

THE IMPACT OF DEMONETIZATION ON PUBLIC AND PRIVATE SECTOR BANKS

Gayathri K¹

Arsha Chacko²
B.COM (Finance & Accountancy)
Department of Professional Studies
Christ (Deemed to be University)
Bengaluru, India

Sindhu Lokesh³

Johns T D⁴
Associate Assurance, EY GDS

Abstract

India witnessed the demonetization of Rs.500 and Rs.1000 notes on the 8th of November, 2016. Demonetization is the act of stripping a currency unit of its status as legal tender. Demonetization affected the Indian economy and its different sectors in varied ways. It led to the boom of certain industries while others suffered a downfall. This paper intends to study the impact of demonetization on the banking sector. The paper focuses on analyzing the impact of demonetization on the returns of private and public sector banks. The study is conducted by comparing the abnormal returns of banks from both the sectors over a period of 10 days prior to demonetization and 10 days post demonetization.

Key words: *Demonetization, Currency, Indian Economy, Industries, Banking Sector*

I. Introduction

Demonetization is a process of cancelling a currency unit of its status as legal tender. On 8th November 2016 Indian government banned Rs.1000 and Rs.500 notes as a move to battle black money, inflation, corruption, crime and to discourage cash dependency in the economy which attracted both positive and negative comments. The Surgical strike on black money created huge changes in all the sectors including banking sector of the country. When the Indian government decided to demonetize Rs.500 and Rs.1000 notes- two biggest denomination in the country's currency system; these accounted for 86% of circulating cash in the country. Demonetization has played a huge role on influencing management of liquidity and its demand by customers to exchange their banned currency notes. Therefore this study is made to find out the impact of demonetization on returns of banks in the public and private sector.

II. Literature review

(Balakrishna & Deepa, march 2018) in their study titled '**Impact of Demonetization on Indian Economy**' have studied how the different sectors of Indian economy were affected by the introduction of Demonetization. The dual objective for introducing demonetization was to make India a corruption free country and curb black money. They have concluded that demonetization will affect suppliers of consumable goods, the hotels and restaurant segment who mainly deal with cash. Banks will see a flush of liquidity post demonetization leading to major reduction in interest costs. This will also lead to an increase in investments by people.

(Mali, december 2016) conducted a study titled '**Demonetization: A step towards modified India**'. Demonetization was introduced to stop circulation of high denomination fake currencies with values of Rs.500 and Rs.1000. It lead to a boom in businesses like E-wallets while it lead to the downfall of micro businesses like grocery vendors. Some of the major effects of demonetization as identified in the study are that online retail stores temporarily stopped cash on delivery facility, disbursement rates of Microfinance Institutions slowed down, Micro businesses faced problems as a result of most transactions being on cash basis and E-wallet firms stood to gain from the withdrawal of cash notes.

(Damji, october 2012) In his paper, he studied about how banks play a major role in making India the next superpower in the world. India has seen an increase of about 800 percent in the number of banks over the last 85 years. Along with the increase in the number of banks, the amount of bank deposits have also seen a tremendous increase over the years. This can be attributed to reasons such as rapid branch expansion, increase in amount of cash, favourable business environment and high rates of interest. Banks extend loans to priority sectors at concessional rates and thereby contribute to economic development of the country.

(Prabhu, Girish, & Mamatha, april 2007) conducted a study on **demonetization and its impact on banking sector**. Through their journal they tried to understand the influence of demonetization on Bank's operations. Demonetization was a 'surgical strike' on Black money. It helped to discourage cash depended economy and also help trade. Banks are the major beneficiaries of demonetization because they receive large amount of deposits without any cost of promotion which they can use to increase their liquidity and profitability. Unaccounted Rs.500 and Rs.1000 notes flooded to the banks. PSU banks are the biggest gainers (over 70%) of rise in deposits.

(Anupama & Sarma, 2017) in their article '**Impact on demonetization in Banking- A Conceptual Study**' emphasized on deposits and growth in Banks. According to them 100% cash reserve requirement (CRR) on incremental deposits would mean that the bank did not earn any interest on deposits for nearly a fortnight. Also the waiving of ATM charges would result in loss of Rs.20 in every transaction. The waiving of merchant discount rate on cards result in 1% loss in every card transaction.

(Kumari & Zaidi, 2017) in their research paper studied about the in '**Impact of demonetization on banking sector**' and also on bank employees. For this they conducted a study among the bank employees to obtain responses on various matters with regard to demonetization. Based on their findings majority of people responded by conveying that demonetization had not at all helped bank employees and had a huge impact on the banking sector. The main reason for their response was because of the inconvenience caused as a result.

(Meher, august 2017) conducted a study on '**Impact of demonetization on NPA positions on Indian banks**' as demonetization brings threats and opportunities to a banking sector. He focused on how the demonetization impacted on the issues of banking sector. Further he concentrated on long and short term impact of demonetization on future NPA positions, analyzed the negative and positive appearance of demonetization on correspondent to NPAs of Indian banks and studied the pre and post demonetization impact on the banks (balance sheet).

(Kaur, april 2017) he studied '**Demonetization: impact on cashless payment system**' as the main objective of imposing demonetization is to run the India with cashless payment system. He studied how

cashless system makes the economy luminous, less time consuming, paper less transactions and less cost. He also expects the future economy transactions in all the sectors are cashless payment system.

(Singhal, november 2016) conducted a study on '**Demonetization and its effect on banking sector**' central government used the instrument called demonetization to remove the black money, terror funding etc. he studied the demonetization effected all the sectors where banking sector is the most effected one by more challenges, opportunities and beneficiaries like depositing cash with lot of liquidity in the banks. He said strategic print of demonetization will have a major addition of a effective and bright banking system in the country.

III. Research Design

Objectives

- To analyze the impact of demonetization on public and private sector banks
- To find whether demonetization has affected the returns of public and private sector banks
- To evaluate the abnormal returns of banks prior to demonetization and post demonetization

Scope

The scope of the study includes banks from both Public and Private sector. The aim of this research is to evaluate whether demonetization resulted in any drastic changes in the returns of the public sector and private sector banks. For this we have selected five banks each from Public and Private sector. Public sector banks include State Bank of India, Canara Bank, UCO Bank, Bank of India, Syndicate Bank and Private sector banks include HDFC Bank, South Indian bank, Yes Bank, Federal Bank and Axis Bank. The banks whose profits have remained stable during the three years preceding demonetization have been selected for the study. This is compared against the performance after demonetization to evaluate the results. The study is based on secondary sources of data which includes available published literatures such as journals, newspapers, relevant websites etc. Sources of information also include the data available from moneycontrol.com.

Methodology

The data has been analysed using techniques such as CAPM, Abnormal returns, Regression and One way Anova.

Limitations

- The study covers only a period of 10 days prior to demonetization and 10 days post demonetization.
- The banks are selected based on net profit criteria which does not cover all the banks in the country.
- The research is restricted to banking industry and no other sectors have been considered.

IV. Findings and Interpretations

<u>BANKS</u>	<u>ANOVA</u>
State Bank of India	0.298
Canara Bank	0.240
UCO Bank	0.199
Bank of India	0.085
Syndicate Bank	0.668

HDFC Bank	0.001
South Indian Bank	0.300
Yes Bank	0.855
Federal Bank	0.439
Axis bank	0.049

The One way Anova results show that the abnormal returns of public sector banks are insignificant as the significance level of all public sector banks are above 0.05. At the same time, in case of private sector banks, three out of five banks have shown an insignificant result.

The One way Anova test was conducted between the abnormal returns ten days prior to demonetization and ten days post demonetization with the dependent variable being the abnormal returns and independent variable being listing of banks with an event window of -10, +10. The expected return was calculated using CAPM method where the beta value was estimated using an estimation window of -100, +100.

From the results obtained, it is clear that there is no significant change in the returns of the banks. Only two banks in the private sector, HDFC bank and Axis bank has shown a result with significance level below 0.05 indicating a change in the pre and post returns.

V. Conclusion

The objective of the study was to assess whether demonetization had a significant effect on the returns of the banking sector. The study also aimed to find out how differently has demonetization affected public and private sector banks.

Interpreting the results of the study, we can clearly understand that there has not been a significant change in the returns of the banks prior to demonetization and post demonetization. In case of public sector banks, none of the banks covered in the sample seem to have been impacted by demonetization. While in the sample selected of private banks, two of the banks seem to have had an impact of demonetization on their returns.

Concluding from the results, we can see that demonetization has had no impact on the returns of public sector banks while the returns of private sector banks have had a slight impact of the same.

Bibliography

- Anupama, j., & Sarma, S. R. (2017). Impact on demonetization on banks: A conceptual study. PP 3-9.
- Balakrishna, M., & Deepa, G. (march 2018). impact of demonetization on indian economy.
- Damji, B. (october 2012). banking sector in india.
- Kaur, M. (april 2017). demonetization: impact on cashless payment system. *international conference on recent trends in engineering, science and mangement*.
- Kumari, S., & Zaidi, N. (2017). Impact of demonetization on the banking sector. pp 1774-1784.
- Mali, V. (december 2016). demonetization: step towards modified india.

Meher, B. K. (august 2017). impact of demonetization on NPA position on indian banks. *international journal of advance scientific research* .

Prabhu, M., Girish, V., & Mamatha, R. (april 2007). demonetization and its effect on banking sector. pp 20-22.