

Impact of Demonetization on Startup Industries in India

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Abstract

On 8th November 2016, Prime Minister Sh. Narendra Modi announced demonetization of Rs.500 and Rs. 1000 currency notes with a aim to target corruption, black money, terror funding and counterfeit currency.

Demonetization took everyone by surprise. Many people are seen to support this bold move of Prime Minister Modi, the rest have not welcomed it with open arms. Many people are seen standing in long queues outside ATM's, rushing to petrol pumps, rushing to the grocery stores.

A start-up company is potentially feasible commercial venture which is generally a newly transpired, rapidly growing business model that focuses to achieve a market requirement by promoting or offering an innovative and extraordinary product, process or service. Startup is usually an enterprise such as a partnership, private limited company or an organization purposely designed for the rapid development of a potentially viable entrepreneurial venture. startup companies exploit technologies such as telecommunications, e-commerce, Internet, computers or robotics in a more innovative and out of the box processes of the development, validation and research for target markets. Government has taken lot of initiative to boost Startups through various supportive schemes such as Make in India, Stand up India, Pradhan Mantri Kaushal Vikas Yojna, Mudra Yojna, etc. The Banking sector has to play significant role in mounting their reach for facilitating sustainable growth in Startup sector. In this research paper the author tries to find out both positive as well as negative impact of demonetization on startup industries.

Keywords: Demonetization, Startup, Make in India, Mudra Yojna, Unified Payment Interface (UPI), Unstructured Supplementary Service Data (USSD) and E-Commerce.

Classification-JEL : E63, F18

1. INTRODUCTION

Demonetization is the act of withdrawing the legal tender status of a currency unit in circulation. It occurs whenever there is a change

of national currency: The current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the

old currency with new currency. Anticipating positive changes on the liquidity structure, countries often adopt demonetization policy as a measure to counter balance the current economic condition.

In India the demonetization of currency notes firstly occurred on 12th January, 1946 when currency notes of Rs. 1,000 and Rs. 10,000 were demonetized primarily to unaccounted money.

The second time it happened during the rule of Morarji Desai government in 1978, when the government decide to demonetized the re-introduced Rs. 1,000, Rs. 5,000 and Rs. 10,000 currency notes entirely from the cash system.

The third time as a measure to curb the circulation of fake currency notes, black money, terrorist activities and to protect the economy from the clutches of inflation, Prime Minister Narendra Modi announced demonetization of Rs. 500 and Rs. 1,000 currency notes on November 8, 2016.

Beside India countries like Britain, Ghana, Nigeria, Soviet Union, Australia, Pakistan, Zimbabwe, North Korea, and Myanmar have used demonetization at some or the other point to control situations such as inflation, black money, fake currency, to boost economy of the country, etc.

A start-up company is potentially feasible commercial venture which is generally a newly transpired, rapidly growing business model that focuses to achieve a market requirement by promoting or offering an innovative and extraordinary product, process or service. Startup is usually an enterprise such as a partnership, private limited company or an organization purposely designed for the rapid development of a potentially viable entrepreneurial venture. As such, the word "Start-up" is not a new word in India it is originated with software services fulfilling the software needs of Indian companies and later exporting of software service in late 1990's.

More often, start-up companies exploit technologies such as telecommunications, e-commerce, Internet, computers or robotics in a more innovative and out of the box processes of the development, validation and research for target markets.

Government has taken lot of initiative to boost Startups through various supportive schemes such as Make in India, Stand up India, Pradhan Mantri Kaushal Vikas Yojna, Mudra Yojna, etc. The Banking sector has to play significant role in mounting their reach for facilitating sustainable growth in Startup sector.

Department of Industrial Policy & Promotion, Government of India defines Start-ups as an entity that is incorporated and registered in India under the following conditions:

- Up to a period of seven years from the date of its registration/ incorporation or up to ten years in case of Start-ups in Biotechnology sector
- As a private limited company or registered as a partnership firm or a limited liability partnership
- With an annual turnover not exceeding Rs. 25 crore for any of the financial years since its registration/ incorporation
- Working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation.

Provided that, an entity formed by splitting up or reconstruction of an existing business shall not be considered a 'Start-up'. An entity shall cease to be a Start-up:-On completion of seven years from the date of its registration/incorporation, ten years in case of Start-ups in Biotechnology sector, Or If its turnover for any previous year exceeds Rs. 25 crore.

2. OBJECT OF THE STUDY

- i) To know about demonetization.

- ii) To know about startup industries.
- iii) To know reasons behind demonetization
- iv) To know the benefits of demonetization.
- v) The impact of demonetization on startup industries.

3. RESEARCH METHODOLOGY

The present study is based on secondary data only. The secondary data is collected from the website of RBI, Startup India, government of India, various books and other published material.

4. LIMITATION OF STUDY

- The study is accomplished with the help of available secondary data.
- The study has been completed in given time period by university.

5. REASONS BEHIND DEMONETIZATION

Demonetization of Rs. 500 and Rs. 1000 currency notes took everyone by surprise. Many people are seen to support this bold move by Prime Minister Narendra Modi, the rest have not welcomed it with open arms. Many people are seen standing in long queues outside ATMs, rushing to petrol pumps, rushing to the grocery stores.

Some of the reasons provided by the government with respect to the aim and results of the demonetization were:

- i) It will block financing to terrorists and work as an obstacle in spreading terrorism,
- ii) It will help in revealing black money and fake currency in circulation,
- iii) The revealed black money will also develop the fiscal space to the government,

- iv) It will help in reducing interest rates in the banking system,
- v) It will help formalize India's informal economy and reduce the extent of cash transactions,
- vi) It will help to motivate digital transactions and in the creation of cash less economy.

The government offered several incentives to encourage people to use digital transactions too. They include:

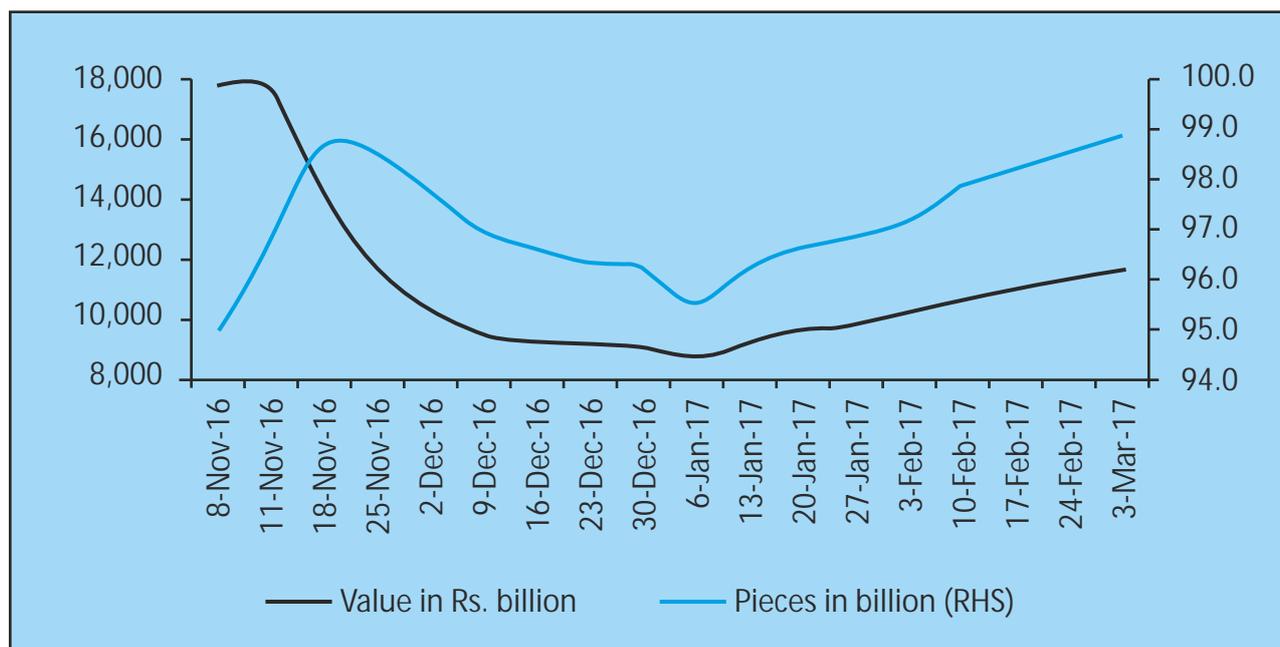
- Reduction in the merchant discount rate (MDR) and point of sale (POS) fees;
- Monetary incentives in the form of discounts and prizes;
- Service tax relief on MDR for small transactions;
- Waiver of charges for small value transactions under Immediate Payment Service (IMPS), Unified Payment Interface (UPI) and Unstructured Supplementary Service Data (USSD) based *99# platform;
- Broadening Prepaid Payment Instrument (PPI) reach by enhancement of limits;
- Introduction of a new category of PPIs;
- Permitting banks to issue PPIs to a larger set of entities;
- Permitting National Payments Corporation of India (NPCI) to launch:-
 - (a) The common app for UPI;
 - (b) National Electronic Toll Collection system (NETC).

6. BENEFITS OF DEMONETIZATION

The possible benefits of demonetization are:

- a) Increase in the savings of ordinary people: After the announcement demonetization, people start depositing their cash with a bank and store less currency with them in physical form. This helps the people of the country to save more.

Chart 1 : Notes in Circulation



Source : RBI

b) Decrease in the deposit and lending rates: Due to demonetization, the money moves from people to banks and financial institutions. Therefore, it leads to better circulation of money. Banks and financial institutions have a lower cost of funds which results into decrease in deposit & lending rates and loan become cheaper.

c) Monetary Transmission: Reduction in Deposit and Lending Rates-

Table 1 : Post Demonetization (Up to March 7, 2017) (bps)

Bank Group	MCLR (Median)	Term Deposit Rates (Median)		
	1 year	Up to 1 year	1 to 3 year	All Tenors
Public Sector Banks	85	26	35	28
Private Sector Banks	65	50	48	50
Foreign Banks	40	8	34	6
Schedule Commercial Banks	70	31	40	38

MCLR- Marginal Cost of Funds Based Lending Rate.
Source- RBI

d) Reduction in the rate of inflation: Food inflation declined from 3.7 per cent in October 2016 to 2.6 per cent in November, to 2.0 per cent in December and further to 1.3 per cent in January 2017. This was mainly on account of vegetables and pulses. Vegetable prices declined by 6.2 per cent on a month-on-month (m-o-m) basis in November 2016 and further by 11.7 per cent in December 2016. The vegetable price decline continued in January 2017 albeit at a lower rate of 4.7 per cent. Pulses prices declined by 7.4 per cent between October 2016 and January 2017.

e) Curbing anti social and terrorist activities: Usually, smugglers or terrorists use fake currency or cash through "Hawala" as a mode of transaction. By demonetizing Rs. 500 and Rs. 1,000 currency notes, the government forced these anti-social and terrorist units to find ways to get rid of the old notes. This allowed the government an opportunity to get a better control over the unaccounted money in the economy and curtail anti-social and terrorist activities.

f) Reducing counterfeit currency notes: During demonetization, people deposit their all

Chart 2 : Drivers of Vegetables Inflation : Month on Month

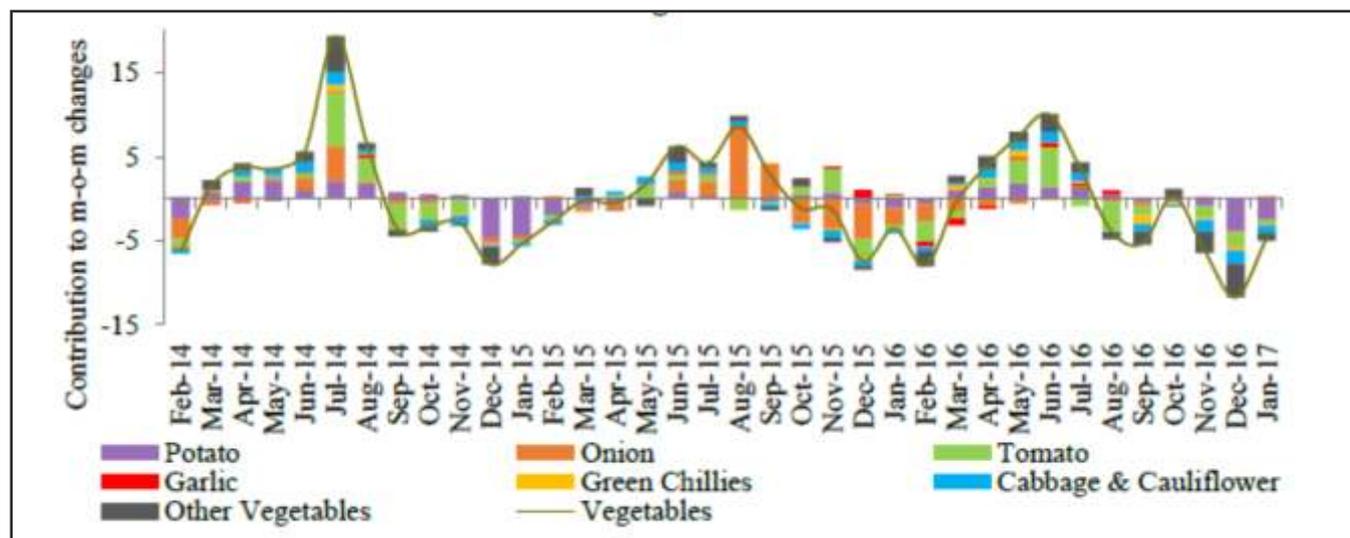


Table 2 : CPI Inflation in Select Groups (y-o-y in per cent)

Category	Nov-15	Dec-15	Jan-16	Oct-16	Nov-16	Dec-16	Jan-17
Fuel & light	5.3	5.4	5.3	2.9	2.8	3.8	3.4
Clothing & footwear	5.8	5.7	5.7	5.2	5.0	5.0	4.7
Housing	5.0	5.1	5.2	5.1	5.0	5.0	5.0
Miscellaneous*	3.8	4.0	3.9	4.7	4.8	4.7	5.1
CPI-excluding Food-Fuel	4.7	4.9	4.7	4.9	4.9	4.9	5.1

* Includes household goods and services, health, transport and communication, recreation and amusement, education and personal care and effects.

Source: Central Statistics Office (CSO)

old currency notes with banks that check if the notes are genuine or fake before accepting them. Therefore, this allows the government to dig out counterfeit currency notes circulate in the market.

g) Improved economy: Since demonetization encourages people to deposit their cash with the banks, there is a high circulation of money in the economy. The government receives more taxes and can commence more development ventures. Ultimately, this leads to improved and better performing economy. At present India becomes the fifth largest economy in the world.

7. IMPACT OF DEMONETIZATION ON STARTUPS

Business houses are a vital element of

the country's economy. While medium and large scale businesses are unmoved to such ban but many medium and small commercial establishments are severely affected by such unexpected move by the government. The economy of the country experience decline in the coming few weeks of demonetization but get back to its shape soon after the measures taken by Modi government.

8. IMPACT OF DEMONETIZATION ON FEW SECTORS

a) E-Commerce Startups: Mainstream of tech savvy customers prefer online transfers or payment through E-Wallet. Such as: Net Banking, Paytm, Airtel Money, etc.

E-commerce industry is rising at a fast pace and many customers stay away from the

option of cash on delivery (COD) as the cost may be slightly high due to inclusion of transportation cost. However, we cannot ignore people who are not familiar of using virtual cash. This may affect sales to a marginal extent in quantity and amount. Taking into consideration the expansion of E- Commerce startups in India, almost all end customers will get familiar with net banking and E-Wallets.

b) Cab Startups: Cab startups have their own wallet arrangement and the move of demonetization will not affect them deeply. Many people in India use smart phones and pay for cabs through their E-Wallets. The two prominent Cabs startups are: Ola & Uber.

c) E-Wallet Startups: The demonetization of currency notes boosts the revenue of E-wallet startups. From teenagers to youth to middle-aged people, everyone download the relevant app. E-wallet startups also gave higher amount of cash back to the new customers to attract higher number of downloads. Eventually, after a few months, the cash back given by some of the E-wallets would trim down to nil. The daily transactions through e-wallet services such as Paytm, FreeCharge and MobiKwik increased from 1.7 million when demonetization was announced to 6.3 million within a month of announcement of demonetization.

d) Food Delivery Startups: These startups allow customers to pay for their food orders through net banking, E-wallets, debit cards, credit cards, etc. So, it is quite reasonable that food delivery startups like Zomato, Swiggy, Food Panda, etc., remains unharmed from the adverse effect of demonetization.

e) Information Technology Startups: The services rendered by Information Technology Startups are generally highly priced, the likely mode of acceptance of payments are through net banking, cheque, bank draft, NEFT, IMPS, RTGS, etc. Therefore, it is very reasonable that ban of currency notes of two particular denominations are not going to harm these IT firms.

f) Accounting and Financial Consulting Startups: An Accounting and Financial Consulting Startups provides services to their clients that help them evaluate financial data so that they can make important business decisions. Their tasks involve:

- I. Creating and analyzing financial documents.
- II. Looking for financial areas that need improvement.
- III. Optimizing accounting procedures and forecasting future profits.

g) Venture capital market: The effect of demonetization on the Venture Capital market and four leading S&P BSE Indices: S&P BSE SENSEX, S&P BSE LargCap, S&P BSE MidCap and S&P BSE SmallCap.

Table 3 : Index Total Returns

Index	Index Value on November 8, 2016	Index Value on March 14, 2017	Percentage Increase
S&P BSE SENSEX	38,829.29	41,516.06	6.92
S&P BSE LargCap	3,874.84	4141.88	6.89
S&P BSE MidCap	15,010.27	15,755.02	4.96
S&P BSE mallCap	15,093.32	15,943.86	5.64

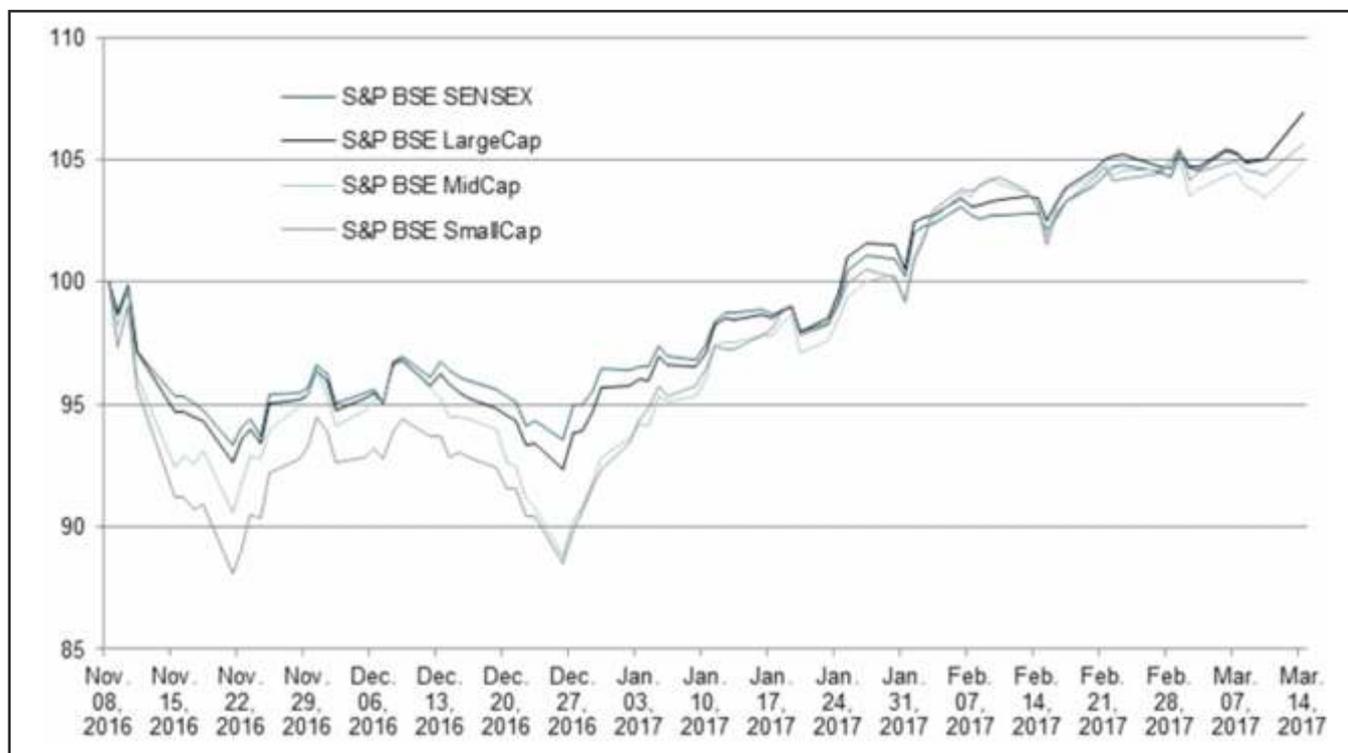
Source: S&P Dow Jones Indices LLC. Data from November 8, 2016 to March 14, 2017.

It is clear from the fig-2 that all the four indices fell for about two weeks after the announcement of demonetization due to ambiguity in the economy. Then become stable for two weeks and again fell just near the cutoff date for depositing the old currency December 30, 2016, due to contingency related to availability of new currency in circulation.

Small and medium enterprises: Transactions in small and medium enterprises are cash based. Demonetization slows down the economic activity of these firms. With liquidity crunch, they find it difficult to pay their workers, suppliers and partners and hence hamper completion of service or sale. The government of India under various policy initiatives like

It is clear from the above table that there is positive return in all the four indices. The return of S&P BSE SENSEX and S&P BSE LargeCap is higher than S&P BSE MidCap and S&P BSE SmallCap.

Chart 3 : Index Total Returns



Source: S&P Dow Jones Indices LLC. Data from November 8, 2016 to March 14, 2017

Digital India, Make in India and Start up India announced several measures to boost funding for startups. But the funding received set back with demonetization move. The venture capitalists will be reeling under the sense of uncertainty and insecurity. Thus, some projects, which they otherwise would have funded, might have lost ground.

9. CONCLUSION

Decline in currency in circulation on account of demonetisation led to a surge in bank deposits. The demonetised notes were accepted at bank counters till December 30, 2016. Between October 28, 2016 and January 6, 2017 total currency in circulation declined by about 8,800 billion. This, in turn, was largely reflected in sharp increase of about 6,720 billion in aggregate deposits of the banking system even after outflows in NRI deposits during the period.

Remonetisation has been progressing at a fast pace. Between end-December 2016 and early March 2017, there was a net increase in currency in circulation by about 2,600 billion. During this period, deposits with banks also declined moderately. Importantly, currency in circulation in terms of number of pieces and value has been steadily rising since early January 2017.

The positive side demonetization was that there is a significant boost to the E-wallet companies and the digital modes of payments picked up sharply. The government offered several incentives to encourage people to use digital transactions too. These companies have taken of this opportunity and made digital payments through their application a common and easy solution for citizens. This clearly shows that mobile wallet companies have witnessed an exponential expansion. It has been found that that demonetization shaped the profitable

market for companies providing mobile wallets and digital payment systems that have amplified their user base by up to 10 times since demonetization was announced. The shortage of cash encouraged customers to purchase grocery from virtual platforms, which specifically

in India had not attracted attention so far, as cashless purchase was possible in this medium.

With liquidity crunch the small and medium enterprises find it difficult to pay their workers, suppliers and partners and hence hamper completion of service or sale.

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