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DEMONETIZATION AND ITS IMPACT ON BANKING INDUSTRY

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ABSTRACT

Demonetization is an act of stripping a currency unit of its status as a legal tender. In simple words, demonetization is the process by which the demonetized notes cease to be accepted as legal currency for any kind of transaction. After demonetization, the old currency is replaced by a new currency, which may be of the same denomination or may be of a higher denomination. Demonetization is done by a country for various reasons. In India Demonetization happened three times. First time it happened in the year1946 and then in the year 1972. Third time it happened on 8 Nov 2016. It affected many sectors of the nation but banking sector was the most affected one as it was the main channel through which whole economic process had moved on. It was assumed that banking sector had an edge over the rest during the entire exercise of demonetization. It becomes necessary to understand Demonetization effect on banks financial performance as banks financial performance directly related to a country's economic growth. The present study is made out of available literature on post demonetization. It illustrated how the demonetization affected the banking industry.

Key Words*:* Demonetization, Banks, Liquidity, digitization.

INTRODUCTION

Demonetization

Demonetization is the process of removing a particular kind of money from use as legal tender. Most of the economies in the world have consistently done this stating the various reasons for doing so. In India, demonetization took place three times. The RBI demonetized the Rs. 1,000 and Rs. 10,000 notes for the first time on January 12, 1946, and again on January 16, 1978. The government demonetized 1,000, 5,000, and 10,000 banknotes on 1978. Then, it took place on November 8, 2016. On November 8, 2016, the government announced that the Rs. 500 and Rs.

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1000 banknotes would no longer be functional for the general population. Demonetized currency had a total value of $15.4 trillion, or around 86.9% of all currency in circulation. The government also declared that it would introduce new 500 and 2,000 banknotes to replace the current demonetized currency notes. People were given a window of time of two months to deposit all of this demonetized money with the banks. According to the government, the three main objectives of this demonetization were to discourage black money, remove counterfeit money from the economy and to reduce the amount of cash transaction in order to encourage a cashless society. The government described it as fruitful action and revealed that new notes have certain unique security characteristics.

OBJECTIVES OF STUDY

To study the impact of demonetization on the banking Industry.

RESEARCH METHODOLOGY

This study is based on secondary data. It includes available published literatures like various journals, newspapers and relevant government websites.

Literature Review

Survase (2019) analyzed how India's demonetization affected banking transactions, online purchases and financial inclusion. The analysis was based on secondary information that was provided by the RBI, a number of government agencies, departments, scholarly works and news articles. Researcher divided the analysis in two parts. In first part, all banking payments and transactions both before and after demonetization were included. In the second part, the number of Jan Dhan Account users and beneficiaries both before and after demonetization were included. According to the study, India's banking payments and transactions suffered because of demonetization. Since demonetization, use of Internet, electronic and digital transactions greatly increased and prepaid payment systems (E-Wallets) gained popularity. Additionally it was also found that deposits into Jan Dhan accounts significantly rose following demonetization.

Srivastava (2018) analyzed the effect of demonetization on banking sector. For the study, researcher did comparative analysis of one public sector bank (SBI) and one private sector bank (AXIS) from year 2016 to 2017, on the basis of some parameters. For the study, data was collected from bank official websites. The finding of the study was that it has affected both the banks financial performance as there was surge in deposits which resulted fall in cost of fund. Also, it was said that for the short period, it put excessive burden on bank employees.

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Rastogi (2018) tried to find the demonetization impact on Indian economy. Researcher studied about the decision of demonetization and its outcomes in many different countries from 1982 to 2016 by using secondary data and found that it was not successful in every country but in India people accepted government decision. It was revealed by researcher that the main objectives of demonetization in India were to curb illegal money, fake currency and to encourage people for cashless transactions

Sapna & Nida (2017) examined the demonetization impact over banks. The researcher gathered both primary and secondary data for the study. Primary data collection was done from Meerut city. A set of questionnaire was given to respondents. Based on their responses, researchers discovered that Demonetization helped India to control black money and bribery. The demonetization process also annoyed individuals as they faced the problem of cash shortage. It had an impact on bank employee's work-life balance also because it had increased their burden. The bank could not provide its lending service during demonetization. The demonetization also increased the use of plastic cards, online banking, opening new accounts and using ATMs.

Shanthini & Rajini (2017) wrote about the effects of demonetization on rural economies. The study found that most people are not having bank accounts. Also they are not willing to use digital services because they afraid of using this. The rural economy suffered more because they were dependent on cash .Same way other sectors like real estate, gem and jewellery dealers, tourism, the retail market, agriculture, etc affected badly.

Sujata looked at the variables that affected electronic banking both before and after demonetization. In this survey, researcher designed a questionnaire to determine how familiar adult Indian respondents are with online banking. It was discovered that prior to demonetization, banks were already attempting to educate their clients about the new channels by hosting seminars and other events. Many people were also aware of and even used e-banking. However, after demonetization, internet banking usage has increased and people are more concerned about privacy issues. Indian consumers demand better services that are customized to meet their needs.

Positive impact of Demonetization over Banks

Growth in Deposit There was the surge in banks as a result of demonetization. Due to an excessive inflow of currency of Rs. 500 and Rs. 1000 into the banks, the size of deposits expanded dramatically. This liquidity improvement persisted in the banking sector even the following year after the demonetization. Additionally, it helped banks to boost their current account and savings account (CASA) ratio and to decrease their high cost deposits. Banks boosted their loans and advances by Rs. 1,008 billion.

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Fall in cost of Funds After the demonetization, cash deposits increased in the banks. Over 70% cash was deposited to PSU Banks .This increase in deposits helped banks to decrease their funding cost. Numerous banks reduced their domestic term deposit and lending rates after the demonetization. During the period of November 2016 to February 2017, the weighted average term deposit rate of banks decreased by 24 bps, while the median term deposit rates of SCBs decreased by 38 bps (up to January 2017).

Demand for Government Bonds After demonetization, as public sector banks deposits increased, they invested their excess funds in government bonds. It was assumed that return on bond investment would increase 15 to 20 percent to banks earnings. Banks received around Rs 2 lakh crore in the span of 42 days only after the currency ban and thus the cost of new borrowings were reduced for the government. Besides this, people started operating their dormant accounts which would give profits to Banks. New bank accounts were increased in rural and urban area.

Opening of Jan Dhan Account under the Pradhan Mantri Jan Dhan Yojana (PMJDY) After demonetization, 23.3 million new accounts were established and the majority of which (80%) were with public sector banks. 53.6 percent of the newly established Jan Dhan accounts were in urban regions and 46.4 percent was in rural ones. Post-demonetization, deposits in PMJDY accounts considerably surged. From November 9, 2016 to December 7, 2016, the total sum in PMJDY deposit accounts reached on its peak, rising by 63.6% to Rs. 746 billion from Rs. 456 billion . The government issued a warning against the abuse of such accounts after hearing accusations that these accounts were being used to convert black money into white.

Move toward digital banking After demonetization, in the initial days people found difficulty to conduct business because of this acute cash crunch then more and more entities had to shift to digital to do business. Young generation, educated people started paying online for goods and services after demonetization. Some feedbacks from Payments companies were that online transactions in urban area were double in the two years since demonetization. Public came into the habit of using cards, e-banking and phone wallet. E-banking saved banks and customers time.

Increased number of Customers Demonetization encouraged the general people to visit banks and conduct transactions. Even those from low income groups went to the bank and opened accounts as a result. It raised the number of bank account holders while raising the amount of deposits.

Negative impact of demonetization over banks

Cash Reserve Requirement After demonetization banks experienced surplus deposits, RBI announced 100% CRR on new deposition in banks. Hundred per cent CRR on incremental

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deposits means that banks were unable to get any profit on Rs 3 lakh crore deposits for fifteen days.

Waived off ATM Charges During the period of demonetization, banks did not take ATM charges for transactions. A customer was permitted five free transactions per month from ATM. Banks would charge Rs 20 beyond the permitted transactions. The waiver of ATM charges means bank had to bear loss of Rs 20 in every transaction

Impact on NPAs Some SME companies experienced a 50–80% decline in revenues as a result of demonetization and could default in their installments to banks. Due to this, banks began to view it as an NPA, which had an impact on its stock level.

Stress on Employees Bank employees faced many difficulties due to this demonetization. The work life balance of bank employees got affected due to this over loaded operational activity. They didn't get any extra remuneration for their extra effort.

Lending Services As primary work of banks was to exchange notes so that time they were unable to provide lending service.

Conclusion

This is the third time when demonetization has happened in India. Three key objectives of this event were to control the problem of black money, counterfeit currency and corruption which were achieved to some extent but it could not achieve its full objectives. This could not be implemented in the proper way and it looks like it was a hasty decision of government of India. At that time, there was the liquidity problem in the market; people had to wait in the queue for deposit and withdrawal of money from the banks. Tourism industry, Real estate sectors were badly affected as they need more cash for running their business but in spite of this, general public welcomed this decision. Banks were the main channels that were operating this process. It has also positively affected the banks financial performance as deposits of the banks significantly increased. It also increased the profitability of banks as they invested this surplus fund in government bonds. Besides this, people started operating their dormant accounts which would give profits to Banks. New accounts in banks increased in rural and urban areas. For the short term, liquidity problem arose there in the market as a result of which people moved to digital banking services. It saved time and money of both banks and customers. It increased the burden on bank employees due to long working hours. Perhaps banks were not ready to handle this sudden change. Although for the short term period it showed its positive and negative impact on banks operative and financial performance but the long-term impact is yet to be come out. As now people are moving to e-banking therefore banks should make a robust security system so that cybercrime and frauds can be controlled.

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