

# Effect of Cashless Economy on Micro, Small and Medium Enterprises (MSMEs): A Study from Indian Perspective

Ibrahim P. A.\*, Nasir Zameer\*\*

## Abstract

The present study is to examine the impact of cashless monetary policy on micro, small and medium enterprises (MSMEs) in India. The government's initiative towards cashless economy triggers with demonetisation of high denomination currencies. Cashless economy is a financial environment that minimises the use of physical cash by providing alternative channels for making payments, and fosters a clean and digital economic culture. Demonetisation, for a while, slows down all economic activities and imputes to use digital mode for transactions. The MSMEs prefer to do all its transactions with conventional mode; sudden move by the demonetisation severely affected the MSME sector. Stringent reactive policies are required to this segment for surviving in a cashless economy. Economic reform without considering MSMEs will result negative impacts, it acts as a mediating role in economic growth. Currently the dealers and customers are adopting digital infrastructure and slowly it will create a digital economic culture. The objective of the study is to determine possible implications of a cashless economy on micro small medium enterprises in India. It also discusses challenges that MSMEs would face in a cashless society and points out some possible solutions. The study is based on secondary data and simple statistical tools are used for analysis.

**Keywords:** Cashless Economy, Demonetisation, MSMEs, Digital Culture, Electronic Payment

## Introduction

Monetary policy is a technique of economic management to bring about sustainable economic growth. Policy makers are vigilant to acquaint diverse measures time to time, to manage the economy. The cashless economic policy has been a front burner of the Indian economy since last few months. India's struggle towards cashless economy has not escaped from critics, hence the need to address the concerns of the citizens and business houses, particularly small scale entities, which are dormant to adopt technology to their functions. Cashless economy is viable and best alternative for financial transactions in a technology dominated era. The anticipated benefits of the adoption of cashless economy have been greatly stressed, but the people and business entities have not been convinced that the policy good for all. The current economic system germinates through a series of transits, simply trades by barter, which later grown to markets and currencies. Development in information and communication technology (ICT) resulted in technological application in human activities. Rapid advances in digital technology and its applications have stimulated human life with a dramatic growth at globally, in economic activity too. The digital economy is not limited to traditional business models; it is a social change towards digital platform. It embraces all aspects of modern life: entertainment, health, education, business, politics, citizen engagement with government and vice versa. Cashless economy is nothing but application of ICT and digital infrastructure in monetary transactions; technology eases monetary transactions too. With advent of information technology and the Internet, the monetary system is taking a new swing into using electronic money as legal tender for exchange. A cashless economy is one in which

\* Research Scholar, Department of Commerce, Aligarh Muslim University, Aligarh, Uttar Pradesh, India.  
Email: [ibrahimkuzhikkattil@gmail.com](mailto:ibrahimkuzhikkattil@gmail.com)

\*\* Professor, Department of Commerce, Aligarh Muslim University, Aligarh, Uttar Pradesh, India.

all transactions are done using cards and digital means and use of physical currency is kept minimal. The motive behind this move is to build a clean economy and have transparency in transactions. Globally, move towards a cashless economy has already begun among policy makers, academicians, and commercial enterprises. The trend towards cashless economy commenced in daily life during the 1990s, when electronic banking became popular. By 2010, digital payment methods became common. As per the World Payments Report (2015), global non-cash transactions reached 358 billion in 2013, an increase of 7.6% over 2012. Further, the trend in developed countries shows a steady graduation towards cashless economy. Several pieces of literature have pointed out the emergence of a cashless economy where present legal tender is replaced with electronic money. India's move towards a cashless economy is not an isolate one; it is a move along with global counter partners. In view of this drastic change in the financial transaction, this study aims to examine the effect of cashless economic policy on small business sector. This paper is organised in three sections. First section describes the concept and evolution of cashless economy. Second section discusses the initiative for cashless economy in India and third section analyses the effect of cashless policy on the micro, small and medium enterprises. The concluding part of this paper fortifies the sudden shift to a cashless economy which made a significant impact on small business and called attention for a stringent policy for the survival of the segment.

## Literature Review

Various literature fortifies that cashless economy is an economic system in which goods and services are exchanged through electronic form. It is a process of adopting ICT facilities in economic transactions.

Basel Committee (1998) expressed the difficulty in rightly defining the electronic money but agreed that it blends technological and economic characteristics.

According to European Central Bank (1998), electronic money is broadly defined as an electronic store of monetary value on a technical device that may be widely used for making payments to undertakings other than the issuer without necessarily involving bank accounts in the transactions, but acting as a prepaid bearer instrument.

Jain (2006) opined that e-payments will be able to check black money. Taking fullest advantage of technology, quick payments and remittances will ensure optimal use of available funds for banks, financial institutions, business houses, and common citizen of India. He also pointed out the need for e-payments and modes of e-payments and communication networks.

Ajay (2014) opined that electronic payments have a significant number of electronic benefits apart from their convenience and safety. Automated electronic payments help deepen bank deposits, thereby, increasing funds for economic activity.

Das (2010) in his article "Cashless Payment System in India- A Roadmap" argued that cash as a mode of payment is an expensive proposition for the government. The country needs to move away from cash-based payment system towards a cashless (electronic) system. This will help reduce currency management cost, track transactions, check tax avoidance/ fraud, etc., enhance financial inclusion and integrate the parallel economy with the main stream.

Vincent (2005) in the article "Credit cards - Modern payment system" provided information about credit card functioning in India and settlement and concluded that it is a blessing to both the traders and customers.

Omotunde, Sunday, and John-Dewole (2013) opine that cashless economy is an economy where transactions can be done without necessarily carrying physical cash as a means of exchange of transaction, but rather with the use of credit or debit card payment for goods and services.

## Research Objectives

- To understand the concept of cashless economy and its evolution.
- To examine India's move towards a cashless economy initiated by demonetisation.
- To determine possible implications of a cashless economy on MSMEs in India and point out challenges its implication.

## Research Methodology

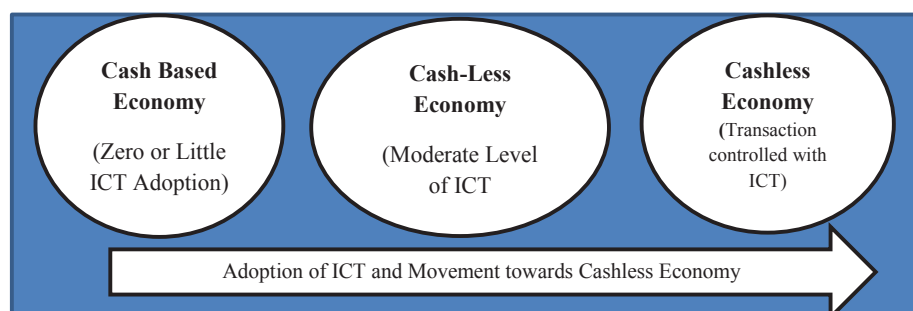
The key intention of this paper is to analyse the effect of cashless policy on small business in a sudden changed economic environment in India, so this study is purely based on secondary sources of data. Secondary data have been collected from different published sources such as magazines, journals, newspapers, and relevant website which have been consulted in order to conceptualise cashless economy and its impact on MSME segment. Descriptive statistics has been used in the analysis.

## Concept of Cashless Economy

Cashless economy is an economic system which aims at reducing, not eliminating the amount of physical cash

circulating in transactions. A cashless economy, according to Adewale (2012), simply illustrates a gradual or a radical movement of the entire payment system of an economy from the use of physical cash to a systemic adoption of other non-physical cash mode of payments in settlement of all types of transactions, including all commercial, homes, personal, local and international trade both in public and private life within the economy. Under the cashless payment system, customers could do their normal basic transactions like payment for goods and services, person to person transfer directly on their electronic devices. Both parties in a transaction require to have these facilities. The digital payment facilities don't limit to commercial transactions, but also extend to payment of utility bills, school fees, hotel bookings, house rents etc. The most outstanding cashless payment channels all over

the world are mobile banking, Internet banking, telephone banking, electronic cards, implants, point of sale (POS) terminal, ATM etc. Many countries are now working for a cashless society; Sweden is shaping up to be the first country in the world to plunge its citizens into a fascinating and a terrifying economic experiment for a cashless society. Sweden started the journey towards cashless economy many years ago. Take a bus ride, buy a magazine or a chewing gum, digital payments are accepted everywhere. Countries like Norway, Denmark, Belgium, France, UK etc. also lined up for a cashless society. Move towards the cashless economy is not a single day framework. It is the evolution with information and communication technology (ICT). Fig. 1. shows the evolution from cash-based economy to cashless economy.



**Fig. 1: Evolution of Cashless Economy**

A cashless system is the ability to store cash in digital form and use it according to requirements. Users are issued a card or digital payment mode by a bank or financial institutions. A range of terminals at consumption points are provided which are able to read cards and digital payment modes. Simply by inserting the card into the terminal or entering a digital payment code, and following given instructions, money is transferred and transactions comes to end. Card readers (terminals) are installed at all points of sale (e.g. vending machines, restaurant tills, coffee bar). There is no physical cash exchange so it is free from theft, damage, losses, etc. Instead of carrying physical cash at the point of sale, the card or digital payment clears the total sum of the purchase quickly and accurately. The amount is deducted from the customer's account.

### India's Move Towards Cashless Economy

The move towards a cashless economy is not a sudden decision. The government has approved a slew of initiatives in February 2016 to encourage digital payments and a transition to less-cash economy. Prime Minister Narendra Modi had urged people to adopt cashless transactions in his *Man Ki Baat* address in May 2016. He also stressed for digital culture

by using mobile and other electronic devices. Towards this end, the government had launched a major drive for financial inclusion in terms of opening Jan Dhan accounts, giving a statutory basis for Aadhaar, implementation of direct benefits transfer, GST, introduction of RuPay cards, and voluntary disclosure scheme for unaccounted money. Demonetisation of 500 and 1000-rupee notes on 8th November 2016 sped up the transition towards cashless economy. The economic slowdown resulted from demonetisation, has led to several myths regarding the new economy. This effect would be more severe on individuals who earn and spend mostly in cash. Switching from cash-based economy to a cashless economy would require concrete efforts. Cashless economy in Indian context is a result of both perennial issues in the financial system and the adoption of ICTs in payment and settlement. In 2009, the Planning Commission estimated that only 27% of PDS expenditure reached the targeted low income group. Clean and transparent business transactions aren't only surging tax collection, but also curbing the illegal practices like shadow economy, money laundering, and commission in welfare schemes. Economic management cost will be minimum. In 2015, RBI spent Rs. 27 billion on currencies issuance and management. The cashless economic policy has broad objectives for long term, first, to drive the development and modernisation of the payment

system with transparency; second, a voluntary shift of economic activities from informal to formal so that all illegal economic activities come to an end; and last, financial inclusion, yet it remains as challenging task, but in the mid of Universal Basic Income (UBI) discussion such economic change could ensure financial inclusion.

### Moving Forward: Government Initiatives

In order to reach cashless economy and promote digital payment culture, the government introduced a series of measures. It announced on 15th December 2016 two schemes Lucky Grahak Yojana and Digi-Dhan Vyapar Yojana to give cash awards to consumers and merchants who utilise digital payment instruments for personal consumption expenditures. As on date, nearly 95 per cent of India's personal consumption expenditure transactions are cash-based giving rise to a very large informal economy, limiting the ability of the state to levy and raise taxes. The daily Ru-Pay card transactions in the country have risen from 3.85 lakh on 8th November 2016 to 16 lakh on 7th December 2016; the e-wallets transactions have increased from 17 lakhs to 63 lakhs; the UPI transactions increased from 3721 to 48238; the USSD increased from 97 to 1263; and PoS (point of sale) transactions increased from 50.2 lakh to 98.1 lakh. Digital economy is one of 10 central themes for Budget-2017 for establishing speed, accountability, and transparency in the system. The government, as part of the plan to expand the digital payments eco-system and facilitate the move towards cashless transactions, decided that an additional one million new post terminals should be installed by 31st March 2017. The Ministry of Labour & Employment and States' Administration organised 2,73,919 camps to open 24.54 lakh bank accounts for unorganised workers.

### MSMEs: As a Balancing Role in Economic Growth

The micro, small and medium enterprises (MSMEs) not only play a crucial role in providing employment opportunities at comparatively lower capital cost than large industries, but also helps in industrialisation of rural and backward areas, reducing regional imbalances and assuring more equitable distribution of national income and wealth. This segment is an integral part of Indian economy in terms of size of the enterprise, varieties of product, service produced, and its contribution to national growth indices. It is always treated as stimulating element of economic growth. The micro, small and medium enterprises can contribute more than the big businesses. The policy makers and researchers considered this sector essential for achieving targeted economic goal.

The MSME sector has created well profile in the Indian economy with 32 million units, 70 million employment opportunities, product range consisting of more than 6000 varieties, 45% of total manufacturing output and about 40% of export directly and indirectly. Its role is also noticed in mitigating economic inequality. It is a driving force for socio-economic development. It is an acknowledged fact that MSME sector can help realise the target of the proposed manufacture policy for raising share of manufacture sector in GDP from 16% to 25% by the end of 2022. The government and policy makers started working on it, with new policies such as Make in India, Startup, Skill India, Zero Defect, etc. The government is giving high attention to protection and promotion of MSME sector with policies and schemes. There is no universally accepted definition for MSMEs; the criteria for classification differ from country to country, time to time. In India, this segment was earlier called small scale industries (SSI), now it is renamed as MSMEs. The Micro, Small, Medium Enterprise Act 2006 has given exhaustive definition for small business on the basis of investment in plant and machinery. Table 1 shows the detailed classification of MSMEs.

**Table 1: Classification of Small Business, according to MSME Act 2006**

Form	Manufacturing enterprises	Service enterprises
Micro	Up to Rs. 25 lakh	Up to Rs. 10 lakh
Small	More than Rs. 25 lakh and up to Rs. 5 crore	More than Rs. 10 lakh and up to Rs. 2 crore
Medium	More than Rs. 5 crore and up to Rs. 10 crore	More than Rs. 2 crore and up to Rs. 5 crore

Since MSMEs represent a major part of demography and geography, even a small change in economy significantly affects the segment. To achieve targeted economic development, small business segment should develop and support accordingly. Hence, there is a need to understand the implication of government policies, such as cashless policy, about them.

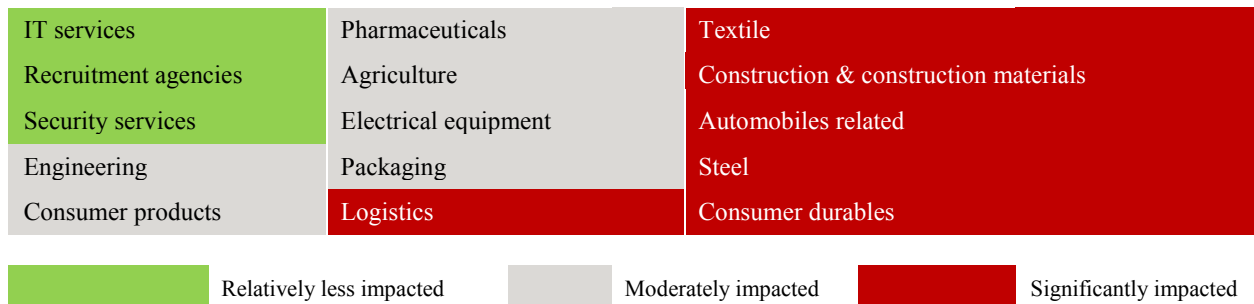
### Growth and Survival of MSMEs in a Cashless Economy

Before taking a further step towards cashless economy, it is more important to know how the cashless policy is affected in the small business segment. What are the supports needed to survive and grow in the changed environment? Cash is a legal tender and everyone can handle it easily. Demonetisation hit vulnerably all sectors in MSME segment. The electronic money scheme is often linked to a bank account, and a good

number of consumers and small business are unbanked. They may also not be literate to deal the technology. It is good to know how payments are made by these people and what changes are needed to survive.

The gain has not come without its share of pain. Demonetisation slows down economy for a while. Sectors

like IT, recruitment services, security services survived in the new economic wave while sectors like textile, construction and construction materials, automobile, logistics, consumer durable etc., were vulnerably affected. In the immediate term, reduced ability of the unorganised sector to deal with digital cash affected the demand. Fig. 2 shows the performance of different sectors as aftermaths of demonisation.

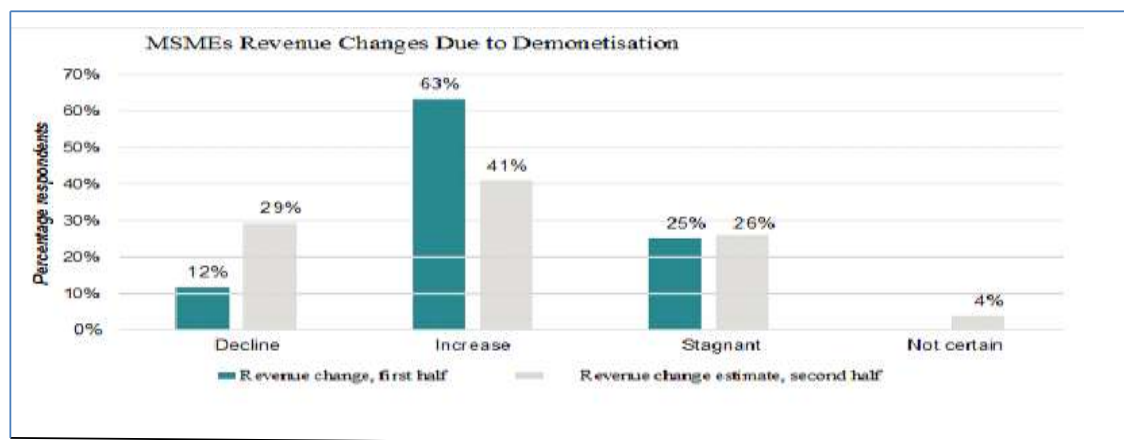


**Fig. 2: Demonetisation’s Impact on Different Sectors**

Source: CRISIL, Press Release January 5, 2017 | Mumbai

To be sure, the cash ban has impacted business operations, but more importantly, demonetisation has spurred a major change in the way MSMEs conduct business. Most of them see only a short-term impact of demonetisation and positively responded with move towards cashless economy. More than three-fourths believed business would be as usual by June 2017. The CRISIL’s nation-wide survey of micro, small and medium enterprises (MSMEs), conducted between 24 November and 24 December 2016 by covering more than 1100 units, shows a substantial shift away from cash transactions. As many as 41% of MSMEs said their clients have shifted to cheque or electronic payment since

demonetisation. Non-cash payments are already prevalent among mid-sized players. Those affected the most are from the traditional sectors with high reliance on cash transactions, such as textiles, agricultural products, steel, consumer durables, construction and automobiles. Unorganised players (less than 10 employees) are expected to struggle more than their organised counterparts, with 37% of them likely to report negative revenue growth in the second half compared with a quarter of organised players. As many as 41% of those surveyed expect to do better in the second half of this fiscal, while 29% expect de-growth (Fig. 3).



**Fig. 3: MSMEs Revenue Changes Due to Demonetisation**

Source: CRISIL, Press Release January 5, 2017 | Mumbai

MSMEs located in Tier 2 cities and smaller towns have witnessed a significant shift (42% of respondents) to cheque or electronic payments, indicating that the transition is geographically agnostic, and, therefore, has greater implications in the way transactions take place in small cities and towns. Due to greater reliance on cash, sales of MSMEs in smaller towns are expected to be impacted more than in metro and Tier 1 cities. While a third of those in Tier 2 cities and smaller towns expect a decline in revenue in the second half, only a quarter in metros and Tier 1 cities feel similar. In terms of regions, south and west regions are expected to fare better than the cash-heavy regions of north and east. One-third of MSMEs in east and north regions is expected to report negative growth (year-on-year) in the second half of this fiscal compared with 25% in the west and the south.

### The Way Forward

Move towards cashless economy has given short-term struggle in the whole economy, but it identified some positive shift from various segments. It is most important to implement the policy without hampering their existence. For a successful implementation of the cashless policy among micro, small and medium enterprises, the following measures should be taken into consideration:

- **Education:** Poor sensitisation is the major challenge in a country where the literacy rate still remains marginal. There is a need to populace up to the grass root level on the importance of policy.
- **Infrastructure:** Cultivating a fully digital culture requires huge investment in information and communication technology (ICT); digitally literate society are able to use information and technology.  
Actively address cyber vulnerability, the threat of attack and misuse.
- **Security:** The safety and security of funds should be guaranteed. There should be stringent legal framework to handle cases of fraud and other issues arising from payment.
- **Awareness:** Trend, changes and updates in technology should be communicated to the users when necessary. This will enable them to make good use of the system.
- **Internet Connection:** Basic requirement of cashless economy and digital payment is Internet facility and sufficient wi-fi.
- **Consultancy Cells:** The government should start free consultancy services with collaboration of

higher education institutions, universities and NGOs where the general public can get assistance for this shift.

### Conclusion

This discussion started with the trend and concept of a cashless economy globally, followed by India's endeavour towards cashless economy and digital culture. In the discussion, concern was given to MSMEs issues after demonetisation. Globally, there is a tremendous interest among policy makers, academicians, and commercial enterprises to explore the possibility of moving towards a cashless economy. In a technology-dominated society, cashless economy is nothing other than just an application of information and communication technology (ICT) and electronic devices, for a transparent and clean economic environment. It is agreed that the cashless system would curb corruption and money laundering. Government's move towards a cashless economy cannot bring targeted output due to lack of implementation plans. However, the government initiatives after demonetisation ease the way to cashless economy. Sensation, literacy, electrical infrastructure, and conventional habits of people remain hurdle to this endeavour. The government's initiative is appreciated as a lot of measures have been taken, but more is required to be taken to reach the destination. Good action plans can help prepare the worst, through policies, financial infrastructure development and massive campaign for the awareness and acceptance of the cashless economic system among Indians. The sudden shift into a cashless economy severely affected the operation of small enterprises due to reduced ability to deal with digital cash, but the positive reaction of entrepreneurs eases the shift to digital transactions. Shift to digital culture is required more in micro and small entities in rural area than medium entities, which have already adopted. Moreover, attitudinal changes are required from both entrepreneurs and consumers, the development of financial infrastructure and massive awareness at firm level are required to complete the cycle of digital transaction. The micro, small and medium enterprises are the linchpin of the economy, and run with many limitations. Any move without considering this segment will result in a negative impact. Stakeholders should consult on how the policy affects the economy, particularly MSMEs. Micro and small business owners should not be left out. They should be encouraged by making the necessary infrastructure available and affordable. They should be fully empowered and educated to adopt technology associated with the policy and work with it effectively. Policy makers should take stringent plans for survival of this segment while reforming economic sector further.

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