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FEATURES OF DEMONETIZATION IN INDIA

Abstract: demonetization, the sudden and unprecedented decision to withdraw 500 and 1,000 currency notes from circulation in November 2016, marked a significant moment in India's economic history. This measure aimed to tackle black money, encourage financial inclusion, and transition India into a cashless economy. Small and medium enterprises (SMEs), which are vital contributors to the country's GDP and employment, were profoundly affected by this move. This article delves into the multidimensional impacts of demonetization on SMEs, addressing the immediate challenges, the transformative changes in their business models, and the opportunities that emerged post-demonetization. Through the analysis of statistical data and industry insights, this discussion sheds light on how SMEs managed cash flow disruptions, embraced digital payments, and adopted strategies to ensure resilience.

Keywords: demonetization, cashless economy, small and medium enterprises (SMEs), digital payments, Indian economy, financial inclusion, economic transformation.

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ОСОБЕННОСТИ ДЕМОНЕТИЗАЦИИ В ИНДИИ

Аннотация: демонетизация, внезапное и беспрецедентное решение об изъятии банкнот номиналом 500 и 1000 из обращения в ноябре 2016 года, ознаменовала важный момент в экономической истории Индии. Эта мера была направлена на борьбу с теневыми деньгами, поощрение доступа к финансовым услугам и переход Индии к безналичной экономике. Этот шаг серьезно повлиял на малые и средние предприятия (МСП), которые вносят существенный вклад в ВВП и занятость в стране. В этой статье рассматриваются многомерные последствия демонетизации для малых и средних предприятий, рассматриваются насущные проблемы, трансформационные изменения в их бизнес-моделях и возможности, которые появились после демонетизации. Благодаря анализу статистических данных и отраслевой информации статья проливает свет на то, как малые и средние предприятия справлялись с перебоями в движении денежных средств, внедряли цифровые платежи и применяли стратегии для обеспечения устойчивости.

Ключевые слова: демонетизация, безналичная экономика, малые и средние предприятия (МСП), цифровые платежи, индийская экономика, доступность финансовых услуг, экономическая трансформация.

Demonetization was introduced as a bold reform, targeting the reduction of black money, counterfeit currency, and corruption, while simultaneously driving India toward digital transactions. While well-intentioned, the sudden invalidation of ₹500 and ₹1,000 notes created widespread disruptions, especially for small and medium enterprises, which relied heavily on cash for daily transactions such as employee

wages, procurement of raw materials, and sales. SMEs are a cornerstone of the Indian economy, contributing significantly to GDP and generating employment for over 120 million people. However, the abrupt nature of demonetization left these businesses grappling with severe liquidity shortages and operational hurdles. This article examines the broad-ranging impact of demonetization, exploring how it disrupted traditional practices, pushed businesses toward digital adoption, and ultimately led to structural shifts within the SME sector [6,8].

Demonetization created unprecedented challenges for SMEs, many of which were unprepared for the overnight invalidation of currency. As 86% of the currency in circulation became obsolete, liquidity dried up almost immediately, leaving businesses unable to conduct daily operations. For many SMEs, particularly those in rural areas with limited banking infrastructure, cash was the primary mode of payment for wages, raw materials, and transportation costs. The cash crunch resulted in delays, forcing many businesses to temporarily shut down or reduce their scale of operations. A survey by the All India Manufacturers' Organisation (AIMO) revealed that nearly 35% of SMEs experienced a significant revenue drop within the first 50 days of demonetization.

The decline in consumer spending further exacerbated the problem. Sectors such as retail, construction, and agriculture—key areas supported by SMEs—saw demand plummet by 20-40%, according to data from the Centre for Monitoring Indian Economy (CMIE). With reduced consumer spending and constrained cash availability, SMEs faced prolonged disruptions to their business activities. Furthermore, many SMEs lacked the digital literacy and technological infrastructure required to transition to cashless payments. Resistance to adopting digital tools due to inadequate knowledge or fear of cyber risks further complicated the situation, leaving many businesses at a standstill [1,3,5].

While demonetization posed significant challenges, it also acted as a catalyst for change by accelerating the adoption of digital payments across the SME sector. Businesses that relied on traditional cash transactions were forced to explore

alternatives such as mobile wallets and digital banking systems. Platforms like Paytm, PhonePe, and the Unified Payments Interface (UPI) experienced rapid growth during this period, enabling SMEs to process transactions without the need for physical currency. Between 2016 and 2020, UPI transactions surged from just 92,000 per month to more than 2 billion per month, reflecting a major shift in how payments were made.

Government initiatives played a crucial role in facilitating this transition. Policies such as the Digital India Initiative and tax benefits for businesses embracing digital payments incentivized SMEs to adopt cashless methods. Additionally, schemes like the Jan Dhan Yojana enabled many previously unbanked individuals and small businesses to access formal banking services for the first time. These measures not only helped SMEs overcome the immediate cash crunch but also laid the groundwork for a long-term shift toward digital integration [2].

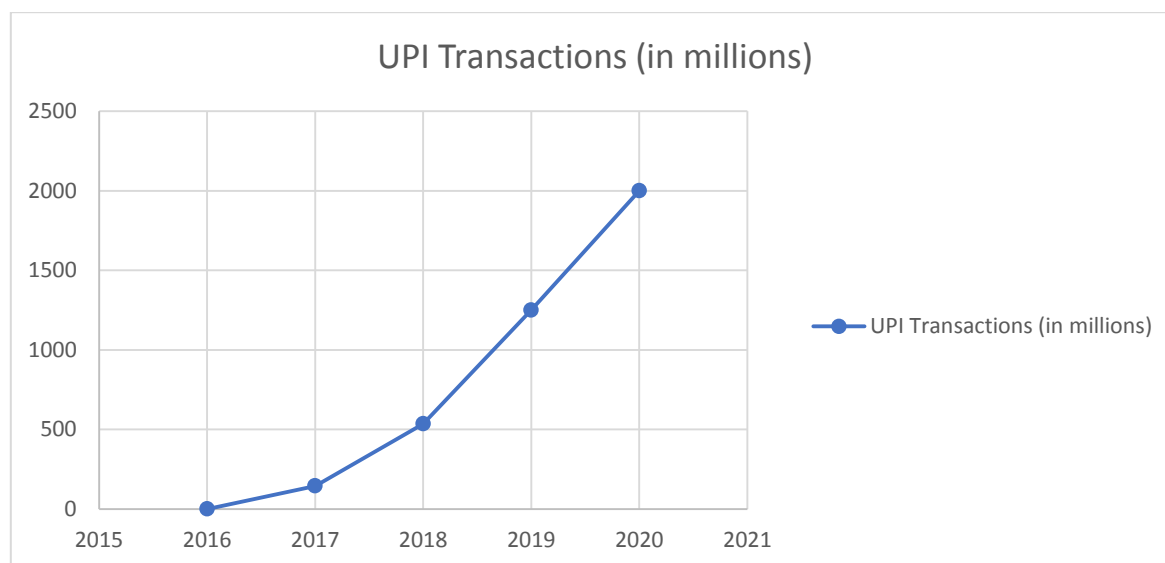


Figure1 – Transactions of digital payments

In the years following demonetization, SMEs have shown remarkable adaptability, leveraging digital tools to overcome challenges and drive growth. The pandemic further accelerated this digital transformation, with many businesses integrating digital payment systems and participating in e-commerce platforms to reach broader markets. By 2023, an estimated 75% of urban SMEs and 45% of rural SMEs reported using at least one digital payment method, up from 60% and 25%,

respectively, in 2020. Similarly, e-commerce participation among SMEs doubled, with nearly 90% of digitally-enabled SMEs attributing 30-40% of their sales to online channels, according to a NASSCOM report.

However, this transformation has not been uniform across the country. States with better digital infrastructure, such as Karnataka and Maharashtra, achieved digital adoption rates of over 85%, while less developed states like Bihar lagged behind at around 30%. The BharatNet project and various digital literacy initiatives aim to address this gap by expanding internet connectivity and training SME owners and employees in digital tools. Programs like those run by the National Skill Development Corporation (NSDC) have already equipped over 1.2 million individuals with digital skills, helping SMEs adapt to the changing landscape.

While demonetization brought about some positive changes, it was not without its shortcomings. The abrupt nature of the policy left businesses and citizens unprepared, resulting in prolonged cash shortages and operational disruptions. Rural SMEs were particularly hard hit, with 75% reporting revenue losses due to limited access to digital tools and banking infrastructure. Additionally, the policy fell short of its goal to curb black money, as 99.3% of the demonetized currency was eventually returned to the banking system, according to the Reserve Bank of India.

The economic repercussions of demonetization were significant, with GDP growth slowing from 8.2% in FY2016 to 6.8% in FY2017. Job losses in sectors such as construction and textiles further highlighted the uneven impact of the policy, with an estimated 3.5 million jobs lost during this period. Although digital payments surged, their adoption remained uneven, with many SMEs in smaller towns and rural areas struggling due to inadequate internet access and the high cost of smartphones. By 2023, cash still accounted for 65% of all transactions, underscoring the deep-rooted behavioral and infrastructural challenges that remain. [7]

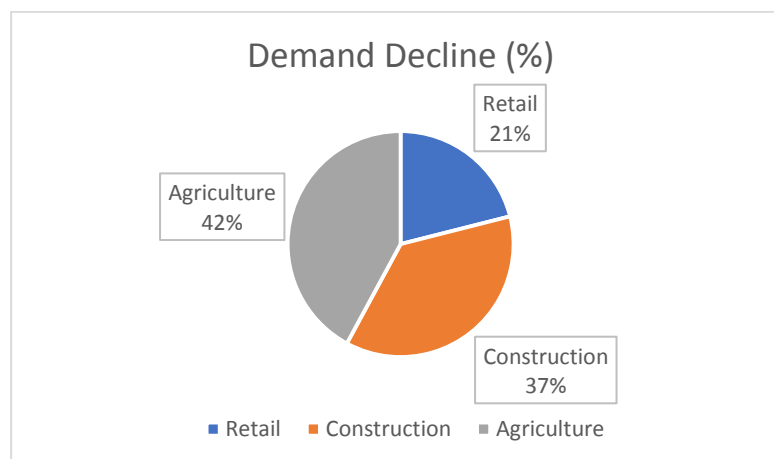


Figure2 – Demand decline over various sectors

The long-term impact of demonetization on cash and digital transactions in India underscores a significant shift in financial behavior, although cash remains dominant in many aspects of the economy. Before demonetization, cash accounted for an overwhelming 95% of all transactions in 2016. The sudden withdrawal of high-denomination currency notes disrupted traditional practices, prompting individuals and businesses to adopt digital alternatives. This period saw a surge in the use of digital payment platforms, spurred by government initiatives such as the Digital India program and the introduction of the Unified Payments Interface (UPI).

By 2018, digital transactions rose to account for 15% of all payments, driven by increasing smartphone penetration and greater acceptance of mobile wallets like Paytm and PhonePe. This shift continued into 2020, with digital payments constituting approximately 25% of total transactions, as businesses and consumers increasingly adopted cashless methods for convenience and safety, especially during the COVID-19 pandemic.

Despite this progress, cash remains a significant part of the Indian economy, with 65% of all transactions still conducted in cash as of 2023. The persistence of cash usage can be attributed to several factors, including the deeply ingrained cultural preference for physical currency, limited digital infrastructure in rural areas, and concerns over cybersecurity. While urban areas have embraced digital payments at a faster pace, rural regions lag behind due to inadequate internet access and a lack of financial literacy.

The continued prevalence of cash highlights the challenges in transitioning to a fully cashless economy. It underscores the need for sustained efforts to bridge the digital divide, expand infrastructure, and enhance trust in digital systems. However, the gradual increase in digital transactions also reflects a growing acceptance of cashless methods, suggesting that India is steadily moving toward a more inclusive and digitally integrated financial ecosystem [4,10].

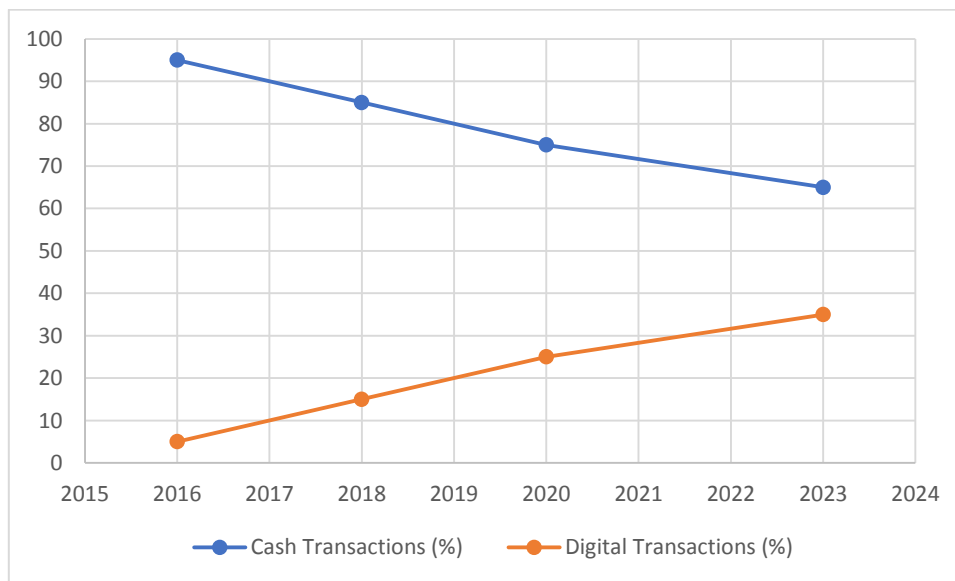


Figure3 – Relation between cash and digital transactions

Demonetization was a defining moment for India's SMEs, presenting both obstacles and opportunities. While the immediate disruptions were significant, the policy catalyzed a long-term shift toward digitalization and formalization. To achieve the vision of a cashless economy, continued investment in digital infrastructure, financial literacy, and inclusive policy support is essential. Bridging the digital divide between urban and rural businesses will be critical in ensuring equitable economic growth across India. Future research should focus on how technology can further empower SMEs and explore strategies to address the barriers faced by rural enterprises, paving the way for a more resilient and inclusive economy [9].

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