 08thNov.2016 demonetization effects, but the effects of third time demonetization are quite different from the previous two.

Because the present demonetization currency is in circulation up to 86% and its impact is meager one as compared to the problems of substitute currency introduction of high value currency that is 2000 rupees note is problematic one for the 99% of the people who run their business, consumption and income on hard cash base only, hence present study is not only concentrated on demonetization problem but also on the problems of Marginal(Micro) Small and Medium Entrepreneurs of India because most of them are either illiterate or ignored about modern system of business and moreover their number is more than 90% in India because the mall system of business is new in India as compared to other modern developed nations. Hence demonitisation is forcefully step towards them to adopt cash less business in India. 1) To study the difficulties in day-to-day business activities of small and marginal businessmen. 2) To study the problems of people in payment of price of small product. 3) Opportunities of modern technology to run cash less business in small business.[7]

### IV. RESULTS

#### Positive & Negative Impact of Demonetization:-

Impact on Black Money and Corruption: 'Black Money' or 'Dirty Money' is the money on which not tax is paid to the Government and it goes unaccounted in the duration of country tax assessment period which causes revenue loss to the government. It is argued that steps taken by the government of demonetization can help curbing black money in the country. Corruption will also be automatically reduced by removing black money from economy.



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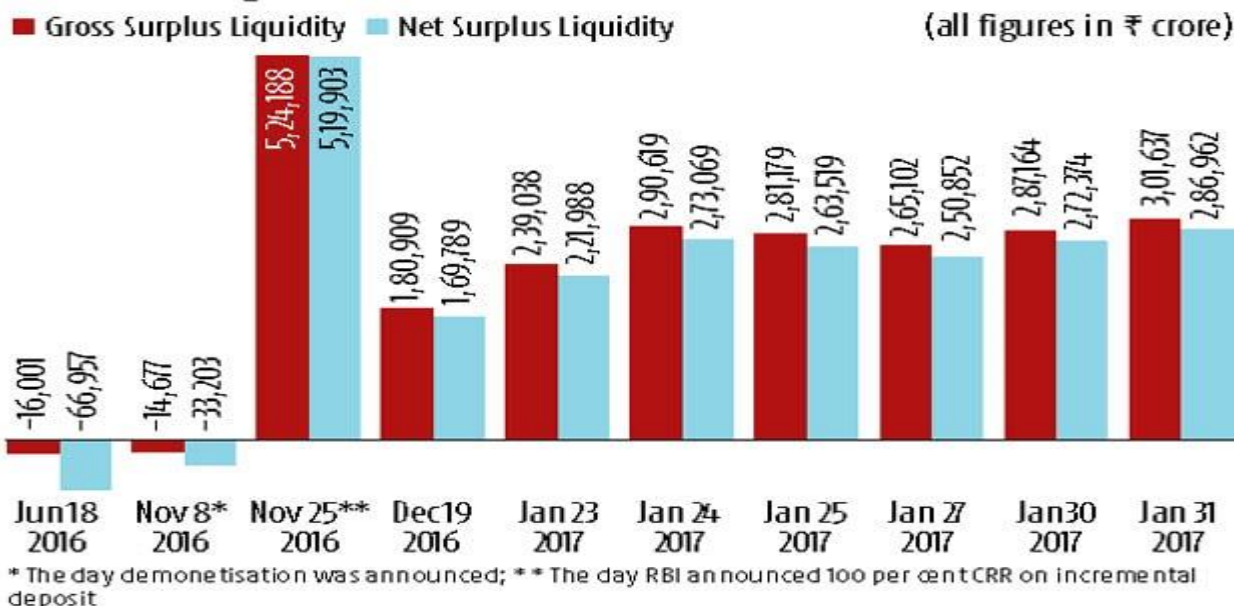
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1. Source: SBI Research, RBI The Table depicts the public holding of high denomination notes worth Rs. 9926 billion as on march 2016. There are 3 scenarios in table. In scenario 1 and 2 it is assumed that 50% of the notes of higher the denomination do not return to the system. It is also reasonable to expect that 60% of Rs. 500 notes and 40% of Rs. 1000 notes would be exchanged at banks/ post offices and RBI before March 31, 2017. Based on such estimates, roughly round Rs. 4.5 lakh crore of money could disappear from the system.
2. Impact on Counterfeit Currency: The Biggest positive impact of the demonetization will be on the counterfeit/fake currency as it currently thrown out of the system fully.
3. Impact on GDP: GDP become down because circulation of currency is less because of cash crunch in the country. The GDP formation could be impacted by this measure, with reduction in the consumption demand. Moreover, this expected impact on GDP may not be significant as some of this demand will only be deferred and re-enter the stream once the cash situation becomes normal.
4. Lower Inflation: Inflation arises due to higher liquidity in the market. Because of demonetization there is less liquidity and less cash flow in the market thats why inflation becomes down. As the black money goes out of the system the money supply will shrink to some degree. This will reduce inflation rate in the Lower absence of any open market interventions by the Reserve Bank of India. Inflation is of four types.[7]

### HOW LIQUIDITY MOVED IN BANKS



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Creeping Inflation (2% – 4%)

Walking Inflation (5% – 10%)

Galloping Inflation (10% – 20%) Hyper Inflation (more than 20%)

- Impact on Purchasing Power: The move of demonetization has affected the purchasing power. This is mainly affect those assets that are used as long term investments like Real Estate, Vehicles and core sectors of cement and steel. The stock prices of the companies of these sectors will have a negative impact. Purchasing power of consumer is also affected due to the shortage of cash because 90% transactions taking place in cash in the Indian economy.

- Impact on Real Estate Sector:

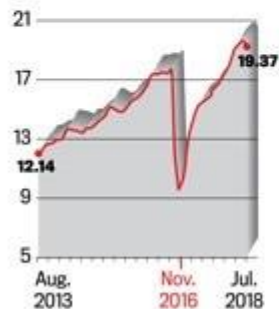
Demonetization smashed the real estate market and it will result in more than 50% drop down and it will remain for further 5 to 6 months. While the short-term impact is negative, Experts hoping that rate cuts in the coming months would boost home sales.

### THE RETURN OF CASH

Cash is again king, and even the switch to digital payments is slow at best

#### Currency in circulation

(Rs trillion)

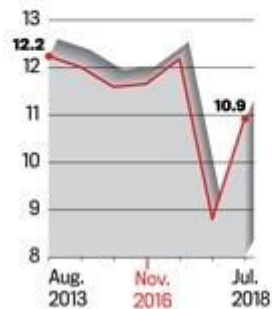


Cash has crossed pre-demonetisation levels...

Source: CMIE, MOSPI

#### Cash-to-GDP ratio

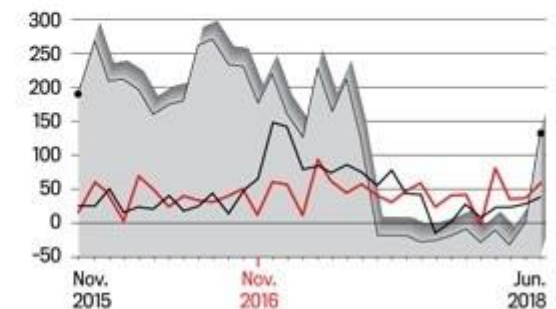
(in %)



...but cash-to-GDP ratio is marginally lower

#### Digital payments

(Year-on-year %)



Digital payments were on an upswing even before demonetisation

Source: CMIE, RBI

**FOLLOW THE MONEY**  
A long queue at a bank in New Delhi post-demonetisation to exchange banned notes with new currency

- Impact on Banks and Financial Institutions:



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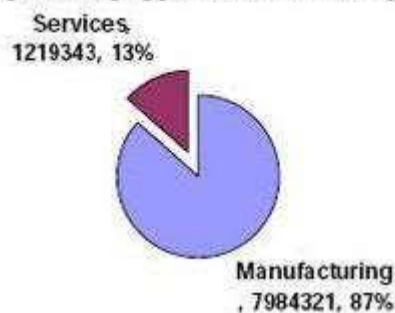
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The demonetization effects on banks will be both on the positive side and the negative side. However, In the long run it will be more on the positive side. As per directions of Government people have to deposit their money with the banks which will increase the liquidity of the banks for short term. This liquidity can be used by banks for lending purpose for long run.

As the liquidity of banks increases, they are expected to enhance the borrowing cycle by the lending money at lower rate of interest. However, the negative impact also as the earning of the banks will also take a hit for the next 2-3 quarters. We may not see loan book growing as the banks will be busy in facilitating the demonetization process.

8. Impact on Lending Rate: Lending rate become down because of Banks getting money at Repo ate and banks lending money at Base Rate. In this situation Repo Rate become less and automatically Base Rate will become down and banks having sufficient money to lend so lending rate become down.
9. Impact on Ecommerce: Impact of demonetization on Ecommerce mostly bad, some good. For the online retail market, gross merchandise value (GMV) of players fell by 40-50% in first few weeks after demonetization, in the middle of their biggest quarter for sales. Things may remain bleak till March. Even high-value items like expensive smart phones are selling less. Products returned are up by 50%. And experts feel consumer sentiment wont improve quickly. But the boost to digital payments (100% jump in transactions) has led industry to hope for a bright medium term. Also, grocery and food delivery set-ups are doing better since they sell essential items. Some saw new customer orders jump to 25%, from the usual 15-16%<sup>[8]</sup>

Employment by type of MSME enterprises



10. Impact on Tourism:

Cash Crunch badly hits the tourism sector. It is very difficult for people for getting the money from the banks and ATMs. The travel and hospitality industries are facing a tough time.

Peak tourism period of November-December badly hit. For tourist destinations beyond metros, business may be down by as much as 40%. Tourism business in metros may go down by 10%. Cash shortage at airports and hotels are a big problem. And many national monuments entry points dont have card payments facilities. Western countries have issued advisories on cash Liquidity in India



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11. Online Transactions and others modes of payment: The Government wants to go cashless, Demonetization will have positive impact on digital transactions and other mode of payment.

With cash transactions facing a reduction, alternative forms of payment will see a surge in demand. Digital transaction systems, E wallets, online transactions using E banking, usage of Plastic money (Debit and Credit Cards), UPI, EFTPOS, Net Banking Aadhar card, etc. will definitely see substantial increases in demand. This should eventually lead to strengthening of such systems and the infrastructures required[6,7]

### V. CONCLUSION

In long run, there are some positive and some negative impact of demonetization but negative impact does not outweigh the positive impact of it. After the demonetization some sectors not affected like Pharma, FMCG, Education, Agriculture, Hospitals, Energy and Telecommunication From an equity market perspective, this move would be positive for Banking and Infrastructure sector in the medium to long term. This would be negative for Real Estates, Customer durables, Luxury items in the near to medium term.

Demonetization can lead to elimination of fake currency and corruption, it can be said that this is a historical step by the Modi Government and should be supported by all. This decision of Government will definitely fetch results in the long term this is the stepping stone towards/ for sustained economic growth in long run.[8]

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