Abstract

In India the demonetisation announced at prime time on November 8 is among the rare, bold economic policy decisions in the history of independent India. It is clear that that a good bit of planning and preparation involving the ministry of finance and the Reserve Bank of India were completed beforehand. That this was done in absolute secrecy is no small feat. To be fair, the authorities have identified nullification of black money hoarded in cash, tackling of counterfeiting Indian currency notes, and curbing of terror financing with fake currency notes as the three objectives of this round of demonetisation. But quite a few commentators and analysts have opined that this will engender a marked fall in the use of cash transactions in India and thus pave the way for the transition to a ‘cashless’ economy.

I. INTRODUCTION

Any decision to withdraw the legal tender status of currency in circulation creates a sense of confusion and some despair. The monopoly rights of the sovereign to issue currency notes and coins are asserted in reverse in demonetisation episodes for achieving economic and political goals that seem difficult with normal policy measures. Its economic costs and benefits are hard to assess ex ante. More importantly, only a few among the population have a clear idea of how demonetisation could deliver the intended outcomes. Even under the best of circumstances, it’s a hard sell for any government. According to Investopedia, “Demonetization is the act of stripping a currency unit of its status as legal tender. Demonetization is necessary whenever there is a change of national currency. The old unit of currency must be retired and replaced with a new currency unit”.

In India the demonetisation announced at prime time on November 8 is among the rare, bold economic policy decisions in the history of independent India. It is clear that that a good bit of planning and preparation involving the ministry of finance and the Reserve Bank of India were completed beforehand. That this was done in absolute secrecy is no small feat. To be fair, the authorities have identified nullification of black money hoarded in cash, tackling of counterfeiting Indian currency notes, and curbing of terror financing with fake currency notes as the three objectives of this round of demonetisation. But quite a few commentators and analysts have opined that this will engender a marked fall in the use of cash transactions in India and thus pave the way for the transition to a ‘cashless’ economy.

II. STATEMENT OF THE PROBLEM

India is a cash-dependent economy. Its cash to GDP ratio, at 11 per cent, is much higher than in most economies. Close to 98 per cent of all consumer payments are made in cash. Financial technology companies in the payment services sector are upbeat that demonetisation will also mean a big digital push for India. Some of them have even seen a spurt in business in the wake of the demonetisation announcement. Seen against the setting up of the Unified Payment Interface (UPI) in August this year and the reported plans of the Government to prohibit cash transactions involving Rs. 500,000 or more, there are reasons to be hopeful that India will leapfrog to much lower dependency on cash over the next five years. The main yardstick to evaluate the success of demonetisation will be the resultant fiscal gain accruing to the RBI and, hence, to the Government.

III. OBJECTIVE OF THE STUDY

1) The Demonetisation and its impact on the society
2) The Demonetisation and its impact on Stock market
3) The Demonetisation and its impact on Non-Banking Finance Companies
4) The Demonetisation and its impact on Professionals
5) The Demonetisation and its impact on FMCG
6) The Demonetisation and its impact on SME sector
7) The Demonetisation and its impact on the e-commerce Industry

IV. SCOPE OF THE STUDY

The study is limited up to the above areas only

1. The Demonetisation and its impact on the society

According to the latest RBI data (end-March, 2016), the notes of Rs. 500 and Rs. 1,000 denomination together constitute, in value terms, 86.4 per cent of the total notes in circulation. Their aggregate value is Rs. 14,180 billion (Rs. 14,180 crore). Over the last few years, the annual growth rates of the circulation of notes of these two denominations have largely tracked the growth rate of nominal GDP, indicating no sudden spurt in their demand. The size of the black economy in India is estimated to be in the 20-25 per cent range. It is safe to assume that the structure of the black economy, including that of its ‘cash component’, has been fairly stable over the years.
This leads another safe assumption that the proportion of black cash in the aggregate currency in circulation is also around 25 per cent. In fact, it should be higher than 25 per cent, given the higher preference for cash in the case of tax-evaders vis-à-vis others.

Nearly 85 per cent of the value of currency in circulation is being withdrawn. As a demonetisation measure, the extent of coverage is far deeper than the previous attempts. The disruption caused to the economy can be both temporary and permanent. Without adequate cash in the hands of households, retail transactions such as those relating to the buying of commodities of common usage such as vegetables can be, and are being affected. The RBI and the Government must overwork the printing press and bring the current situation to an end as quickly as possible by providing adequate currency to meet the normal need for cash. With the limitation on the capacity of note printing presses, advance action over a long period without provoking attention was a necessary prerequisite.

The permanent impact will be on sectors such as real estate where the transactions are largely done through cash. Initially they may shrink. Over the longer run, if cash transactions come down, there will be a salutary change.

The currency to GDP ratio is high in India. If this round of demonetisation pushes society towards more digital transactions, it will be a distinct gain. Through the Jan Dhan Yojana, crores of new accounts have been opened. These accounts, which have remained dormant, can be made active. Even otherwise, at least in urban areas, a strong push should be made to use electronic transfers. This is an opportune moment to make the shift. Aggressive action on the part of banks, including the new payments banks is needed to increase transactions in the digital mode. With the new experience of shortage of cash, many are moving towards the electronic mode.

Some questions have risen about the introduction of new notes in the denomination of Rs. 2,000. On the other hand, there are those who criticise the Government for including 500-rupee notes in the demonetisation net on the ground that the denomination is too low and is used by everyone. The introduction of Rs. 2,000 notes as such does not make any big change, if one takes into account the rise in prices since 2009-10. The impact on the financing of terror can be significant. It will have an immediate effect. The impact on the printing of fake currency will also be immediate, even though old counterfeit currencies may still be in circulation. The new notes, we are told, have several new security features and may be difficult to counterfeit.

2. Preventing Accumulation

As far as measures to check the generation of fresh black money goes, they must be directed towards those forms in which black money gets converted, such as gold and real estate. However, the source of black money is the tendency to avoid payment of tax.

Two steps are necessary in this context. One is to keep the rates of taxation at moderate levels and widen the base, and the second is to tone up and streamline the tax administration. Electoral reforms are equally relevant to curb the excessive use of cash that has been recently noted.
3. Impact On Growth And Inflation
One question that crops up is the impact on growth rate. Certainly, the temporary disruptions can have an adverse effect on growth if they continue to linger. Over the longer run, the beneficial effects are the spread of the organised financial system with more and more transactions being channelled through the digital mode. Also, if followed up by other measures, the generation of black money can come down. The immediate impact on prices will also be beneficial. To the extent that some part of the currency will get extinguished, it may have the same effect on inflation as reduction in money in circulation. This will happen only at the end of the period given for surrender of old currency.

Even as people welcome the measure to demonetise, the major concern is the inconvenience because of the lack of adequate new currency. It also affects the livelihood of the poor. Small businesses, particularly, can face shortage of liquidity which can hurt them seriously. The Government, the RBI and banks must handle this problem on a war-footing; otherwise the generally welcome measure may turn sour.

4. The Demonetisation and its impact on Stock market
The pangs of demonetisation resulting in a cash crunch, coupled with a truncated trading week, saw equity markets losing another 5.22 per cent on Friday. The Nifty lost 5.49 per cent to close at 8,074 (469 points) while the Sensex lost 5.22 per cent (1440 points) to close at 26,150.24. Anand James, Chief Market Strategist, Geojit BNP Paribas Financial Services, said, “As the demonetisation drive entered the second week, the ripple effect of cash squeeze continued across sectors such as realty, jewellery, etc. The pull-out by FIIs to the tune of over Rs. 10,000 crore in the last few days have exacerbated the volatility, and Indian markets are less likely to receive. FPIs pulled out net equities worth Rs. 10,542 crore. DIIs had a net buy position of only Rs. 6347 crore on Friday. It was a highly volatile trading session with the India VIX average over by 16 per cent.

5. The Demonetisation and its impact on Non-Banking Finance Companies
Non-banking finance companies (NBFCs), which serve small traders and local farming communities, are expected to face difficulty in collecting their loan dues in the short term — a fallout of demonetisation. They are likely to be hard hit since a significant part of their loan repayments are in cash. For instance, Mahindra & Mahindra Financial Services (MMFSL), a leading NBFC, has about 60 per cent of its collections in cash.

Ramesh Iyer, Vice-Chairman and MD of MMFSL, said the company’s customers, in general, are daily wage earners — those who need to earn every day and pay their dues — from the farming or small trade community. The liquidity crunch as well as shortage of business would impact them for a couple of days or weeks. They do not have past earnings to fall back on and have to be in business to keep paying their dues. Therefore, in the current situation, some delays will be inevitable. “We don’t see delinquency, but we see delays,” he clarified.

Asked how the company plans to handle the problem, Ramesh said, “We will take a partnership approach with good customers and a reconciliatory approach with customers who are in default.”
So, where customers face genuine difficulties, the company is willing to make concessions and accept requests for delayed payments. Where customers have large dues piled up, the company is willing to look at accepting collaterals as a way to tide over the present crisis.

“This crisis will provide the opportunity of identifying both the intentional defaulter and the circumstantial defaulter,” Ramesh said. Other opportunities may also open up for the company, Ramesh said. For instance, this crisis may actually give a fillip to the second-hand market for vehicles — since some existing customers may want to downscale operations to adjust for lower level of business activity rather than default on their dues.

Or they may be more open to settlement of loan dues and repossession of their old vehicles. MMFSL, which currently has about 10 per cent of its balance sheet in financing second-hand vehicles, expects to take it to about 15 per cent soon. Ramesh said the crisis may be an opportunity to revisit the firm’s business model and persuade customers to use the banking channel more and shift them from excessive reliance on cash. For instance, instead of accepting margin money by cash, the company would ask customers to now think of bringing it by a pay order, he said.

6. The Demonetisation and its impact on Professionals

After merchandise trade, it is now the turn of professionals — from the medical and legal fields — to feel the pinch of demonetisation. For some of these high-fliers, currency shortage has come as a great leveller.

For a leading lawyer in High Court, the government’s demonetisation announcement came as a “bolt from the blue”. In one fell sweep, his fee income from clients has seen a drop of a whopping 30-40 per cent in the last few days. But there have been positive surprises too. Some litigants — who deliberately avoided paying fees for the lawyer’s earlier appearances in court to argue their cases — have started paying the arrears, albeit in old currency notes.

According to him, there is no option but to accept these payments; else the clients may quietly vanish without paying his dues.

Many of the lawyers shared similar stories, saying that the currency withdrawal has badly affected the legal fraternity, including cash transactions in courts. The situation has forced many lawyers to accept part-payments through bank/NEFT transfers from clients. They however, have conceded to accept payment of the balance amounts in cash later in order to avoid tax.

Asked about collection of fees from poor clients who do not have bank accounts or knowledge of online payments, a senior lawyer said, “I will appear for them in court without charging any fee for now. I am sure that my clients will not betray me and pay the fees once the currency situation improves.”

Practising doctors are also facing the brunt of the currency crunch. “There has been a 40-50 per cent drop in consultation fees since the government announcement of demonetisation. Since my patients are facing difficulty in arranging adequate currency, I will not insist on consultation fees,” a senior cardiologist in a leading hospital in Kochi said. On the flip side though, there have been instances of patients being forced to postpone routine follow-ups with the hospital as a result of the currency crunch, he added.
7. The Demonetisation and its impact on FMCGs

Consumers are tightening their purses post demonetisation is not good news for FMCG and packaged food companies. While there has been a slowdown in sales mostly across kirana and mom-and-pop stores; analysts hint at the possibility of a hit in third quarter earnings.

“There may be some short term pain, especially when Q2 of the fiscal saw good growth. Even Q3 results may take a dip, but it is a bit early to say,” said Anil Talreja, Partner, Deloitte Haskins &Sells. Another analyst firm, Edelweiss toed a similar line. “Clearly… some green shoots of recovery is likely to be delayed,” its recent report stated.

**Wholesale trade hit**

According to Harsh V Agarwal, Director, Emami Ltd, the result of realisations from retailers going down is that the cash-backed wholesale trade has taken a beating.

The Edelweiss report also points out that post demonetisation, cash and wholesale trade (those dealing in cash) in the FMCG and packaged food sector has been the worst hit.

“Wholesalers dealing with cash are the worst affected. Until liquidity improves, nothing much may happen,” he told Business Line.

According to B Krishna Rao, Category Head of biscuit-major Parle Products, the company has seen a 10-12 per cent decline in November sales this year, over the same month last year. (Incidentally, FY16 was considered to be a bad year because of poor monsoons.)

“There has been a slowdown in orders that we are receiving from distributors,” he said. For example, if a distributor used to place orders for 100 Skus with Parle, he is now going for 70-odd Skus or even less. “The majority of our distributors dealing with cash payments are badly hit,” Rao maintained.

Companies or products that have a higher direct reach will have less of an impact, sources maintain.

**Premium offerings**

The other worry is premium offerings. Typically, these are said to be the revenue churners. As discretionary spending goes down, purchase of premium offerings are deferred. Staples are unlikely to be heavily impacted.

Market sources indicate that while ITC’s atta sales may not decline, its snacking category offerings can see an adverse impact. Similarly, for Britannia – 55 per cent of whose earnings are from premium offerings – there could be a decline in premium biscuits volumes depending on outlets / region. Both Britannia and ITC refused to comment on the matter.

Retailers – even in the organised retail trade – also speak of consumers moving towards small value packs.

As Abneesh Roy, Senior Vice-President (Institutional Equities), Edelweiss, points out – there will be a tendency to go for smaller packs by consumers to curtail excess spending. “Why just rural, it will not be unusual to see the phenomenon amongst urban consumers also,” he pointed out.

And interestingly, Mohit Kampani, CEO of Aditya Birla Retail Ltd, which owns the supermarket and hypermarket brand MORE, speaks of a movement towards “mid-size and top-up packs”. “As more consumers adopt the supermarket channel at this time we see sales...”
increasing of mid-size and top up packs of everyday grocery items purchased at home,” he said in an emailed response.

Way out
Interestingly, for FMCG majors, the way out seems to be extending the credit cycles. Wholesalers – who are already low on cash – have done the same to retailers and distributors are doing the same at the moment. “To address this liquidity situation some of the consumer companies have extended some credit to the distributor (payments from distributor to the company are generally made in advance via RTGS),” Edelweiss said in its report. ITC in an emailed response said: “Given our long standing relationship with trade partners we continue to engage with them to discuss and resolve issues.”

8. The Demonetisation and its impact on SME Sector
How are small and medium enterprises coping with the fall out of demonetisation? Traditionally, these enterprises run on thin budgets and often suffer long delays in recovering dues for supplies already made. With a liquidity crunch all over the country, these enterprises are having a hard time. Industry insiders admit to some difficulty here and there, but nothing that they cannot tide over. Some of the small and micro units, used to paying workers in cash on a weekly basis, have felt the cash crunch. Though they have been crying hoarse about the tight money situation, workers did not openly attack the management for deferred payment. Industry representatives had initially issued statements stating that they would have to stop operations as withdrawal limits are small and they would therefore not be able to source material or pay off workers, particularly those on weekly basis. But most of these micro and small units are still operational. There seems to be no visible signs of industrial unrest due to non payment of wages.

For industrialists though, life goes on like before. A small scale industrialist didn’t disrupt his holiday plans despite the liquidity crunch. He said he had gone to Kerala for the weekend with his family and friends with just Rs. 150 in his wallet, a couple of the now invalid Rs. 500 and Rs. 1,000 notes, and plastic cards as well. “Gas stations accept these notes, we settled our hotel dues by swiping our card and got back with the money in the wallet intact. If you ask, most people, even small shops accept cards in Kerala, and banks are giving Rs. 4,000 in exchange for these notes,” he said. Meanwhile, bankers think some customers seem to be making good use of loopholes by walking into different banks with the photocopy of his/her identity card, and walking out with enough change.

9. The Demonetisation and its impact on e-commerce Industry
The future of e-commerce is bright despite cash burn and losses incurred by e-commerce players amidst a drying up funding environment, as India is still an under penetrated market, said Sachin Bansal, Flipkart Co-founder and Executive Chairman, who was the first speaker at the third edition of the Global Mobile Internet Conference that opened in the city. Stating that e-commerce companies will have to continue to invest in talent, physical supply chain and logistics and in building systems and processes to support the inevitable growth of e-commerce in the country before focusing on becoming profitable, he foresees that “Only
those companies that bet and invest in data and AI will survive in the next 10 years. Cash burn and cash crunch is a function of the stage of the market. The question we should be asking is when is the right time to stop burning cash and switch to profitability, which can be done anytime we want to.”Asked whether he was afraid of the prospect of either being bought out or destroyed by American and Chinese firms like Amazon or Alibaba, Bansal said “absolutely not.”

Explaining that India is a very different market, he predicted that business models that are unable to get the masses of India on board and are just serving the elite who look much like Americans and European in their income levels and behaviour, will be bought out or will have to shut down, as already seen over the last 12 months. Businesses that are able to Indianise for Indian needs and aspirations and are able to solve local problems using local resources in a much more efficient way will survive.“If you want to beat NASA, don’t replicate the NASA model, but be like ISRO which did the same things at much lower costs. My strong belief in Indian management and entrepreneurial talent leads me to believe that there will be a large number of Indian companies, which will not only stand on their own but also will be buying their American counterparts and will take their model to other developing countries as it is the best suited model for other developing nations,” he said.Bansal said digital payments is the largest bet in the mobile internet space from the technology point of view, becoming an enabler for a whole set of other businesses, whether it is selling cabs or mobile ads or any kind of transaction on the internet.To accelerate the use of digital payments, Bansal feels the government should subsidise low-cost $100 smart phones and bring it down to $50.

V. CONCLUSION

On challenges faced by citizens due to demonetisation, it was a good move which will reduce black money and have a large impact on India. It is an indication from the Centre that we need to move on and use technology more and more. However, the execution should have been better. Printing of enough currency and recalibration of ATMs could have been facilitated with more research and recommendations of an expert panel at the idea stage itself. While bureaucrats do a great job in administration of the country but they lack in subject matter expertise; giving such a technically challenging problem to bureaucrats is not the right thing.

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