

# **Cashless Economy: the Impact of Demonetization on Small and Medium Business**

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**ABSTRACT:** Demonetization refers to withdrawal of a particular form of currency from circulation. It is necessary whenever there is a change of national currency; the old currency must be removed and substituted with the new currency unit. The currency was demonetized first time in 1946, and second time in 1978. On 8th Nov. 2016 the currency is demonetized third time by present Modi Government. The chaos was created in every strata of the society whether upper, middle or lower. Where some welcomed the move as it was seen for curbing black money, many are suffering by this movement. Here we analyze the current and immediate impact of demonetization on Indian economy and work out the probable consequences of the demonetization on small and medium business.

**KEYWORDS:** demonetization, currency, cashless, economy, small, medium, business

## **I. INTRODUCTION**

The Indian economy is one of the fastest growing economies in the world, but it suffers from issues like black money, corruption, terrorism, illicit wealth, etc. To break the grip of corruption and black money, there have always been various ways like auditing and enforcement agencies, but the idea of cashless economy is more appealing, as most economic transactions would be part of the formal system and easy to track. In India, few use non-cash payment methods; only 10-15 per cent of the population is estimated to have ever used any kind of non-cash payment instrument, compared to 40 per cent of people in countries like Brazil and China. Meanwhile, as of 2014, India's ratio of currency in circulation outside of banks to GDP was 11.1 per cent, higher than other emerging economies like Russia, Mexico, and Brazil. This indicates ample scope for strengthening the base of the untapped non-cash user market. Increasing the horizon of non-cash users along with convenient, reliable, secure, and affordable payment systems will have implications for access to other financial services such as loans and insurance to the unbanked, particularly in light of the financial inclusion initiative. However, the challenge is to strengthen the digital infrastructure of banks and to make transactions safe. Cashless society offers the government and the public many advantages. [1]

**Convenient Mode of Payment:** The ease with which every transaction can be carried out certainly promotes going cashless. The cashless economy offers everyone (apart from low-income groups) enormous benefits, including reduction in transaction cost of carrying and doing business/transactions in cash.

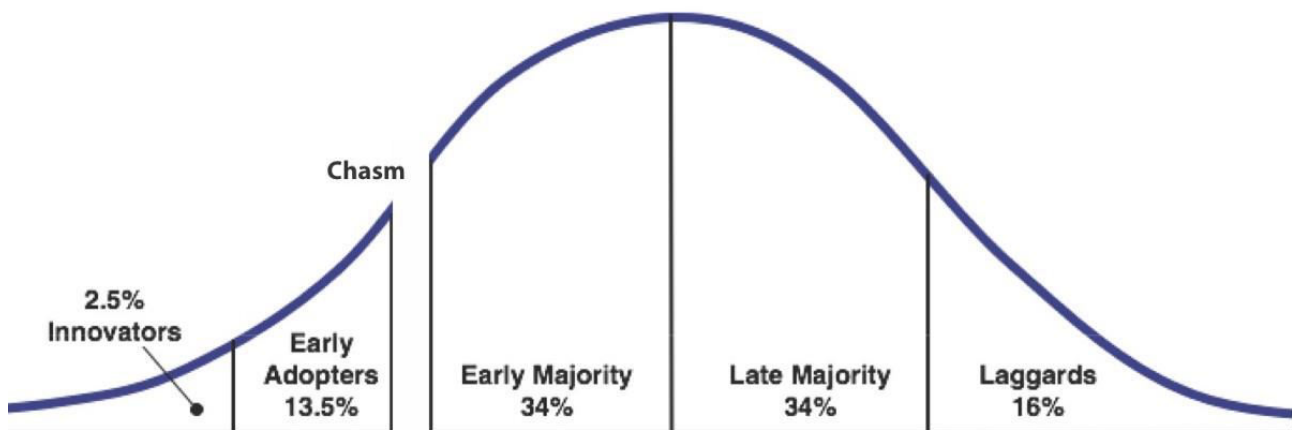
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## Technology Adoption Life Cycle



Lower Risk: With proper cybersecurity, online payment is relatively risk-free, whereas there are always safety issues with physical cash.

Reduction in the Cost of Printing Money: Printing of new currency notes and replacement of soiled and mutilated currency notes involves cost. In 2015, printing currency cost the RBI Rs 27 billion. The cost can be reduced if the economy moves towards a cashless economy

Decrease in Crime Rate: Many anti-social and illegal activities like drug trafficking, prostitution, financing of terrorism, and money laundering are carried out only in cash. A cashless economy will make it difficult to carry out such operations.

Good for the Banking Sector: A digital economy will help the banking system. Once people get used to digital payment and transfers, there would be less demand for cash holding or cash hoarding; this would leave more cash in the banking system and thereby enable more savings

Transparency and Monitoring: Cashless transactions can be easily monitored by the government. Therefore, tax evasion would be difficult and would enhance revenue collection

The move towards a cashless economy or electronic transactions might help curb black money by reducing tax evasion and ensuring transparent functioning of the economy. Ultimately, the risk of carrying money would fall, and a more planned structure of credit access and financial inclusion would come up. Government expenditure will increase in the direction of development process, as there is a possibility of increase in transparency and the flow of revenues.

The move towards a cashless economy is not a sudden decision. The government has approved a slew of initiatives in February 2016 to encourage digital payments and a transition to less-cash economy. Prime Minister Narendra Modi had urged people to adopt cashless transactions in his Man Ki Baat address in May 2016. He also stressed for digital culture by using mobile and other electronic devices. [2]

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Towards this end, the government had launched a major drive for financial inclusion in terms of opening Jan Dhan accounts, giving a statutory basis for Aadhaar, implementation of direct benefits transfer, GST, introduction of RuPay cards, and voluntary disclosure scheme for unaccounted money. Demonetisation of 500 and 1000-rupee notes on 8th November 2016 sped up the transition towards cashless economy. The economic slowdown resulted from demonetisation, has led to several myths regarding the new economy. This effect would be more severe on individuals who earn and spend mostly in cash. Switching from cash-based economy to a cashless economy would require concrete efforts. Cashless economy in Indian context is a result of both perennial issues in the financial system and the adoption of ICTs in payment and settlement. In 2009, the Planning Commission estimated that only 27% of PDS expenditure reached the targeted low income group. Clean and transparent business transactions aren't only surging tax collection, but also curbing the illegal practices like shadow economy, money laundering, and commission in welfare schemes. Economic management cost will be minimum. In 2015, RBI spent Rs. 27 billion on currencies issuance and management. The cashless economic policy has broad objectives for long term, first, to drive the development and modernisation of the payment system with transparency; second, a voluntary shift of economic activities from informal to formal so that all illegal economic activities come to an end; and last, financial inclusion, yet it remains as challenging task, but in the mid of Universal Basic Income (UBI) discussion such economic change could ensure financial inclusion.[3]

### II. DISCUSSION

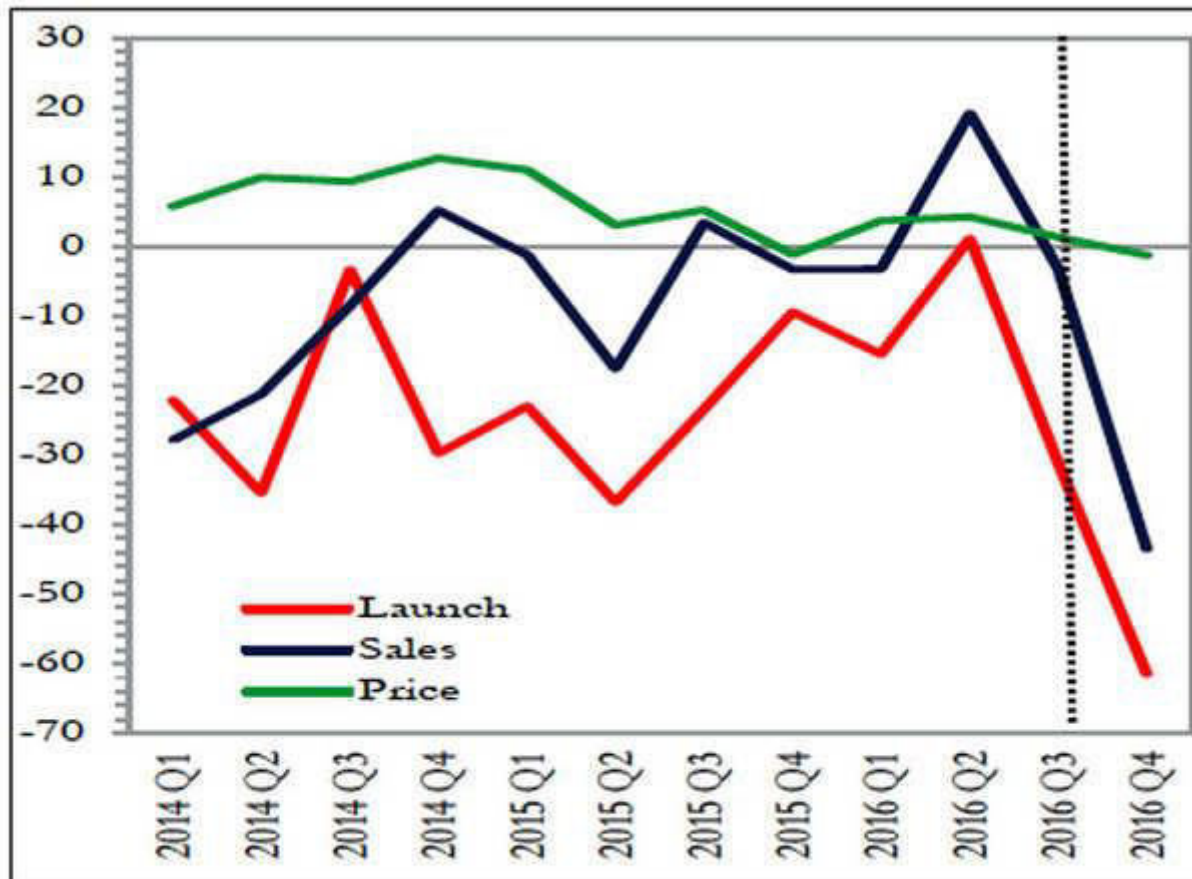
The micro, small and medium enterprises (MSMEs) not only play a crucial role in providing employment opportunities at comparatively lower capital cost than large industries, but also helps in industrialisation of rural and backward areas, reducing regional imbalances and assuring more equitable distribution of national income and wealth.

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**Source: Knight Frank data and survey calculations**

This segment is an integral part of Indian economy in terms of size of the enterprise, varieties of product, service produced, and its contribution to national growth indices. It is always treated as stimulating element of economic growth. The micro, small and medium enterprises can contribute more than the big businesses. The policy makers and researchers considered this sector essential for achieving targeted economic goal. The MSME sector has created well profile in the Indian economy with 32 million units, 70 million employment opportunities, product range consisting of more than 6000 varieties, 45% of total manufacturing output and about 40% of export directly and indirectly. Its role is also noticed in mitigating economic inequality. It is a driving force for socio-economic development. It is an acknowledged fact that MSME sector can help realise the target of the proposed manufacture policy for raising share of manufacture sector in GDP from 16% to 25% by the end of 2022. The government and policy makers started working on it, with new policies such as Make in India, Startup, Skill India, Zero Defect, etc. The government is giving high attention to protection and promotion of MSME sector with policies and schemes. There is no universally accepted definition for MSMEs; the criteria for classification differ from country to country, time to time. In India, this segment was earlier called small scale industries (SSI), now it is renamed as MSMEs. The Micro, Small, Medium Enterprise Act 2006 has given exhaustive definition for small business on the basis of investment in plant and machinery. [4]

Demonetization is not a surgical strike; it is carpet bombing. It impacts everyone. Replacement not only takes time, it also slows down the spending process as everyone tries to protect the newly acquired currency to secure them from the uncertain future. In case of SMEs, most will be unsure of payments coming from customers for some time; this as



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liquidity in the form of unaccounted currency has dried up. If customers don't pay, SMEs will protect what they have and that will mean they purchase less and produce less. Purchasing less will mean further slowdown for the people who provide them with raw material and producing less will mean shortage of supply leading to inflation on what is available.

Reforms in the form of incentives is what we see will happen soon. I am positive that the government is aware of the first point and will take measures to restart the money wheel rolling in the market again. This could happen in several forms, early announcement of GST and BTT, elimination or drastic reduction of Service Tax and VAT until either GST is introduced or something else. Taking steps on taxes will encourage people to spend without having the fear of tax, which is currently seen as systematic 'loot' with minimum or no returns

Improvement in government procedures and monitoring of the monitor. This will happen as a measure to avoid generation of black money in new currency. The government will redesign processes to acquire licenses and approvals with ease, and older redundant requirements will be abandoned. Tax and other compliance officers will need to be monitored to ensure that policing does not give birth to 'under-the-table settlement' culture again.

Visible use of collected money in banks on development of infrastructure that brings benefits to people quickly. 'Quick' is the keyword. We will see money invested in aspects that bring quick results for all classes. The current change has got quick pain with a promise of long-term gain but we have to remember that a large section of our society will need quick gains to survive before they can enjoy the long-term benefits.[5]

SMEs will invest in self-development and improvement in terms of technology, infrastructure and training to self-utilize the increased profitability with unaccounted income now becoming a part of the books that are taxable

SMEs and businesses now by design will have two options. Pay tax or spend on doing more for scaling up and this will have a spiral effect on the overall improvement in the economy.

### III. RESULTS

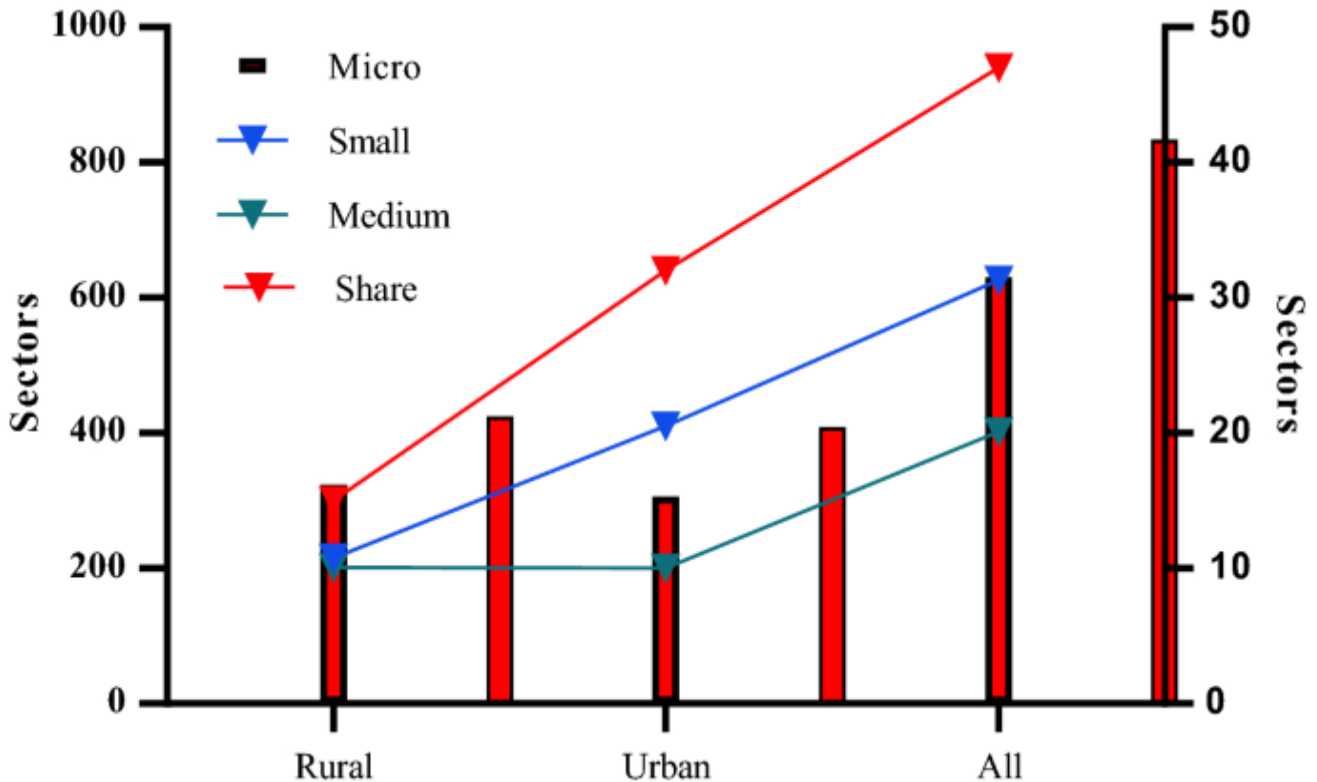
Money is backbone of transactions in modern economies, playing roles like medium of exchange, store of value and unit of account. Monetary policy determines supply and demand for money and changes in monetary policy affects them. Government in India introduced a major monetary policy change in November 8, 2016 by demonetizing specified currencies, i.e. Rs. 500 and Rs. 1000, with objectives of (1) eliminating fake currency, (2) eliminating black money, and (3) controlling subversive activities. Specified currencies were to the tune of 86.4 per cent of total currencies in circulation. Hence, government introduced demonetization to meet above mentioned objectives, besides moving towards cash less economy using modern technology based electronic transactions. Demonetization is a monetary process of stripping a currency unit of its legal tender status, which results in withdrawing currency from circulation. Demonetization has been introduced in various other countries also over time to meet different objectives like controlling excess liquidity, inflation, black money, etc. In India during the initial days of demonetization people experienced difficulties in exchanging old currency to new currency, which was accentuated by inadequate supply of new currencies. It was reported by media that people stood in long lines in front of ATMs and banks to obtain new currencies. It was observed that demonetization promoted digital transactions and payments through electronic payment system increased.

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#### IV. CONTRIBUTIONS IN DIGITAL TECHNOLOGY

Small scale industries in India have been renamed as micro, small and medium enterprises and been classified on the basis investment in manufacturing and service sectors. Among 634 lakh units, large number of MSMEs are micro units at 630.52 lakh, where Uttar Pradesh and West Bengal have large number of MSMEs and Karnataka has over 38 lakh units

Demonetization was an unexpected move by the government as opined by 93 per cent of respondents and electronic media like television are major medium of communication about demonetization. SSIs faced problems in day to day transactions due to reduction in cash availability, which affected salary payment (26 per cent of SSIs) to employees, purchasing of raw materials (6 per cent), etc. The impact was more in rural areas. Large proportion of entrepreneurs (22 per cent) faced problems while transacting with banks, but the point to be noted is that even 22 per cent is not a small proportion as they have faced problems with banks during demonetization.[4]

On employment side demonetization impacted adversely on temporary job workers (14 per cent of SSIs) as entrepreneurs had to stop engaging temporary workers due to non-availability of cash. Entrepreneurs faced problem to pay for their staff and hence some of them relieved their daily wage labourers. Overall, entrepreneurs felt that sudden implementation of demonetization created confusion and problems while severely affecting their business. Demonetization has promoted use of electronic payment system, hence monetary literacy, in terms of reducing cash usage in transactions and adopting electronic methods of payments may be promoted

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## V. CONCLUSIONS

As per the study we can come to a conclusion that demonetization has affected the traders in India which are small scale and medium business holders basically. The most affected traders were small scale traders because they were not been set with new modes of cash payments. Many of the large firms in Small scale and medium enterprises also survived from demonetization as they were set with new cash payment modes. As per the census of Indian merchants in many states there are mainly small scale and medium enterprises (80 percent) and the rest belongs to large scale.

India was mainly a cash dependent business market before demonetization. So the change in the policy of the government has affected the markets of India in modes of Liquidity crisis, less sales, lack of funds etc... From our article it's clear that the merchants slowly had changed their methods of payments to online after demonetization. Many of the extreme small scale merchants still now are not able to set up the online cash payment and officials have not taken any policy in benefits of traders after demonetization. As per the results we can conclude that the demonetization process implemented by the government made huge difficulties to mainly the small scale and medium scale merchants and it had made massive loss in their sales and customer.[5]

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