RESEARCH REVIEW JOURNALS
ICSSR-NLSFIRU
SEP- 2018
Special Issue
ISSN: 2455-3085 (Online)
RESEARCH REVIEW International Journal of Multidisciplinary
www.rrjournals.com [UGC Listed Journal]

Demonetization Boon or Bane of Financial Inclusion in India

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ARTICLE DETAILS

Article History
Published Online: 05 October 2018

Keywords
Demonetization, Financial Inclusion, Digital Finance, Insurance, NBFC's

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ABSTRACT

Demonetisation announced on November 8, 2016 was aimed at addressing corruption, black money, counterfeit currency and terror financing. Although demonetization holds huge potential benefits in the medium to long-term, given the scale of operation, it was expected to cause transient disruption in economic activity. The analysis in this paper suggests that demonetization has impacted various sectors of the economy. Secondary data collected from published journals, magazines and RBI reports. This paper finds that the demonetization created a transformation among the consumers and merchants in all the financial services segments.

1. Introduction

Financial inclusion is the conveyance of financial administrations at moderate expenses to tremendous areas of impeded and low wage gatherings. It is a key measure for comprehensive development and increased fast energy with the administration choice of restricting the Old High Denominations prompting by and large improvement of the economy and profiting the general public overall. India the second biggest populated economy taking such major and medium-term choice like forbidding Old High Denominations. On November eighth 2016 a noteworthy testing and dynamic choice was taken by the Indian Prime Minister Mr.NarendraModi to boycott all the old higher Denominations that cleared method to utilizing account to all the unlawful exercises of subsidizing hostile to psychological oppressor exercises , to check dark cash and defilement by invalidating about 86% of notes.

The estimation of fake notes to unique was 250 out of one million. The move was a help in camouflage to the banking sectors as it would bring into its overlay the undiscovered business covering a noteworthy populace and making familiarity with comprehensive development. Financial inclusion would be perfect to be examined on two noteworthy fronts 1) Individuals with a ledger and 2) Individuals with no ledgers. Despite numerous changes being taken since 5 years the rate increment is impressively low as just 65% of grown-ups do have a financial balance of which 23 percent is lethargic. This emphasizes the point that opening formal records isn't the response for financial inclusion. The roots in Indian economy portray 45% of Gross domestic product and 80% of work in real money driven casual market which is to be promptly incorporated into the administrative procedure. This likewise incorporates computerized and non-digital funds.

Digital Financial inclusion statistics showed that nearly 49 Percent of adults are digitally included but the real purpose of usage became a debatable issue and little data is available on this. The dream of maximum population utilizing bank services was visualized with the demonetization scheme implementation. The banning of the old higher denomination (Old High Denominations) pushed people to the banks to deposit their Old High Denominations to exchange with the newer ones. The big queues in Banks and ATMs made us understand a point that India has a long journey ahead depicting a financial illiteracy to the maximum and reminding that many levers in the society have to operate simultaneously to make INDIA a cashless society. Fintech providers opine that the demonetization pill will not change the scenario overnight. This is to bring the economic exchange into the fold of taxable system by introducing digital finance.

2. Demonetization in India

Indian currencies with denomination 500 and 1000 have ceased to be the medium of exchange from the midnight of 8th November 2016. This demonetization move is implemented as a tool to measure the stock of black money hoarded in these high denomination currencies, and to curb terrorist activities in the country. The government aims to bring the unaccounted money back to the formal banking sector by allowing limited exchange and unlimited deposit of old notes in bank accounts till the end of 2016. However, the biggest problem is that the distinction between unaccounted cash and black money is lost. Money that is derived from illegal activity is harmful, but money circulated in small businesses only adds to economic activity. Indian economy is heavily dependent on cash. Inadequacy of bank branches is one primary reason why cash dominates especially among small businesses. Every bank branch in a rural and semi-urban Centre caters to more than double the number of people in an urban and metropolitan Centre. According to December 2015 Reserve Bank of India Report, each rural and semi-urban bank branch serves 12,863 people compared with an urban and metropolitan branch which serves just 5,351 people. There were 7.8 branches for one lakh people in rural India, but 18.7 branches in urban India. The spread of ATMs too is skewed in favor of urban Centre's.

Initially, broadly, demonetization of high currency notes had a two-fold objective – first, choking the funding channels of militancy and terrorism from across the border and to fight corruption. Since then, in continuing the focus on corruption, government has placed emphasis on digitizing India. The amount of demonetized notes which subsequently returned to the Reserve Bank of India (RBI) between November 8 and December 31, 2016 strongly demonstrates that corruption is rampant in the economy. The eradication of corruption is not only a social necessity but also has strong economic rationale. The war against the malaise of corruption has to go beyond a series of surgical strikes and needs precise planning with scenario analysis, and then flawless execution. In that respect, demonetization of November 2016 deserves a contextual review wherein the government may consider strengthening efforts to eradicate corruption from an exclusively tax-oriented approach to a broad-based approach. Prevention of corruption needs strong policy deterrence which requires effective administration, and technology-based data processing to generate actionable intelligence.

Understanding demonetization as a policy instrument requires analyzing its effect on performance of the major macroeconomic indicators. The trend from such analysis in the last one year since November 2016 indicates that economy is recovering. The immediate pain in terms of non-availability of high value currency notes could have got reflected in reduction of output in agriculture, which might have in turn spilled over to industry and services. Due to short-term nature of the liquidity constraint, it was expected that consumption might not get impacted, as also business investment which is largely based on overall climate and interest rates.

In the initial months, demonetization was expected to lead to lower conspicuous consumption and real estate activity which could result in suffering of residential investment, impacting nearly 300 industries which provide inputs in housing sector. Therefore, India's growth rate in short run was a matter of concern. The microfinance institutions, in the absence of high denomination notes, could have suspended some of their operations for a short time. In the long run, implications were uncertain. On one hand, confidence in efficient management of the economy would have led to a positive effect while a shock strike at unaccounted economy could have led to shrinkage in production, especially in the informal sector including micro, medium and small enterprises

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3. Review of Literature

Nithin and Sharmila (2016) studied demonetization and its impact on Indian Economy. They opined that demonetization has short term negative impact on different sectors of the economy and such impacts are solved when the new currency notes are widely circulated in the economy. They also argued that the government should clear all the problems created due to demonetization and help the economy to work smoothly.

Nikita Gajjar (2016) deliberated a study on Black Money in India: Present Status and Future Challenges and Demonetization. She described the framework, policy options and strategies that Indian Government should adapt to tackle with this issue and the future challenges to be faced by the Government.

Sherline T.I (December 2016) has undertaken the research on "Demonetization as a prelude to complete financial inclusion ". The main objective of the study was to understand the importance of demonetization as a measure of financial inclusion. The study shows that this move of the Government has likely to create long term benefits. More over medium to long term Current account and Saving account (CASA) ratio could improve. More over demonetization would reduce cash transaction the real estates, which may decrease the price of that avenues which make it affordable to general public. More over the near future inflation will decrease due to less cash transaction.

Vijay and Shiva (2016) examined demonetization and its complete financial inclusion. They felt that the rewards of demonetization are much encouraging and the demonetization is in the long-term interest of the country. They expressed that it had given temporary pain but it taught financial lessons. It influenced banking industries to do considerably investment on digitalization of banking services.

ManpreetKaur (2017) carried out a research on demonetization and the impact on Cashless Payment System. He finds out that the cashless system in the economy has many fruitful benefits less time-consuming, less cost, paperless transaction, and he anticipated that the future transaction system in all the sectors is a cashless transaction system.

MrBrijesh Singh and Dr. N. BabithaThimmaiah (2017) in their research paper studied the effect of demonetization in terms of "Won or lost". It is not all about how much money you are having in your wallet; you can pay by any of the bank card or banking transfer. In the research paper they had shown the effect of demonetization in the areas like, cash rush, stock market, transportation, agriculture, banking, business, income tax, railways etc.

4. Objectives of the Study

- To study the overview of demonetization.
- To study the effects of demonetization and Deposits under PMJDY.
- To understand the growth in digital finance due to demonetization
- To study the effect of demonetization on different sectors (Insurance & NBFC's).

5. Research Methodology

The study is based on secondary data. The required data has been extracted from various sources like Research Papers, various bulletins of RBI, published sources like Reports, Magazines, Journals, Newspaper articles and the authenticated websites.

6. Results & Analysis

Unaccounted Cash Flows

Prior to demonetization, a majority of PMJDY accounts were opened in rural and semi-urban Centre's than in urban Centre's and metros. Following demonetization, public sector banks (PSBs) opened more accounts under the Pradhan Mantri Jan Dhan Yojana (PMJDY) in urban Centre's than in rural areas. Deposits in Jan Dhan account have more than doubled to Rs87,000 crore in 45 days post demonetization.

Table No.1: Deposits under PMJDY (No. of Accounts)

(Rs. In Millions)

Bank Groups	As on 9th Nov. 2016			As on 1st Mar. 2017			Variation		
	Rural	Urban	Total	Rural	Urban	Total	Rural	Urban	Total
Public Sector Banks	114.3	89.3	203.6	122.1	100.8	222.9	7.8 (6.8)	11.5 (12.9)	19.3 (9.5)
Regional Rural Banks	37.1	6	43.1	40	6.4	46.4	2.9 (7.8)	0.4 (6.8)	3.3 (7.7)
Private Sector Banks	5.3	3.1	8.4	5.4	3.6	9	0.1 (1.3)	0.5 (16.8)	0.6 (7.0)
Scheduled Banks	156.7	98.4	255.1	167.5	110.9	278.4	10.8 (6.9)	12.59 (12.7)	23.3 (9.1)

Source: Macroeconomic Impact of Demonetization, RBI.

The above table reveals that, during post demonetization 23.3 million new accounts were opened under the Pradhan Mantri Jan Dhan Yojana (PMJDY), bulk of which (80%) was with public sector banks. Of the new Jan Dhan accounts opened 53.6% were in urban areas and 46.4% in rural areas. The total balance in PMJDY deposit accounts peaked at Rs. 746 billion as on 7th December, 2016 from Rs. 456 billion as on 9th November, 2016 an increase of 63.6%. As there were reports regarding the use of these accounts to convert black money into white, the government issued a warning against the misuse of such accounts.

Table No.2: Deposits under PMJDY (Amount Mobilized)

(Rs. In Billions)

Bank Groups	As on 9th Nov. 2016	As on 1st Mar. 2017	Variation	Variation in Aggregate (17.02.2017 over 11.11.2016)	Accretion in PMJDY Deposits % *
Public Sector Banks	364	502.5	138.5 (38.0)	2733.0 (3.9)	5.1
Regional Rural Banks	76.3	118.1	41.8 (55.0)	616 (18.0)	6.8
Private Sector Banks	16	22.3	6.3 (39.0)	778.0 (3.5)	0.8
Scheduled Banks	456.4	642.9	186.5 (41.0)	4098.0 (4.1)	4.6

Source: Macroeconomic Impact of Demonetization, RBI.

* The ratio pertains Jan Dhan Deposits as on 15.02.2017

The above table reveals that, the government also capped deposits into PMJDY accounts atRs. 50,000 on 15th November, 2016. Although deposits declined to Rs. 643 billion as on 1st March, 2017, they were still higher by 41% over the level of 9th November, 2016. Jan Dhan accounts contributed 4.6% in total accretion of aggregate deposits of Scheduled Commercial Banks in post demonetization period.

Digital Finance:

Increase in the Usage of digital finance consistently figures that country is moving towards cashless economy. Various Systems of digital mode have increased the flow of unaccounted cash from to banks increasing the inclusions in financial services.

Table No.3: Digital Payment Mode System

Digital Payment Mode System in Pre & Post Demonetization

Channel	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17
EFT/NEFT	118	119	113	119	120	133	123	166	164	148	187	143
IMPS	28	30	32	34	36	42	36	53	62	60	67	65
NACH	161	167	190	153	157	169	153	199	159	150	191	222
Cards	942	927	961	972	946	1032	907	1162	1154	1039	1089	1035
PPIs	71	77	78	96	97	127	169	261	296	280	342	352
Mobile Banking	61	63	64	70	73	78	85	111	106	95	114	106

Outstanding	703	717	723	739	755	767	772	789	847	869	885	898
No. of ATMs	214271	215192	216030	216997	218542	219578	220166	219793	220402	221302	222475	221959
No. of POS	1415582	1432727	1443899	1496769	1480309	1512068	1589263	1767733	2015847	2224977	2529141	2614584

Source: RBI Website

- **a. EFT/NEFT**: Transferring electronically funds from any branch of the bank to another account. According to RBI reports NEFT has increased by 20% in volume and 24% in value from Nov 2016 to Feb 2017.
- **b. IMPS:** Immediate Payment Services (to transfer through net banking money immediately) have increased by 65% in volume and 48.5% in value in just a period of 3 months Post demonetization
- **c. NACH:** National Automated Clearing Houses are the electronic clearance services on credit and debit payment done by banks to avoid the payment charged by the credit houses
- **d. Prepaid Payment Instruments** like M-wallets, Paper vouchers have increased from 169 million to 280 million over 3 Months.
- **e. ATMs**: Number of ATMs have increased by 1 million e. Mobile Banking: It has increased by 15 million within one month.
- **f. Cards outstanding**: The cards outstanding has increased from700 million to 898 million. These digital payments system has increased the number of Account holders in just a period of six months' post demonetization.

Life Insurance Companies

Premiums collected by life insurance companies more than doubled in November. Premiums collected by Life Insurance Corporation of India (LIC) increased by more than 140 per cent (y-o-y) in November 2016 as compared with less than 45 per cent by private sector life insurance companies. About 110 per cent of the total collections by LIC in November 2016 were under the 'single premium' policies, which are paid in lump sum, unlike the non-single premium policies that can be paid monthly, quarterly or annually.

Table No.4: Life Insurance Premiums

(Rs. In Billion)

Category	Oct-15	Oct-16	Nov-15	Nov-16	Dec-15	Dec-16	Jan-16	Jan-17
Private Insurance Companies	28	35	24	35	37	48	36	44
Y-O-Y growth %		25.0%		45.8%		29.7%		22.2%
LIC	80	76	52	125	73	83	67	87
Y-O-Y growth %		-5.0%		140.4%		13.7%		29.9%
Grand Total	108	111	76	160	110	131	103	131
Y-O-Y growth %		2.8%		110.5%		19.1%		27.2%

Source: Macroeconomic Impact of Demonetization, RBI.

Non-Banking Financial Companies (NBFCs)

Loan disbursals by all categories of NBFCs declined significantly in November 2016 compared with the monthly average disbursals during April-October 2016, especially for micro finance companies (NBFC-MFIs) whose business is more cash intensive. Inability of borrowers to make down payments slowed consumer loans. The demand from real estate sector was anecdotally the worst affected as buyers expected prices to decline sharply. To sum up, demand for credit declined due to customers postponing decisions on account of uncertainty.

Table No. 5: Disbursals by Non-Banking Finance Companies in India

(Rs. In Billion)

Category	Monthly Average Disbursals		Nov-15	Dec-15	Nov-16	Dec-16
	Apr-Oct 2015	Apr-Oct 2016				
Asset Finance Companies (19 Companies)	122	145	125	150	123	161
Loan Companies (19 Companies)	296	361	322	373	278	293

Micro Finance Companies (17 Companies)	34	51	39	54	29	25
Housing Finance Companies (81 Companies)	207	243	199	250	232	261

Source: Macroeconomic Impact of Demonetization, RBI.

In contrast with loan growth, collections (i.e., repayments of loans due) of loan companies (LCs) during both November and December 2016 increased over the monthly average collections during April-October 2016. Although collections by asset finance companies (AFCs) declined in November, they increased in December 2016. Collections by NBFC-MFIs declined in both November and December vis-à-vis April-October 2016, but December figures were better than those of November 2016. Consumer finance, which is mainly through post-dated cheques was less affected. Collections by HFCs, after marginal contraction in November, rebounded significantly in December 2016.

Table No. 6: Collections by Non-Banking Finance Companies in India

(Rs. In Billion)

Category	Monthly Average Collections		Nov-15	Dec-15	Nov-16	Dec-16
	Apr-Oct 2015	Apr-Oct 2016				
Asset Finance Companies (19 Companies)	105	120	107	117	117	127
Loan Companies (19 Companies)	239	203	251	295	217	223
Micro Finance Companies (17 Companies)	28	46	31	35	44	46
Housing Finance Companies (81 Companies)	124	165	108	162	161	180

Source: Macroeconomic Impact of Demonetization, RBI.

The growth of credit extended by banks to NBFCs also appeared to have been impacted due to demonetization. Bank credit growth to NBFCs decelerated from 5.1 per cent on y-o-y basis in October 2016 to 1.3 per cent in November 2016, which further declined by 0.6 per cent in January 2017.

7. Conclusion

Demonetization had a strongly positive effect on financial inclusion, leading to increases in account registration, and active and advanced use of registered accounts. In Post demonetization the usage of financial services increased dramatically. There was a great advancement from nonusers to users, increasing the financial inclusion in the country. The requirement to exchange demonetized notes was a strong impetus for financial engagement that overrode tendencies towards non-engagement. The increase in the number of Post Office Bank users may not be a lasting change now that all demonetized notes have been exchanged. The cash shortage did contribute to increased mobile money use, but not to the degree approaching the envisioned “cashless society.” More effort is required to spur mobile money adoption, particularly among less well-off consumer segments. Maximum of consumers and merchants were adopted cashless payments to facilitate transactions during the cash shortage after demonetization. However, the few merchants who did adopt these products and services found them valuable, which indicates that barriers to uptake are not product-specific but related to limited utility in the current context of early adoption.

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