Impact Of Demonetization On The Indian Retail Industry

Swadesh Deepak
Research Scholar, Faculty of Commerce, Udai Pratap Autonomous PG College, Varanasi, U.P.

Abstract

The 8th November, 2016 is the important date in the history of the Indian economy, when our honorable Prime Minister announced the decision to demonetize the 500 rupee note and 1000 rupee note. It was a surprise move that has affected the consumption activity in the Indian economy. This move has affected the Indian retail sector due to lack of liquidity in the economy.

It has also resulted into the low footfall in shopping malls, more use of plastic money and electronic payment. The impact is felt more by the small traders and the unorganized retailing segment as their transaction is in cash. But it is estimated that Indian economy can grow considerably after curbing the counterfeit money and increase in the economic activity. This paper analyses the impact of demonetization on the Indian retail sector both organized and unorganized. The argument posited in favour of demonetisation is that the cash that would be extinguished would be “black money” and hence, should be rightfully extinguished to set right the perverse incentive structure in the economy. While the facts are not available to anybody, it would be foolhardy to argue that this is the only possibility. Therefore, it is imperative to evaluate the short run and medium-term impacts that such a shock is expected to have on the economy. Further, the impact of such a move would vary depending on the extent to which the government decides to remonetise. This paper elucidates the impact of such a move on the availability of credit, spending, level of activity and government finances.

INTRODUCTION
The movement against the black money was initiated by former law minister Ram Jethmalani along with many other well-known citizens.
They filed a Writ Petition (Civil) No. 176 of 2009 in the Supreme Court of India seeking the court's directions to help bring back black money squirreled in tax havens abroad and initiated efforts to strengthen the governance framework to prevent further creation of black money. The Supreme court on 4 July 2011, ordered the appointment of a Special Investigating Team (SIT) headed by former Supreme court judge BP Jeevan Reddy to act as a watch dog and monitor investigations dealing with the black money. On 12 May 2015, Ram Jethmalani attacked Modi Government for failing to bring back the Black money as was promised before Election. On 2 November 2015, HSBC whistleblower Herve Falciani said he is willing to "cooperate" with the Indian investigative agencies in black money probe but would need "protection". Prashant Bhushan and Yogendra Yadav furnished a letter written by Falciani on 21 August 2015, to Justice (retd) M B Shah, who is heading the SIT on black money. Under the supervision of the SIT the I-T department has recovered just around Rs 3,500 cr from some of the account holders and expected to recover a total of 10000 crore till March 2015. When Narendra Modi came on the position of Prime Minister, he took several steps like Beti Bachao, Digital India and Sawach Bharat campaign. Demonetization move was taken after the expiry of 3 months’ time given to the people to disclose their income on which tax had not been paid yet. This move is a part of his initiated campaign Sawach Bharat (cleanliness of India) and Digital campaign (create transparency in the movement of money and information). 8th November, 2016, the day of demonetization of the bank notes rupees 500 and rupees 1000.

The two highest currency denomination that was available in India was no more a legal tender after this date. The old denomination can be utilized for commercial transaction till 10th December, 2016. This decision was estimated will hit the economy hard for the short term. The consumption activity was grinded and the Indian economy came on the verge of a halt. As retail segment involves a lot of cash transactions. After this decision, the sales of this sector was estimated to be reduced over the next one or two quarters. The impact is felt more on the unorganized and small traders than the organized retailers. However, use of plastic money and transactions through
online payments will release the money into the retail segment. The domestic consumption was estimated that it will be stable due to India’s strong economic base and demographics. Low footfalls in the shopping malls were there but this situation was estimated to be temporary and turnaround as and when more currency would be circulated in the market. The market eco system will become more transparent and structured after this decision.

**Demonetization**

Government of India announced demonetization of the high value currencies of Rs. 500 and 1000 with an objective to unearth the black money and to curb the corruption, counterfeit currency as well as terror funding. This decision is considered as biggest cleanliness drive against the black money in the history of Indian economy whose benefits will be reaped in the long run. However, the impact of this sudden move is causing major cash crunch in the economy affecting day to day requirements of the common man and businesses. Various analysts, experts and scholars have expressed their views regarding impact of demonetization on the economy and have estimated 0.5% - 3% impact on the Gross Domestic Product (GDP) of the country in the current financial year 2016-17. Against this backdrop, PHD Research Bureau of PHD Chamber of Commerce and Industry conducted a survey to assess the impact of demonetization on the Economy, Businesses and People. The major objective of the survey was to know the feedback on the Economy, Businesses and People and to provide few recommendations to the Government for effective implementation of remonetisation.

**SHORT-TERM AND MEDIUM-TERM IMPACTS OF DEMONETIZATION:**

**Short-term Impact:**

The demonetisation, by removing 86 per cent of the currency in circulation, has resulted in a very severe contraction in money supply in the economy. This contraction, by wiping out cash balances in the economy, will eliminate a number of transactions for a while, since there is no or not enough of a medium of exchange available. Since income and consumption are intrinsically related to transactions in the
economy, the above would mean a severe contraction in income and consumption in the economy. This effect would be more severe on individuals who earn incomes in cash and spend it in cash. To a lesser extent it would also affect individuals who earn incomes in non-cash forms but need to withdraw in cash for consumption purposes, since a number of sectors in the economy still work predominantly with cash. In terms of the sectors in the economy, the sectors to be adversely affected are all those sectors where demand is usually backed by cash, especially those not within the organised retailing. For instance, transport services, kirana, fruits and vegetables and all other perishables, would face compression in demand which is backed by purchasing power. This in turn can have two effects: while it is expected that supply exceeds demand, there would be a fall in prices, however, if supply too gets curtailed for want of a medium of exchange, prices might, in fact, rise. Thus, while generally people seem to expect prices to fall, it is quite possible that prices would instead rise.

**Medium-term effects:**

In the medium term, the effects would be related to the extent to which the currency is not replaced within the economy. If the entire currency is replaced, there would not be any major effects on the economy. However, it is to be expected that the entire currency would not be replaced – to the extent currency is extinguished and to the extent some of the currency remains as bank deposits, there would be some impact on the economy. The first effect would be a compression of the economy to the extent the extinguished currency was working as a medium of exchange. The currency that is placed in the banks but not withdrawn, it is argued, would generate an expansion in deposits in the economy. In the discussions on demonetisation, there is a consistent reference to the resultant increase in credit creation in the economy. Like Finance Minister Arun Jaitley says, “Bank deposits will increase and they will have more capacity to support the economy.”4 The total cumulative credit that can potentially be generated is defined in terms of the reserve ratio. Total credit potential = incremental deposit generated
Economic Shock to the Indian Economy- with the Demonetization Step:

Economic shock has a long history that had an unexpected effect on the Indian economic system. Although some shocks have a positive impact, for instance, technological breakthroughs. Other types of economic shocks are fiscal profligacy, world trade shock, oil price shock, counterfeiting of notes and money earned on which taxes are not been paid. In India, funds earned in the black market on which taxes have not been paid or which is the outcome of criminal activities such as bribery, kickbacks and corruption have paralyzed the Indian economy. India ‘s Central Bureau of Investigation said that Indians have US $ 500 billion of illegal funds in foreign tax havens, more than any other country.

According to 3rd report published in May, 2012, Swiss National bank estimates total deposits as below:

<table>
<thead>
<tr>
<th>Country</th>
<th>Money Deposited</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>US$1, 456 billion</td>
</tr>
<tr>
<td>Russia</td>
<td>US$ 470 billion</td>
</tr>
<tr>
<td>UK</td>
<td>US$ 390 billion</td>
</tr>
<tr>
<td>Ukraine</td>
<td>US$ 100 billion</td>
</tr>
<tr>
<td>China</td>
<td>US$ 96 billion</td>
</tr>
</tbody>
</table>

India topped the position in the context of black money deposited in the Swiss bank account. This report had created the economic shock in the country. On 8th November, 2016, the government has implemented a major change in the economic environment by demonetizing the high value currency notes of 500 and 1000 rupees denomination. The plan by the government involves the exclusion of these existing notes from circulation and a gradual replacement with a new set of notes. In the short term, it is intended that the cash in circulation would be substantially cuddled since there are limits placed on the amount that individuals can withdraw. The explanations...
offered for demonetization are to control counterfeit notes that could be contributing to terrorism, in other words a national security concern and to undermine or eliminate the “black economy”. According to the table A, it has been interpreted that without any jugglery of numbers, this ratio could be simply higher at around 17 per million NIC if it is assumed that counterfeiting in lower denomination notes (less than 100 rupee) is negligible, which is more realistic, and it might be possible that the whole bunches of about two million counterfeit notes (19,52,160) detected over a period of five years had been there in the system to begin with, which got detected over a five-year period. Counterfeiting money has been prevalent throughout history and is sometimes called the world’s “second oldest profession.” In India, the circulation of fake Indian currency notes (FICN) has been on the rise, according to the Reserve Bank of India’s (RBI) annual reports. The Financial Action Task Force (FATF) report of 2013 found that the Indian rupee was the ninth most counterfeited currency in terms of its value and stood third in terms of the number of FICN detected around the world. As reported by various sources, most counterfeit Indian currency notes are printed in Pakistan. From Pakistan, FICN are either moved directly into India or make their way through a network of other countries. Major transit points include India’s neighbouring countries Nepal and Bangladesh. Dubai is another route that the traffickers use to smuggle the fake currency notes into India; other transit points include Thailand, Malaysia, and Sri Lanka. China is emerging as a new transit route (as indicated by reports about the seizure of fake Indian currency concealed in a shipping consignment en route from Pakistan to Nepal via Hong Kong).

**Indian Retail Sector- Most affected by the Demonetization Step:**

Retail Sector in India has been emerging as the strongest pillars of its economy and accounts for about 14 to 15 percent of its GDP. The Indian retail market is estimated to be US$ 450 billion and one of the top five retail markets in the world by economic value. India is one of the fastest growing retail markets in the world, with 1.2 billion people. India's retail and logistics industry employs about 40 million Indians (3.3% of Indian population). The unorganized retail sector
mainly deals in cash transactions. When the Demonetization step was announced by The Prime Minister of India on 8th Nov, 2016, it had resulted into a cash crunch that affected day to day purchasing. This impact was estimated to be of short duration till the floating of the new currency in the market. Considering the fact that India is among the most cash-intensive economies in the world, with a cash-to-GDP ratio of 12 per cent. That is almost four times that of countries like Brazil, Mexico and South Africa. The recent decision has led to retail shops and malls wearing a deserted look, albeit even for a short period of time.

**Attack of the Demonetization step on the Indian Un-Organized Retailing:**

The Indian retail sector mainly comprises of owner manned small shops. In 2010, larger format convenience stores and supermarkets accounted for about 4 percent of the retail sector, and these were present only in large urban centers. Unorganized retail sector comprises the major portion of the Indian retail sector. They are affected by the demonetization move as doing the cash based transactions. Due to the unavailability of cash in the market, their sales had been affected. To stay afloat and conquer the challenges that demonetization has posed, the offline retailers are now encouraging the consumers to move away from cash and are giving various payment alternatives to avoid purchase hindrances and to initiate the market ecology to become more transparent and structured. The long-standing growth story of the Indian retail sector continues to be characterizing with the attributes: pliability, adaptability and growth.

**Scope of the study:**

Demonetization is an outstanding step in the Indian History to curtail the black money and counterfeiting of Indian currency. This step is also an outbreak for the promotion of organized retailing and the Digital India Campaign. This study will identify the impact of demonetization on the Indian Retail Industry with specific to Indian unorganized retailing. The study is covering 150 retailers (130 from unorganized sector and 20 from organized sector) in the Jaipur (Capital city of the largest state of India that is Rajasthan).
Objectives of the study:

- To analyze the impact of demonetization on the Indian retail sector,
- The aim is to identify the effect of demonetization on the organized and unorganized Indian Retail Sector.
- The future benefits that will accrue as a result of demonetization.

The impact of demonetization on the percentage of sales increase in the Indian Retail Industry during 9th Nov. To 10th Dec, 2016:

The retail industry of India is identified with the unorganized retailing till date. With the demonetization move the unorganized sector is being affected the most as they involve more in cash transaction. So, the percentage increase in sales during 9th Nov. to 10th Dec., 2016 was high in context to unorganized sector as they accepted the demonetized notes in exchange of goods than organized sector. The increase in sales in unorganized sector is 20 to 30 percent in comparison to 0 to 10 percent in unorganized sector.

The impact of demonetization on the sales of Indian Retail Industry after 10th Dec. 2016:

After 10th Dec, 2016, When the Indian retail store had stopped the acceptance of demonetized notes of 500 and 1000 rupees notes and the supply of new currency was in scarcity. The sales had been affected due to the aforesaid reasons. The impact on sales decrease is more on unorganized sector that was 30 to 40 percent than the organized sector where the sales decrease was 0 to 10 percent as they provide alternative mode of payment that is payment through debit and credit cards.

Effect of demonetization move on the customer spends per visit and Customer footfall:

The customer spend per visit has been decreased as they were in a fear of unavailability of liquid in the Indian Market. The customer spending and customer footfall was decreased by 40 percent in the unorganized retail sector as they provide cash as a mode of payment in comparison to 0 to 10 percent in the organized sector as they also accept e- cash not only the liquid money for payment.
Impact of demonetization on inventory stock level and supply of inventory:

The traditional retail format was the victim during the demonetization move as the customer buying behavior had changed that affected their inventory. The supply of inventory gone down as the purchase from the unorganized retailers was reduced and the buying behaviour was turned towards the organized retail format that provides one roof concept with competitive price and offer.

The mode of payment that were introduced during that move to gain competitive advantage:

The mom and pop store that are unorganized were dealing only in cash before 8th Nov.2016. After that these stores identified the several problems regarding sales due to scarcity of currency in the Indian Economy. These retail stores also provide assistance in payment through Pay TM and extending credit facility to make the payment afterwards when flow of new currency will start. The organized sectors particularly supermarket were at an edge as they were providing variety of options to the customer in regard to payment.

Alternatives to currency: would they evolve in the face of demonetisation?

A number of agents in the economy would be required to move from the informal sector to the formal sector. For these agents as well as for agents who have been operating through the medium of cash and find the transition difficult, certain informal cash substitutes might emerge. For instance, even at present, there are coupons like the SODEXO coupons which are used for paying for certain purchases. These are accepted by a range of establishments in place of formal currency. It is, therefore, possible to see an expanded use of these coupons.

The change might induce the generation of other tokens as substitutes for money as well - the agency collecting MCD’s green tax has started issuing tokens in place of change. Similarly, for high value transactions one can think of bitcoins and other such crypto currencies on one side and foreign exchange on the other as a mechanism for settling transactions. Perhaps these would not take on a dimension
large enough to challenge the official currency, but it can disturb the expectation that the unaccounted economy would be brought into the formal sector since there might exist alternatives to the formal currency. Here it is important to explore the possibility and acceptability of peer to peer payment instruments – a category which has been evolving in recent times.

**Effects on government finances:**

The effects of demonetisation on government finances can be divided into three categories: the impact through RBI’s finances, the impact through taxes and the impact through credit available to finance deficits.

**Through RBI’s finances:**

The RBI earns seigniorage through the printing of currency. In the demonetisation, a part of the currency will be extinguished. For this part of the currency, the RBI can print the notes given the assets on its books, but there would be no takers. In other words, this part of the currency would be like new money that can be introduced into the economy and hence yields seignior age to the RBI once again when released into circulation. RBI, however, cannot lend this to the government since that would involve additional liability build up on its balance sheet. So, this currency can only be released when foreign exchange is being converted to rupees for instance and not sterilised thereafter. At this point there would accrue some dividends to the government as well. However, to the extent the government and the RBI seek to move the economy towards digital instruments, this option might not be exercised and the dividend might not accrue.

**Impact through taxes:** There are multiple channels through which taxes will be affected:

- At the point of transition to the new regime, people have attempted to convert cash balances into commodities like gold or luxuries. On these transactions the governments would have a spurt of taxes. This would however not last beyond the transition phase.

- In the subsequent period, the impact on indirect taxes would be negative because of the compression in demand.
On property taxes, some local bodies have given people a window of opportunity to pay old as well as current taxes in the scrapped notes. This would result in an increase in revenue collections in property tax. 16

On income tax there can be two potential effects: first, with compression in the economy, there could be a reduction in the tax collection. In the unlikely event of people choosing to deposit unaccounted balances in the bank and pay taxes and penalty on the same, or if the tax department through investigation, finds that some of the deposits are not explained income tax collections would increase.

For any individual depositing balances above Rs 10 lakhs, the tax and penalty together would absorb the over 90 per cent of the deposited amount. This would serve as a disincentive for people with large balances to come and deposit the same into accounts. In other words, the government cannot expect to get major collections in terms of the tax and penalty on unaccounted incomes revealed.

Through financing of fiscal deficit:

The generation of additional deposits and credit, as a result of the SLR requirements can make more credit available to governments. Given the FRBM (Fiscal Responsibility and Budget Management) limitations, the amount of borrowing that governments can take on may be limited and the additional supply can mean a decline in the interest rate that governments pay on their debt. This could be a positive spin-off for the governments.

Demand of the products that were affected the most:

On 8th Nov., 2016, When 500 and 1000 rupees notes were announced as no legal tender that twisted the Indian Economy. After that announcement, the demand for the product by the customers was changed. The people who were having liquid money were settling their cash by demanding esteem goods. On the other hand demand for only convenience goods were there.

Correlation between the percentage (%) decrease in sales and customer spend per visit:
During the demonetization the sales of the retail stores is decreased due to the reduction of customer spending per visit as the lack of availability of currency in the market.

**Survey on impact of demonetization on People**

The inputs from the segment of people reveal that demonetization is directly affecting the short term consumption needs of the people which includes daily wage labourers, women, students, small vendors, shop keepers etc. basically belonging to the lower and middle class families for whom cash is the primary mode of payment for their day to day activities. Along with this, the direct impact of demonetization drive is seen on those who live in remote areas of country, having no bank accounts and no identification proofs. We surveyed in order to assess the level of difficulty people are facing because of demonetization and we found that 58% respondents reported that they are facing high level of difficulty whereas rest responded that the impact is quiet modest on their daily activities. Further, we assessed the impact of currency crunch on the life of people and observed that the major impact of currency crunch is seen on daily needs of the people (92%) such as purchase of eatables, dairy products and other necessities, transport (76%), health care & wellness (68%), beauty & cosmetics (43%), entertainment (40%), tourism (37%) and shopping (34%).

**Findings of the study:**

- The demonetization move has a major impact on the Indian Retail Industry.
- The Unorganized sector in the Indian Retail Industry which has a major shareholding in the industry is affected the most by this move.
- The Indian economy was cash driven economy before 9th Nov., 2016. After that the economy had adapted to change in the environment. The Unorganized retail Sector also started providing different mode of payment to the customer in respect of cash.
- The sales of the store were majorly affected when the banks stopped the currency to be changed with the legal tender notes.
The demand of the shopping and esteem goods was affected. There was no major impact on the demand of convenience goods.

As the sales were affected, the inventory supply level of the unorganized retail sector was also reduced. But at this point the organized sector had an edge as their inventory turnover increased due different mode payment other than cash and made various promotional offers during that time to increase the footfall in the store.

**Conclusion and Recommendation:**

The Indian Economy is cash oriented economy. The customer’s preferential mode of payment is cash. The Indian customers are not much attracted towards virtual buying. On 8th Nov., 2016 the Honourable Prime Minister of India, announced the demonetization of 500 and 1000 rupees notes from the Indian Market. Our Economy was shattered at the moment that decision was announced as the economy consist of major two section that is below poverty line and esteem group. Both Section of the society got affected as the esteem section had ample money in the denomination of 500 and 1000 rupees and below poverty line were having limited money to run their livelihood for particular period. This decision had affected the sales and purchasing behaviour of the customers till date. This decision is an innovative promotional step towards the organized retailing in the Indian Retail Industry.

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