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**DEMONETIZATION AND ITS IMPACT ON MSME SECTOR IN INDIA**

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**ABSTRACT**

*The MSME sector constitutes a vast network of over 63 million units and employs around 111 million people, contributing around 30% to the GDP, accounting for about 45% of manufacturing output and around 40% of total exports. The MSME sector has witnessed two major recent shocks, demonetization and introduction of goods and services tax. After that contractual labor in both the wearing apparel and gems and jewellery sectors reportedly suffered as payments from employers became constrained after note ban. Similarly, GST led to increase in compliance costs and other operating costs as most of MSMEs were brought into the tax net as over 60 per cent of them were not ready for the new tax regime. Credit growth fell significantly and turned negative during November 2016-February 2017. Therefore, it seems that demonetization accentuated the slowdown in credit growth, particularly to industrial sector. However, credit growth to the sector recovered after February 2017 to reach an average of 8.5 per cent in January-May 2018.*

**KEYWORDS**

impact on MSME, cashless society, objective of demonetization, economic development.

**JEL CODES**

E49, E51.

**INTRODUCTION**

**D**emonetization of currency means to discontinue with the said currency and issuing new currency by replacing the old one. According to Forbes "**Modi's Demonetization is a cure worse than disease in India**". Prior to the year 2016 demonetization, two similar instances took place. In India it has been done in

- 12 January 1946, Where Indian rupee 1000 and 10000 were withdrawn.
- 16 January 1978, where Indian Rupee 1000, 5000 and 10000 were withdrawn.

However, at the same time, it has created unavoidable income losses to the MSME sector which is basically cash based sector and where incomes are based on their daily work. Moreover, inadequate liquidity has caused gross disruption in all sectors of the economy and in India the digital transaction culture has yet to catch up with all sections. Following demonetization, the Indian economy is totally bereft of liquidity as 86% of the cash in the system is withdrawn without any speedy replacement.

**Demonetization can also be referred to as the process of moving people from a cash-based system to a cashless system (digital system).**

Keeping hard cash is a practice that is not encouraged by the government as well as financial institutions. It is easy for people to evade taxes in an economy where people mostly deal with cash. Keeping cash out of the bank also erodes the deposit base of these financial institutions and drives the cost of credits through the roof. It means that the government has to opt for foreign sources to secure funding and in the process increase the national debt. The economic impacts of which are many and severe. Moving people to a cashless system is, therefore, a favorable economic policy for many stakeholders.

**REVIEW OF LITERATURE**

- Dr. Manmohan Singh (2016): confronted that this step of present government to demonetize the currency will create disorder in lives of millions of poor people as cash is the base of their livelihood.
- Charon Singh (2016), RBI chair professor said that this step will result in positive and negative impacts on the society. He concluded that this will also bring up India's rank as it reflects that our country is against corruption and wants to eradicate it. Moreover, the output in agriculture and many more industries was reduced due to scarcity of cash.
- Patil (2016): Due to demonetization the credit cost dropped quickly which led to increase in raising money for investment purpose. As Rs 500 and Rs1000 notes were declared invalid people were forced to deposit their currency in banks to get it changed with new currency notes. Thus they were able to raise loan to be used for investment in business.
- Venkatesh and Muthiah (2012) examined the MSMEs in the industrial sector were showing positive growth and also highlighted the need of initiatives in this sector to ensure continued development.
- Srinivas K T, (2013) has studied the performance of micro, small and medium enterprises, and their contribution in India's economic growth and concluded that MSMEs play a significant role in inclusive growth of Indian economy.

**LIQUIDITY OF MSMEs**

Demonetization has also impacted the liquidity of MSMEs. The more affected micro, small and medium enterprises (MSMEs) belong to traditional sectors with high reliance on cash transactions such as textiles, agricultural products, steel, consumer durables, construction and automobiles. The impact of the drastic economic measures resulted in job losses and closure of several units, they added. The demonetization, announced on November 8, 2016, rendered 86% of India's old currencies of Rs 500 and Rs 1,000 invalid. According to sources there are 8.58 lakh crores of Rs.500 notes and 6.86 lakh crores of 1000 notes resulting in a total of 15.44 lakh crores being taken out of the system causing an acute liquidity dehydration.

Punjab and Haryana have more than 3 lakh MSMEs, predominantly in the manufacturing sector. Out of total MSME loans in Punjab, around 14% are NPAs, amounting to Rs 6,791 crore as of March 31, 2018. In Haryana, NPAs under the category of MSME loan, was about Rs 5,480 crore in the corresponding period,

which is 9% of the total MSME loans. "While the MSMEs are struggling to get loans from banks, many banks are offering safe passage to large companies by writing off their heavy NPA amounts.

### EFFECTS OF NOTE BAN ON MSMEs

Micro, small and medium industries play a vital role in the Indian economy. It generates a large part of GDP and provides employment to a large population. MSMEs were much affected by the demonetization as a large number of industries in this segment are organized and mainly follow the traditional cash basis transaction method. Soon after the demonetization, retail trade came down significantly from Rs 14,000 crore per day to Rs 3,500 crore per day. Further a data collected over 200 cities reveal that 90% of the small traders have witnessed decline in their trade. The acute shortage of currency has forced the MSME industries in Punjab to stop payment of their staff. So that, it has been seen that MSMEs has been largely effected by such move because of following of cash basis system and due to status of non-organized.

- Industry still facing liquidity crunch
- Around 30 per cent decline in orders
- Non-performing assets of MSMEs heading North
- Over 3 lakh MSMEs affected in Punjab and Haryana
- MSME accounts also turned non-performing assets (NPAs)

### PURPOSE OF DEMONETISATION

- **War on Black Money:** Black money is the money that has been earned illegally and not declaring them at the time of tax purposes. Black money is used in the form of real estate, foreign exchange, gold etc. Black money leads to cancerous growth in the country's economy which will surely lead to ruination.
- **To Promote Cashless Transaction:** The main purpose of demonetization was to promote cashless transactions. Cashless transactions can be done through various banking instruments like internet banking, debit card, credit card etc.

Statistics have shown Belgium, where 90% payment is done cashless followed by France 92%, Canada 90%, UK 89% and Sweden 89%, where in India only 22% is non-Cash payment. This proves that there is strong negative correlation between India and other countries with reference to online transaction. A cashless society would discourage money laundering and terrorism.

### LIMITATIONS OF THE STUDY

This study has covered only the Indian MSME Sector. On long term Effect the research has limited its scope in examining only the long term effect of Development in Micro, Small and Medium Enterprises. And this study has focused the development of micro, small and medium enterprises.

- Study is confined only to the Micro, Small and Medium Enterprises Development in India
- The study of this analysis was mainly based on primary and secondary data.
- The study is analysis was analyzing the performance of MSME sector in the present scenario.

### TOOLS OF ANALYSIS

The collected primary data are analyzed by using the mean, standard deviation, cross tabulation and chi square test.

### DATA SOURCES AND METHODOLOGY OF THE STUDY

The study involves a critical analysis of Development of some micro, small and medium scale enterprises in India. And this study gives importance to, impact of demonetization in MSME.

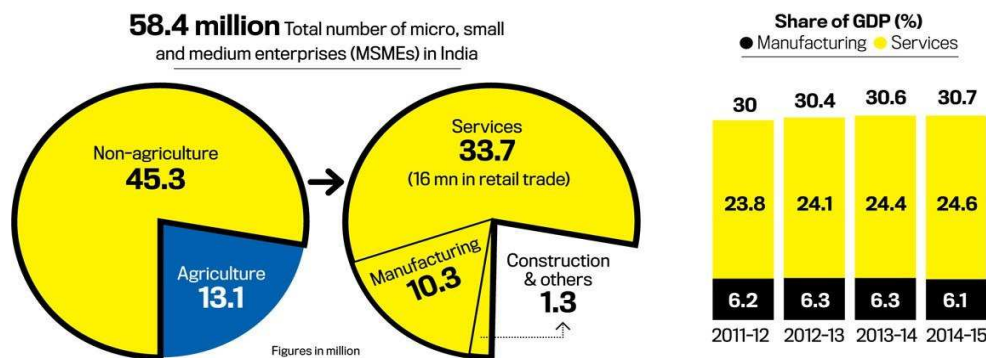
### RESEARCH METHODOLOGY

This study is concerned with the examination of impact On Demonetization Effects on Micro Small Medium Enterprises. The purpose of methodology is to describe the process involved in research work. It makes use of both primary data and secondary data. Micro Small Medium Enterprises who are the main source of primary data collected through a well-structured questionnaire. The current study is based on sample of 150 respondents from Indian MSME sector. Questionnaire and schedule are used as data collection tool for collecting necessary information from the respondents. The statistical tools like percentage, ranking, mean score, standard deviation are used for analyzing the data collected from the respondents.

### IMPACT ON VARIOUS SECTORS OF INDIAN ECONOMY

1. **GDP Growth** - The renowned economists said our economy is not growing more than 1% due to unorganized sector that has very badly affected by GST and demonetization. Now-a-days growth is less because demand is less hence investment and Bank credit is also less. Until and unless demand increase from unorganized sector growth will not increase, GDP growth has declined from 8% in 2015-16 to 7.1% in 2016-17.
2. **Real Estate** - 40%-plus drop in key markets in India. Dealers in secondary market must stand still. Home buyers waiting for big price reduction. After demonetization real estate industries will be more transparent in the years to come. 7% buyers shifted from 'Buying now' to 'Renting now'.
3. **On Employment** - being highly populated India has the highest number of unemployed people also. Every year 200 million people are entering to the job market. Since demonetization slowed the consumer demand, hence industrial production so employment generation is adversely affected. Hiring Experts say jobs at senior level are not and won't be impacted. Overall hiring is right down as managers seek to protect revenue/profit targets.
4. The sectors most affected are retail, consumer goods, real estate, infrastructure logistics and building.
5. **Tourism:** Peak tourism period badly hit during demonetization. Tourism business in metro cities gone down by 10%.
6. **Industrial Sector-** The industrial sector in India is an important contributor of growth accounting 31.1 % of the total gross value added (GVA) in 2016-17. A strong and robust industrial and manufacturing sector helps in country development, exports and employment. Demonetisation hit hard this sector especially manufacturing and construction sector.
7. **Telecom:** Mobile phone shipment fell by 26%. Big seller who does card and online transaction less badly hit. Sales for feature phone gone down by 25%.
8. **Agriculture:** Agriculture is a way of life in India and provides employment to 48.9% workforce and contributes about 20% in exports. This is the sector where all transactions are done in cash. Demonetization hardly hit this sector as there was cash crunch and for banks it was very difficult to take cash to these remote areas. Unfavorable impact of input and output channels in agriculture. Distribution breaks in supply chains etc.
9. **Information Technology:** The demonetization had a very less or negligible impact on IT sector.

CHART 1  
**THE MSME UNIVERSE**



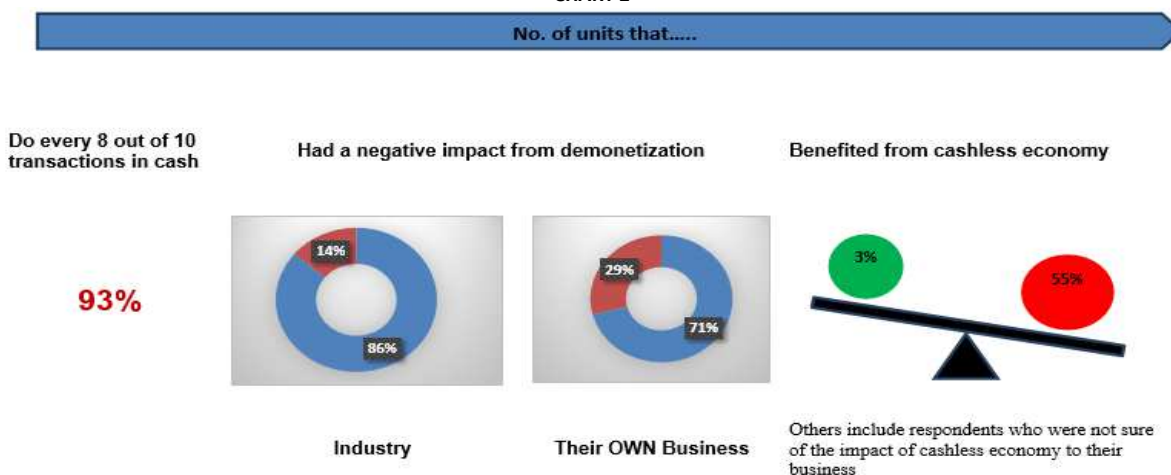
We see on MSME universe in India as a total number of MSME is 58.4 million. The non-agriculture based on 45.3million and agriculture based on the 13.1 million. On that 45.3 million of non-agricultural MSME as includes the services basis is 33.7million in that services as available the 16million of retail trade. It also includes the 10.3 million of manufacturing sector and 1.3 million of construction and others are shown in the time of non-agricultural scenario of MSME. On use of agricultural scenario in MSME is 13.1million. We see on Share GDP both manufacturing and services are increasing way on the basis of the year 2011 to 2015.

**DEMONETIZATION HAD A SEVERE NEGATIVE IMPACT ON THE SECTOR**

**DEMONETIZATION IMPACT: INDUSTRY & BUSINESS**

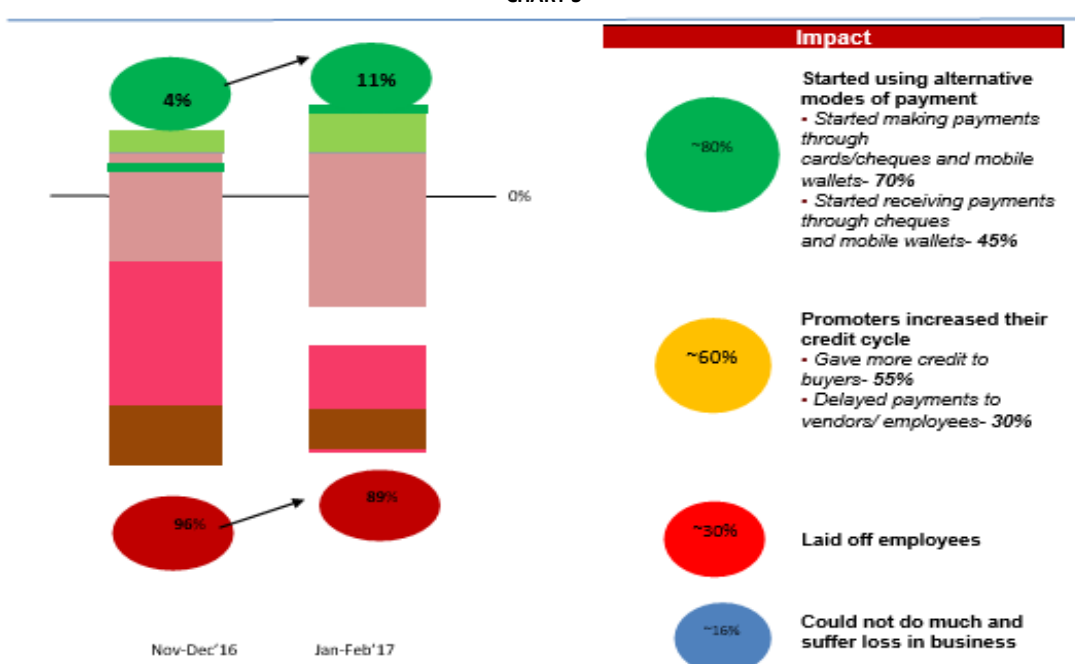
In %Respondents, N=150

CHART 2



**COMMENTS-** MSMEs are highly cash dependent, only 3% of the respondents claimed to have benefitted from cashless economy. Resulting in loss of employment, increased credit cycle and promoter had to lose a lot of business unless they took significant steps...

CHART 3



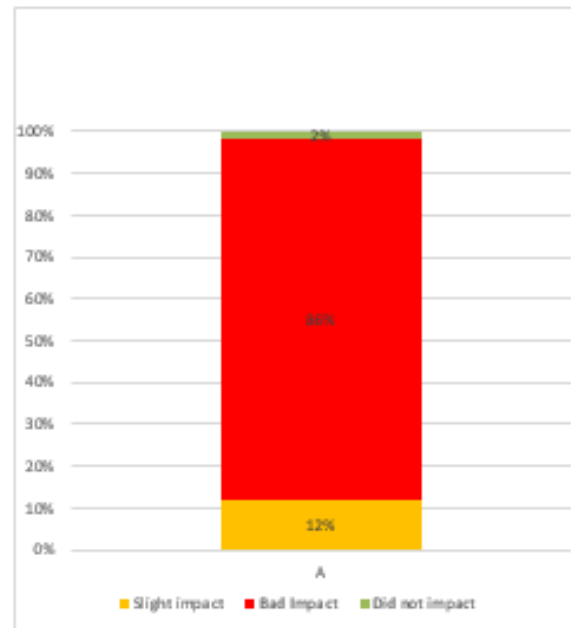
DEMONETISATION IMPACT ON INDUSTRY

In %Respondents, N=150

CHART 4

How was the impact of demonetization on your industry?

Industry was **negatively** impacted by Demonetisation with sales going **down** for ~all industries



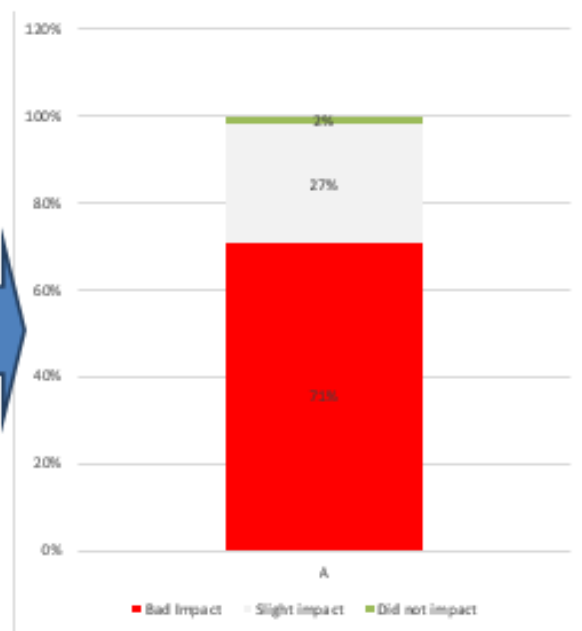
Demonetisation Impact On Respondents' Business

In %Respondents, N=150

CHART 5

What was the impact of demonetization on your OWN business?

Business were also **negatively** impacted by Demonetisation like the Industry

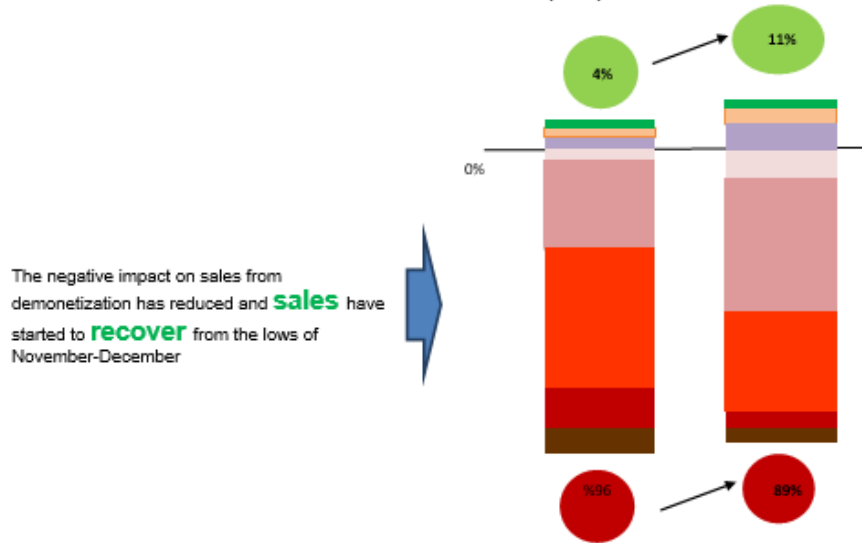


Sales impact post demonetization

In %Respondents, N=150

CHART 6

As per your estimate, how much was the impact on your business in terms of sales (in %)

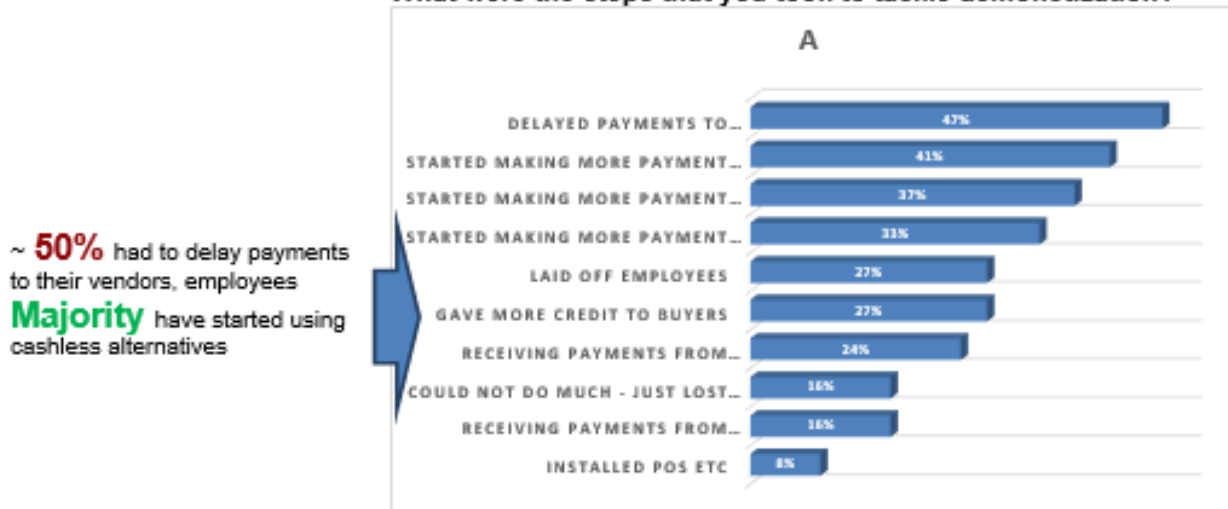


Steps taken by promoters to tackle demonetization

In %Respondents, N=150

CHART 7

What were the steps that you took to tackle demonetization?

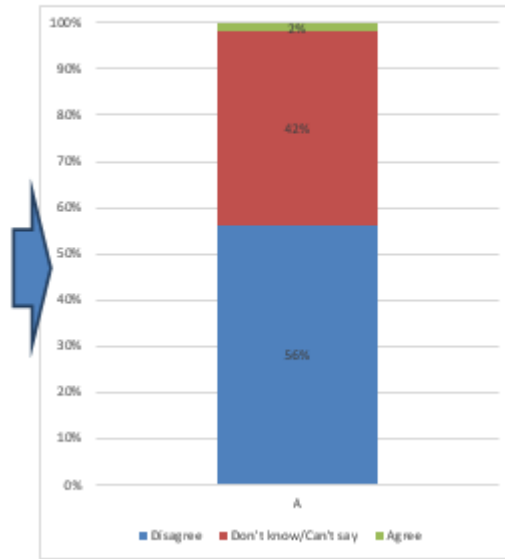


Benefits from Digital Transactions

In %Respondents, N=150

CHART 8

Have you benefited from digital transactions or See any benefit from same?



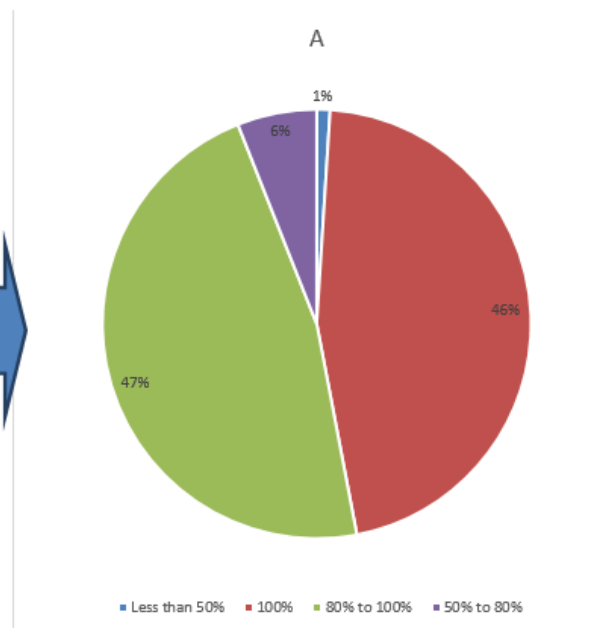
~98% people don't agree that digital transactions benefitted their business

Cash dependence of businesses

In %Respondents, N=150

CHART 9

How much of your business is usually done in cash?



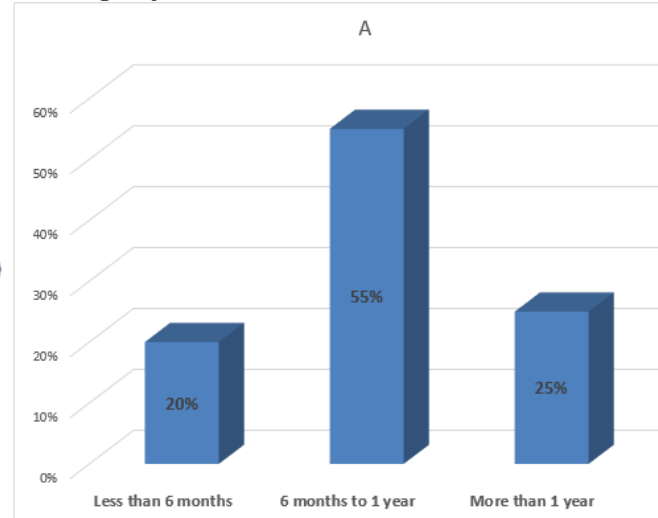
Business dependence on cash is ~90%

**Demonetization: Impact**

In % Respondents, N=150

**CHART 10**  
How long do you think the effects of demonetization will last?

**More than 50%** of Respondents feel that industry and business will take at least 6 months to a year to totally recover from the impact of demonetization  
**~25%** of the respondents said the effect will last more than a year

**CONCLUSION**

The move by the government to demonetise old currency and replacing it with the new one has taken the country by surprise. The move was an effort to handle the threat of illegal money, corruption, terror funding and counterfeit currency. Demonetization is not a surgical strike; it is carpet bombing. It impacts everyone. Replacement of currency 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. We see overall impact of demonetization affects negatively on the MSME sector's industry and business. Lot of changes in the employment and cash dependence businesses. The peoples are don't agree on digital transactions case of SMEs, most will be unsure of payments coming from customers for some time; this as 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. Overall development in demonetization will take long term to recover the business on normal level.

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