

## **HOSTILE IMPACT OF DEMONETIZATION ON MSME's IN INDIA**

**Jia Ravi Makhija**

Research Scholar

AISECT UNIVERSITY, BHOPAL

### **ABSTRACT**

*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 paper is based on secondary data collected from different newspapers and online sources, mentioned in references. The effect of demonetization has been studied on various participants of financial inclusion drive such as ordinary individuals, informal sector, rural population, MSMEs, NBFC MFIs and E-wallet companies. The demonetization decision was believed to have been taken to tackle the rampant corruption, unrecorded (or black money), and control the fake currency that often finances terror activities. As per the yearly report of Reserve Bank of India of 31 March 2016 that total currency notes in circulation is 16.42 lac crore of old Rs. 500 and Rs.1000 banknotes. As per the report of RBI dated on 14-12-2016, the total amount of old notes of value of Rs. 12.44 lac crore has been deposited by the customers till 10-12-2016. Banks started accepting deposits from 10 November but within a period of 15 days approximately half money has been received by the banks. The present paper is an exercise in examining demonetization impact on Micro and small enterprises (MSMEs).*

**KEYWORDS:** *Demonetization, MSME, GDP, Small Traders*

### **INTRODUCTION**

Micro, Small and Medium Enterprises (MSME) sector has emerged as highly vibrant and dynamic sector of the Indian economy over the last five decades. MSMEs contribute nearly 8 % of the country's GDP, 45 % of the manufacturing output and 40 % of the exports. MSME is estimated to employ about 595 lakh persons in over 261 lakh enterprises throughout the country. Further, this sector has consistently registered a higher growth rate than the rest of the industrial sector. MSMEs generally operate on tight budgets, and are often unable to procure adequate financial resources for the purchase of machinery, equipment, raw materials, or even day-to-day operational expenses which is due to account of their low goodwill and limited fixed investment base.

*The demonetization moves by the Government of India created multifaceted waves in the country. All the sectors of the economy had faced mixed emotions as a result of this move. When a currency note of a particular denomination ceases to be a legal tender it is termed as demonetization. But since our government is replacing the old Rs 500 notes with newer ones and doing away with the*

Rs 1,000 notes, it would be more appropriate to call the move as 'scrapping'. It is the process of devaluing a piece of currency to zero. In other words, changing the value of a particular denomination of currency to nil. Making it a piece of paper with absolutely no value greater than a regular piece of paper. When a currency note of a particular denomination ceases to be a legal tender it is termed as demonetization. Indian currency valuing 500rs and 1000rs notes were called invalid from 12am. of Nov 9th 2016.

## **OBJECTIVES**

- To study the of impact of demonetization on MSME
- To analyze the immediate impact of demonetization on financial status of MSME
- To bring out the government procedure of demonization on MSME sector
- To work out the pros and cons of demonetization on MSME
- To know how demonetization effects the technological advancement of MSME sector.

## **RESEARCH METHODOLOGY**

The given research paper is based on the secondary source of data collected from various newspapers and magazines, journals on finance and latest news.

## **REVIEW OF LITERATURE**

Mishu, Saurabh & Rikin did the work entitled "Challenges faced by micro, small and medium enterprise (MSME) Sector in India", in the year 2016. This paper examines the major issues in the financing of MSMEs in the Indian context, such as the information asymmetry facing banks and the efficacy of measures such as credit flow for MSMEs; whether transaction lending would be adequate to address the information issues or would lending have to be based on a relationship with the MSME, using both 'hard' and 'soft' information; and whether the size and origin of the bank affect the availability of credit to MSMEs.

Dahale, Khairnar, Jain & Patil did the study entitled on "Analysis of Role Played by Financial Institutions in Development of Indian MSME's" in the year 2015. This paper focuses on the role played by financial institutions in overall development of MSMEs across the nation. Paper also aims to evaluate opportunities and challenges in the sector for raising funds through financial institutions which should be considered by policy makers for better results

## **Unorganized MSME**

MSMEs are plagued by restrictive regulatory regime and inspector raj. The data on MSMEs, as per the Fourth Census of MSME, 2006-07, reveal that there are 200.18 lakh unregistered rural sector units, and they make up over 55 % of such enterprises in India while urban MSMEs are 161.58 lakh. The bulk of the MSMEs in India have turnover in just a few lakhs of rupees and

maximum of MSMEs are dominated by the micro enterprises. Majority of their transactions are on cash. With uneven spread of bank branches and ATMs among rural and urban regions, the micro and small enterprises operating in rural areas are adversely affected.

The Fourth All India Census shows that 4.3 % of MSMEs are registered while 95.7 % prefer to remain out of the radar. Of the registered MSMEs, only a fifth filed the Entrepreneur Memorandum Part-II (EM-II) as per the provisions of the MSMED Act, 2006. Much of the small businesses prefer to remain in unorganized sector in fear of compliance to various business laws.

### **IMPACT OF DEMONETIZATION ON SME**

The small and medium-sized enterprise (SME) sector is a big chunk of the economy, contributing to eight percent of the GDP whilst employing more than 80 million people year on year. Most SMEs are traditionally-operated, family-run businesses. Broadly, there are two kinds of players in the market in this segment. One, the businesses that were formed because their promoters saw the opportunity early on before anyone else could and went on to become successful businesses quickly.

While much attention has been focused on the manner in which demonetization has inconvenienced the general public, the sudden invalidation of 86% of Indian cash may create a short-to-medium-term impact that is brutal for small businesses. The importance of Micro, Small, and Medium Enterprises (MSMEs) cannot be overstated. According to the estimates of the Ministry of MSME, the sector generates around 100 million jobs through over 46 million units.

Where GDP growth moderation due to demonetization is estimated at 50bps at the lower end to as much as 300bps at the higher end, it can be presumed that the impact on MSMEs will be higher than the rest of the economy due to their greater dependence on hard cash. Their virtuous cash cycle begins from an expense base that is almost exclusively cash-based. This then incentivizes the business to earn revenues in cash as well.

The following are the impact that demonetization will have on the SME sector

#### **Impact on Receivables from Customers**

Most MSMEs found demand for their products and services taking a dip. The impact was uneven in rural and urban areas. The rural segment was hit even more badly than their urban counterparts because of greater availability of cash, a sparse bank branch network and rather no digital payment systems. The MSMEs' receivables have been increasing due to lack of bargaining power with large corporate customers. And the compulsion to deal with large corporates to avail of bulk orders and to increase scalability has meant many MSMEs face difficulty in managing their working capital.

### **Impact on Credit**

MSME is one segment of the economy which is credit constrained. About 17% of the bank lending is to MSMEs. Expansion in the potential credit in the economy could expand the credit available to this segment of the economy which is more employment intensive than the organised manufacturing. In other words, if the access to credit for this segment can be improved, it can generate many positive spin-offs. One reason why this segment might get better access to formal sector credit would be if all their transactions move to the digital format, thereby making available to the lending institutions evidence of credit worthiness. However, for this the transactions need to move digital before they can get access to credit. In other words, unless the banking sector is exploring more risky asset categories, they would not be the beneficiaries of the expansion in potential credit. It should be kept in mind that credit is not the only constraint faced by the MSMEs. There is a cost of compliance with regulation in the formal sector both of tax legislation and other legislation which would increase the cost of operation. In the absence of economies of scale, after incurring all these costs, some of the MSMEs might not be viable in the new environment. 41% of MSMEs say that their clients have shifted to cheque/electronic payment since demonetization.

### **Impact on Employment**

Demonetization has had an adverse impact on job creation in the economy as the micro, small and medium enterprises (MSME) sector bore the brunt of the reduced cash in circulation. MSMEs that primarily engage in infrastructure projects reported 35 % cut in employment and 45 % revenue loss. Industries engaged in export-oriented activities (including foreign companies) reported 30 % job losses and 40 % revenue fall. In the manufacturing sector, medium and large scale industries reported a revenue hit of 20 %.

### **Impact on Operations**

MSMEs stopped operations for certain period of time as the withdrawal limits were small and they would therefore not be able to source material or pay off workers, particularly those on weekly basis. MSMEs sector has been impacted significantly as the sector is majorly driven by the contractual and daily wage work force and most of the mobile work force doesn't have their bank accounts at the place of their working whereby lots of working capital and transaction of money from various entity to the target entity but due to demonetization the market lacked the sufficient amount of currency which is essential for this units to run fluently and smoothly. Impact on prices is prevalent on most of the products due to demonetization. As cash withdrawal was limited, even the basic functioning of units got choked. Units found it difficult to pay wages and meet expenses for transport.

### **FINDINGS**

- Demonetization will require a wholesale rethink by participants in the parallel economy.

Businesses need to think about first entering the banking system, second digitizing, and third full declaration. Big resets to practices and mindsets will need to happen for this coming as this move does just months before the planned implementation of GST.

- Undercutting legitimate, competitive businesses through lower pricing via cash dealings will probably end or at least reduce. This will improve the overall competitiveness of MSMEs generally. Enterprises with organized systems and planning processes will make the transition sooner, giving themselves a tangible advantage, thus taking the already substantial contribution of 38% to GDP or even higher.

- On the capital front, many MSMEs faced difficulties in credit appraisal before demonetization due to the large volume of unaccounted transactions. Once the initial setback phase is over and businesses streamline their processes and accounting, they will be able to access credit markets more efficiently and at better pricing, thus lowering their cost of funding.

## **CONCLUSION**

The impact of demonetization has not been confined to the manufacturing sector. Its impact on services and other tertiary activities, especially in the small-scale sector, has been quite profoundly adverse.

If the money disappears, as some hoarders would not like to be seen with their cash pile, the economy will not benefit. On the other hand, if the money finds its way in the economy it could have a meaningful impact. However, experiences from different countries shows that the move was one of the series that failed to fix a debt-burdened and inflation-ridden economy.

De-monetization has already affected the micro, small and medium enterprises. Since the bulk of transactions in this sector are cash-based, a liquidity crunch will likely cause a slowdown in economic activity. In the medium and long-term, however, there is reason for optimism. The inflow of deposits should logically allow for lower interest rates, spurring investment in this sector. Further, the shift towards cashless transactions will encourage registration among such enterprises and allow them to benefit from central and state schemes and incentives. The access to low cost capital should also improve if there is a significant shift to a digital and cashless economy

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