

Impact of Demonetisation on Financial Inclusion in India

L.V.Kamala Devi, L.V.Rajavalli Devi

*Assistant professor Faculty in and Management BVC GIST
SainikpuriSec-bad Jagayyapeta A.P*

Abstract: *Financial inclusion is the delivery of financial services at affordable costs to vast sections of disadvantaged and low-income groups. It is a key measure for inclusive growth and gained rapid momentum with the government decision of banning the Old High Denominations (OHDs) leading to overall development of the economy and benefitting the society as a whole. Financial inclusion can be divided into two as non-digital finance and the other being digital finance. Nearly 2 Billion are unbanked, a quarter of the total population not using these financial services effectively which implies no savings no insurance and paying too high a transfer fees. It implies to meet the credit requirements of the common man by bringing banking services to the doorstep. It is indeed assuring financial security to the poor as various section of population are covered with financial inclusion. This instills the economic growth by increased standard of living as businesses can grow, large expenses met and savings properly planned. Considering the improvements that have to take place in financial inclusion, this paper is an attempt to study the impact of demonetization on Financial Inclusion. It studies the various challenges, benefits and effects of Financial Inclusion. The findings of the study reveal that demonetization had a positive impact on financial inclusion.*

Keywords: *Financial inclusion, Demonetization, Digital finance.*

I. Introduction

Financial inclusion is the delivery of financial services at affordable costs to vast sections of disadvantaged and low income groups. It is a key measure for inclusive growth and gained rapid momentum with the government decision of banning the OHDs leading to overall development of the economy and benefitting the society as a whole. India the second largest populated economy taking such major and overnight decision like banning OHDs. On November 8th 2016 a major challenging and dynamic decision was taken by the Indian Prime Minister Mr.Narendra Modi to ban all the old higher denominations that paved way to leveraging finance to all the illegal activities of funding anti-terrorist activities , to curb black money and corruption by nullifying nearly 86% of notes. The estimation of fake notes to original was 250 in one million. The move was a boon in disguise to the banking sectors as it would bring into its fold the untapped business covering a major population and creating awareness of inclusive growth.

Financial inclusion would be ideal to be discussed on two major fronts 1) People with a bank account and 2) People with no bank accounts. In spite of many reforms being taken since 5 years the percentage increase is considerably low as only 65percent of adults do have a bank account of which 23 percent is dormant. This stresses the point that opening formal accounts is not the answer for financial inclusion .The roots in Indian economy depict 45% of GDP and 80% of employment in cash centric informal market which is to be readily included in the regulatory process .This also includes digital and non digital finances.

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 (OHD) pushed people to the banks to deposit their OHDs 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. Forbes contributor Naazneen Karmali stated that India's banks could "get turbocharged," as \$75 billion in old currency pours into the system in the form of new deposits. Digital economy is a real time experience as it includes every transaction.

Need for the study

In spite of many reforms taking place in India to include the illiterate sections into the financial sector there is still a large section of the society who due to limited access towards the benefits in the financial system pays high charges on financial performances. Demonetization had forced people to use the digital finances

leading to a greater increase in the inclusion of the unaccounted cash of the economy. Hence there is a need to study the impact of demonetization on financial inclusion.

II. Objectives Of The Study

1. To study the various challenges faced in financial inclusion and challenges faced after demonetization.
2. To study the impact of demonetization of financial inclusion

III. Review Of Literature

There are many literatures on financial inclusion in India. In 2002 Charansingh the then RBI Chair Professor Economics & Social Science of IIMB concluded that India is still lagging behind in reaching out to the rural and household unbanked accounts. The scenario has changed over the decade. There has been an increase in financial literacy and inclusion over these years though at a slow pace. Nitin Kumar (2013) in his paper "Financial inclusion and its determinants" discusses the importance of socio economic and environmental setup in shaping the banking habit of masses and its impact on financial inclusion. Dr Tarun in April 2017 in his paper "Demonetization in rural areas of Lucknow" discussed the benefits and limitations of Demonetization. Parul Mahajan and Anju Singh in their paper discussed the positive impact of demonetization on Financial Inclusion.

Limitation of the study

The study is basically limited to secondary data and only discusses the one aspect of financial inclusion. It does not take into consideration all the factors or determinants of Financial inclusion.

Methodology

The study is based on Secondary data from magazines, Journals, Annual reports and websites. The analysis was made with the help of Statistical tools like t-test to find the impact of demonetization on Financial inclusion.

Hypothesis

H₀: There is no significant impact of Demonetization on financial inclusion

H₁: There is significant impact of Demonetization on financial inclusion

Challenges of financial inclusion

There has been a need to reframe the guidelines of RBI in Financial inclusion towards the challenges faced in Financial Inclusion

- a. To include the excluded sections of the society, both in rural and urban areas
- b. Channelizing the credit to the vulnerable sections of the society
- c. Confidence to borrowers and deposit holders on Banks
- d. Financial Literacy
- e. Financial Support to the people with Unbanked Accounts
- f. Interest rates on loans.

At the bottom, too many problems act as barriers for financial inclusion like – Financial exclusion barriers like location, access, knowledge, support and confidence. This is a prime challenge for financial inclusion and should make the total population to be a part of it. There is an urgent need to provide financial services so as to prevent regional disparities and not to be a hindrance in the path of the economy. Financial sector is only sector that acts as facilitator and multiplier to attain overall economic growth and sustainability.

It will add to the GDP if the informal is tracked, regulated and pushed into formal. Is this a decision for personal benefits the answer being no, leads to a more structured and regulated economy. This also means more revenue to the governments treasure. A whopping 268% increase in tax year on year from Nov 2016 the month the demonetization campaign began.

Challenges after Demonetization

1. After the major break-through rupee becomes weaker compared to 96 countries or economies.

If we take data for past 6 months before demonetization from 08 May 2016 to 08 Nov 2016, rupee has become stronger than 125 currencies. But after 26 days of ban on Rs. 500 and Rs. 1000 notes, rupee has become stronger than only 47 currencies.

Rupee has become weaker by 2.66% against US Dollar (\$) from 66.40 to 68.17 INR per unit US Dollar. Rupee has become weaker against some popular currencies like British Pound, Canadian Dollar and Hong Kong Dollar too. But also became stronger than Euro, Australian Dollar, Swiss Franc, Singapore Dollar and Japanese Yen.

Indian rupee (INR) became weaker than currencies of other south asian nations Pakistani Rupee, Sri Lankan Rupee, Bangladeshi Taka and Nepalese Rupee.

Table 1 Indian Rupee after Demonetization			
Period	Stronger	Weaker	Same
After 50 days of demonetization (08-11-16 to 28-12-16)	60	96	5
6 month before demonetization (08-05-16 to 08-11-16)	125	32	4
In Modi government (26-05-14 and 28-12-16)	94	65	2
In Modi government before demonetization (26-05-14 and 08-11-16)	93	66	2

<http://statisticstimes.com/economy/indian-rupee-after-demonetization.php>

2. Ratings : Major Care Ratings has revised our GDP rate to a 7% from 7.8 % set at the beginning of the year. Rural India engaged in farming and SME face a major cash crunch and a downfall in their business. The cashless economy we dream of in the inception has various problems due to cash crunch. World Bank has downgraded the INDIAN economy growth rate fall due to downsurge in the real and automobile sector because of banning OHD.

Reasons for down fall -Household consumption expenditure faces a crunch as consumers are forced to buy on subsistence buying. By the end of 2017 the market expects a slowdown of 6 months. It expects a growth decelerate of 0.5% by the end.

3. Corporate's face huge losses as to nearly 1.5 lakh crore of market value from the day of ban.
 4. A major cut is also seen in Fresh investments and marketing expenditure due to liquidity crunch.
 5. The reverse situation is found in banks as huge pour in money may result in heavy cut off rates in deposits and costs. Banks have deposited over Rs 1.5 lakh crore with the RBI by the reverse repo window, till the last count. Deposits with RBI, via banks, will keep rising and RBI has to cough out huge interest on them: about 6.2 per cent per annum. (Daily.o.in)
 6. A consistent slowdown in Debt service flow also is predicted due to rise in NPA in retail sector where major transactions are in cash in rural areas.
 7. Government: Rs 3 lakh crore is in the form of extinguished money which is uncertain and the government has to bear a brunt of Rs 11000 crores for reprinting the money
- As of now the cash crunch made our emerging global economy into one of the fastest slowing economy.

Benefits of demonetization

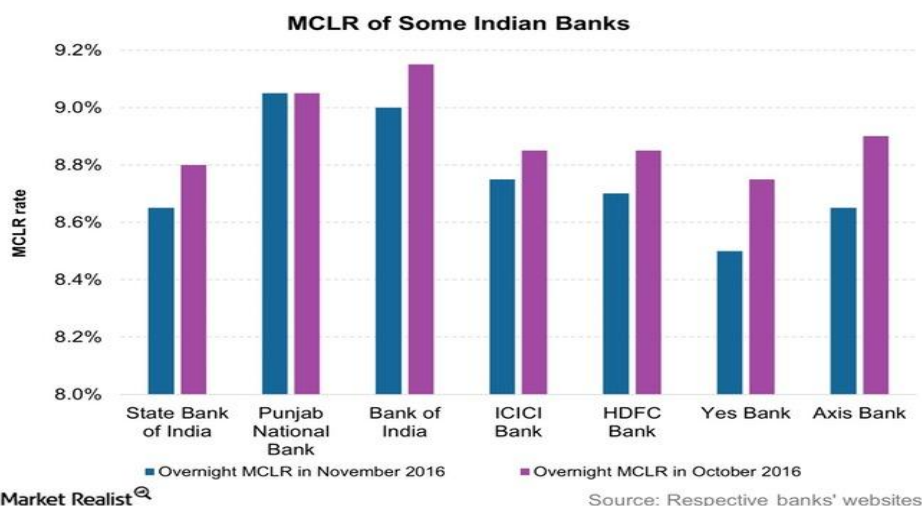
1. RBI considers CPI as inflationary measure and states that CPI growth targets at 5% inflationary index on March 2017. Since November 9th there was a negative impact on inflation as India came to a standstill where people could not spend with banning of the higher denominations. The immediate impact could be felt in the real estate sector as nearly 30% fall in prices of houses in major cities.
2. Launch of BHIM (Bharath Interface form Money) app crossed 1 crore downloads .
3. It also helps for a better and cleaner society keeping a checkmate on terrorist activists , racketeers and for printing fake currencies as all transactions are through banks only.

Impact of Demonetization on Financial Inclusion

1. Currency rains into banks: Up to 97% of the demonetized bank notes have been deposited into banks which have received a total of 14.97 trillion (\$220 billion) as of December 30 out of the 15.4 trillion that was demonetized. This is against the government's initial estimate that 3 trillion would not return to the banking system. Of the 15.4 trillion demonetized in the form of Rs 500 and Rs. 1000 bank notes of the Mahatma Gandhi Series, 9.2 trillion in the form of Rs 500 and Rs.2000 bank notes of the Mahatma Gandhi new Series has been recirculated as of 10 January 2017, two months after the demonetization.

According to RBI data, India possessed Rs 14,180 billion cash in high denomination by March 2016. Out of this, around 30 per cent or Rs 4,254 billion was with banks and other government agencies, while cash with the public stood at 70 per cent or Rs 9,926 billion.

2. MCLR : We could visualize the overnight decrease in the MCLR (Marginal cost of funds –based Lending rate) after cutting the deposit rates. We could further even see the rates cut due to the heavy inflow of cash into banks. Deposits rose to 13.9% or Rs 12.7 lakh crore to Rs 105 lakh crore a 10% rise to last according to RBI.



3. Unaccounted Cash Flows :Post the ban note unaccounted cash flow between Mumbai and other cities has paralyzed the gold bullion market at Zaveri bazaar .A major breakthrough for unaccounted cash transfers by angaadias. (ANGADIAAS are Private couriers shuffling between Mumbai and other parts of Gujarat and other cities ferrying precious stones jewelry pieces and cash for a meager amount of Rs 250-300 as commission for Rs. One lakh worth consignments) and also unauthorized money changers trade was impacted . Hats off to the parallel unaccounted economy to be thrashed by the decision of demonetization.

4. Jan Dhan Accounts

Table 2 Pradhan Mantri Jan Dhan Accounts

(in million)Bank-Group	AsonNovember9,2016			AsonMarch1, 2017		
	Rural	Urban	Total	Rural	Urban	Total
PublicSectorBanks	114.3	89.3	203.6	122.1	100.8	222.9
RegionalRuralBanks	37.1	6	43.1	40	6.4	46.4
Private Sector Banks	5.3	3.1	8.4	5.4	3.6	9
ScheduledCommercialBanks	156.7	98.4	255.1	167.5	110.9	278.4

Source :Pradhan Mantri Jan DhanYojana website

The above table shows that in the Post-demonetization period, under the Pradhan Mantri Jan Dhan yojana 23.3 million new accounts were opened out of which (80 %)were with public sector banks. Of the new Jan Dhan accounts opened, 53.6 % were in urban areas and 46.4 % in rural areas. with addition of 27 million accounts post-demonetisation (November 9, 2016 to March 31, 2017). The latest data indicate that 50 million new accounts were opened since demonetisation until October, 2017

5. Digital Finance: Increase in the Usage of digital finance consistently figures that country is movingtowardscashlesseconomy. Various Systems of digital mode have increased the flow of unaccounted cash from to banks increasing the inclusions in financial services.

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 valuefrom Nov 2016 to Feb 2017.

b. Imps: Immediate Payment Services (to transfer through netbanking 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

c. Prepaid payment instruments like M-wallets,Paper vouchers have increased from 169 million to 280 millions over 3 Months.

d. 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 millions to 898 million.

These digital payments system has increased the number of Account holders in just a period of six months post demonetization.

Table 3 Digital Payment Mode System

Digital Payment Mode System in Pre and Post Demonetisation												
	May	June	July	Aug	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.
EFT/NEFT	117.5	118.91	113.48	118.55	120.15	133.21	123.05	166.31	164.19	148.21	186.7	143.17
IMPS	27.66	29.68	32.18	33.89	35.93	42.09	36.17	52.78	62.42	59.75	67.41	65.08
NACH	160.59	166.5	189.6	153.33	157.29	169.39	152.51	198.72	158.74	150.45	191.01	222.17
Cards	941.82	927.27	961.25	971.81	945.86	1,032.14	906.78	1,162.39	1,154.21	1,039.40	1,089.38	1,035.38
PPIs	70.95	76.98	77.85	96.28	97.07	126.9	169.03	261.09	295.8	280.02	342.09	352.23
Mobile Banking	60.76	62.52	64.44	70.05	72.63	78.1	85.45	110.64	106.12	95.41	113.65	106.18
Outstanding	702.75	716.68	723.17	738.77	755.05	766.63	771.95	789.44	846.83	869.06	884.72	898.33
Number of ATMs (in actuals)	214271	215192	216030	216997	218542	219578	220166	219793	220402	221302	222475	221959
Number of POS (in actuals)	1415582	1432727	1443899	1496769	1480309	1512068	1589263	1767733	2015847	2224977	2529141	2614584

Table 3 Source : RBI website (amount in millions)

Findings:

The study here is to summarise the combined evidences of demonetisation and show its impact on financial inclusion. The impact is shown with the help of paired t-test.

Table 4 Paired Samples Test									
No. of Pairs	Digital Payment System	Paired Differences	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference		t	Df	Sig. (2-tailed)
		Mean			Lower	Upper			
Pair 1	EFT/NEFT	-34.9717	24.161	9.864	-60.327	-9.6162	-3.54549	5	0.0165
Pair 2	Immediate Payment Service (IMPS)	-23.6967	8.241	3.364	-32.345	15.0483	-7.04346	5	0.0009
Pair 3	Number of ATMs (in actuals)	-4247.83	1134.968	463.349	-5438.909	3056.76	-9.16768	5	0.0003
Pair 4	National Automated Clearing House (NACH)	-12.8167	31.627	12.912	-46.007	20.37343	-0.99265	5	0.3665
Pair 5	Prepaid Payment Instruments (PPIs)	-192.372	52.050	21.249	-246.995	137.749	-9.05307	5	0.0003
Pair 6	Mobile Banking	-34.825	9.999	4.082	-45.319	24.3314	-8.53098	5	0.0004
Pair 7	Number of POS (in actuals)	-660032	374578.025	152920.838	1053127.36	266936	-4.31617	5	0.0076

Table 4: Source Author

A paired t-test was run on a sample of 7 digital payment systems to determine whether there was a statistically significant mean difference between digital payment system before and after demonetization. Each Pair in column 2 consist of Digital payment systems - NEFT,IMPS-Immediate Payment System, National Automated Clearing House NACH, Number of ATMs, Number of POS, Prepaid Instruments-PPIs and Mobile Banking in terms of Volume in the Pre demonetization and the Post demonetization period. In Pair 1 NEFT payment system the p value is 0.0165 which is less than 0.05. This shows that null hypothesis is rejected i.e. there is a significant impact of demonetization on digital payment system. Similarly in Pair 2,3,5,6 and 7 the p

values are less than 0.05 showing a significant impact of demonetization on digital payment system. However in case of Pair 4 i.e. NACH the p value is 0.3665 is greater than 0.05 which show that there has been an increase but it did not have a significant impact of demonetization.

IV. Conclusion

Table 4 of Paired t test shows that there is a significant impact of demonetization on digital payment system (in volumes) for 6 pairs taken in the sample NEFT,IMPS-Immediate Payment System, NACH, Number of ATMs, Number of POS, Prepaid Instruments and Mobile Banking except in case of NACH. The mean value of these 6 pairs is negative because the mean in Post demonetization is more than the mean in Pre-demonetization which shows that there is a significant impact of demonetization on these digital payment variable in the Post demonetization period. The Confidence Interval of the differences is also negative for all the 6 pairs i.e NEFT, IMPS, PPIs, Mobile Banking, Number of ATMs, Number of POSs as Post demonetization Volume is more than Pre demonetization volumes. But in case of NACH there is no significant impact of demonetization on volume of NACH in the Post Demonetization period. NACH is National Automated Clearing House is useful for corporate and financial institutions that make payments in bulk like dividend, salaries, interests etc. The Bulk Transaction might not have been affected due to demonetization. But in each of the cases other than NACH Post demonetization have favourable value related to digital payment system like NEFT, IMPS, PPIs, Mobile Banking, Number of ATMs, Number of POSs.

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. Ahyan Kose director of development prospects group at the world bank opined “Any reform has short term costs but ultimately bring long term gains as in India we expect an adverse affect of these changing of notes to basically disappear in the medium term”. worldbank. news press-release 2017-05-29. He expects a growth picking up for the FY 18 and 19 supported by private consumption infrastructure spending and rebound in investment growth.

To overcome the epidemic it is mandatory for the government to thrash a whip to overcome the disease. When the bureaucratic and the political system is corrupted it is gangrene passing to the total economy and have to be imputed. This has to be curbed by severe punishments to make our economy healthy. Success could be seen when the banks had the circulated money into its fold and using the CRR and SLR to the maximum benefit of the society. This will in turn benefit by crushing the interest rates because of banks compulsion to utilize the surplus low cost cash with them. The businesses which was just an illusion due to heavy interest rates will see day light with the cut in interest costs. Cost benefit analysis may be negative in the beginning marking difficulties and problems to the maximum, troubling the poor and the common man. But the rays of hope are too colorful to visualize India as a powerful economy visualizing the 2020 vision to be fulfilled and real.

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