

## **Executive Summary**

Money is backbone of transactions in modern economies, playing roles like medium of exchange, store of value and unit of account. Monetary policy determines supply and demand for money and changes in monetary policy affects them. Government in India introduced a major monetary policy change in November 8, 2016 by demonetizing specified currencies, i.e. Rs. 500 and Rs. 1000, with objectives of (1) eliminating fake currency, (2) eliminating black money, and (3) controlling subversive activities. Specified currencies were to the tune of 86.4 per cent of total currencies in circulation. Hence, government introduced demonetization to meet above mentioned objectives, besides moving towards cash less economy using modern technology based electronic transactions.

Demonetization is a monetary process of stripping a currency unit of its legal tender status, which results in withdrawing currency from circulation. Demonetization has been introduced in various other countries also over time to meet different objectives like controlling excess liquidity, inflation, black money, etc. In India during the initial days of demonetization people experienced difficulties in exchanging old currency to new currency, which was accentuated by inadequate supply of new currencies. It was reported by media that people stood in long lines in front of ATMs and banks to obtain new currencies. It was observed that demonetization promoted digital transactions and payments through electronic payment system increased. Keeping in view impacts of demonetization on all sectors of the economy, this study tried to analyse impacts of demonetization on SSIs in Karnataka.

Review of literature illustrated limited number of studies on small scale industries. Some of the available studies are narrow in coverage of issues and

samples. Hence, this study tried to fill this gap on impacts of demonetization on SSIs.

This study has been conducted in Karnataka, which has 3.82 lakh SSI units employing 22.77 lakh people. Objectives of the study were to understand need and context for demonetization in India, study revenue of SSIs, examine impacts demonetization on production, sale and employment during demonetization. This study is limited to SSIs in Karnataka only and the reference period is April 2016 to May 2017 and used both secondary and primary data. Primary data were collected from study districts Bangalore Urban and Kalaburgi, respectively representing urban and rural areas, canvassing structured schedules among 235 SSI units.

Small scale industries in India have been renamed as micro, small and medium enterprises and been classified on the basis investment in manufacturing and service sectors. Among 634 lakh units, large number of MSMEs are micro units at 630.52 lakh, where Uttar Pradesh and West Bengal have large number of MSMEs and Karnataka has over 38 lakh units.

Karnataka is an important industrial state promoting high technology based, capital intensive and knowledge based industries. MSMEs constitute a significant place in Karnataka, with over 4.8 lakh registered units employing over 28 lakh people during 2014.

The study observed that Karnataka has 13959 factories, including readymade garments, textiles, chemical and engineering employing over 15 lakh people. Bangalore Urban district has over 43 per cent of factories, while it is around 1 per cent in Kalaburgi. Karnataka has 176 industrial estates thus encouraging industrial growth. The state has 3.82 lakh SSI units providing employment for 22.77 lakh people, out of which Bangalore Urban district has largest share.

Large number of MSMEs, 62 per cent, in the study area were established during the period 2001-10, which might be due to changes in industrial policies to capture opportunities provided by economic reforms. Majority of SSIs (84 per cent) under study had markets in few districts around their location, which indicates SSIs meeting local demands. Establishment cost of SSIs was on an average over Rs. 1.5 crores from both districts together, indicating large number units in the category of small scale industries according to the MSME classification. Average revenue of SSIs declined from Rs. 5.16 crores in 2011 – 12 to Rs. 4.41 crores in 2016 – 17, due to reduction in demand, lack of financial support, increased competition were factors as expressed by entrepreneurs.

Demonetization was an unexpected move by the government as opined by 93 per cent of respondents and electronic media like television are major medium of communication about demonetization. SSIs faced problems in day to day transactions due to reduction in cash availability, which affected salary payment (26 per cent of SSIs) to employees, purchasing of raw materials (6 per cent), etc. The impact was more in rural areas as observed in Kalaburgi district. Entrepreneurs adopted measures like using cash in hand (14 per cent) to borrow loan to meet their requirements of cash and cash usage is more in Bangalore than Kalaburgi.

Large proportion of entrepreneurs (22 per cent) faced problems while transacting with banks, but the point to be noted is that even 22 per cent is not a small proportion as they have faced problems with banks during demonetization.

Demonetization process adversely affected production of SSIs (25 per cent) and it was more (70 per cent) in Kalaburgi, which experienced decline in production. Further, sales in 25 per cent of SSIs reduced during demonetization due to declined production and also non-availability of cash. The reduction was

more in rural areas (Kalaburgi – 70 per cent of SSIs). The average revenue also fell sharply during demonetization, from Rs 484.6 lakh in October 2016 and declined to Rs. 379.67 lakh in November 2016. The study reveals that demonetization created negative impacts on production, sales and revenue of SSIs.

On employment side demonetization impacted adversely on temporary job workers (14 per cent of SSIs) as entrepreneurs had to stop engaging temporary workers due to non-availability of cash. Loss of temporary employment is high in Kalaburgi district (40 per cent), which shows vulnerability of rural less skilled labourers during sudden shocks. The study observed relatively large number of entrepreneurs (34 per cent) opining demonetization as not a good move as it adversely affected production and revenue of SSIs.

Demonetization affected private money lenders and this in turn affected SSI owners also, explaining the need to strengthen financial system to meet needs of SSIs. Further, SSIs which function on job work basis suffered more as most of them deal in cash. Impact of demonetization was more on recently started firms due to non-availability of money. Entrepreneurs faced problem to pay for their staff and hence some of them relieved their daily wage labourers. Overall, entrepreneurs felt that sudden implementation of demonetization created confusion and problems while severely affecting their business.

Findings of this short term study on impacts of demonetization on SSIs leads to the following policy suggestions.

Demonetization has promoted use of electronic payment system, hence monetary literacy, in terms of reducing cash usage in transactions and adopting electronic methods of payments may be promoted.

Use of electronic methods of payments has increased finance related cyber-crime, indicating the necessity of taking adequate security measures to control finance related crimes.

Growth of industries need to be promoted in other districts also to create employment opportunities particularly in rural areas.

SSIs should be encouraged in all districts to meet demands of these regions.

Inadequate financial support was a major reason for the difficulties of entrepreneurs and hence this problem needs to be addressed by creating financial institutions that help SSIs.

Any policy change will immediately impact on vulnerable groups like casual and less skilled labourers. Hence, efforts should be taken to protect these groups from adverse impacts of policy changes.