

## Demonetisation's impact on domestic remittances

The volume of domestic remittances from urban to rural areas is a weathervane for the health of the informal sector. These remittances, which are used for a variety of uses, including agricultural operations, marriages and deaths, were estimated at Rs1.5 trillion per annum by the Economic Survey of 2017. Trends in domestic remittances before and after demonetisation would provide an insight into the impact of the policy on incomes, liquidity, as well as choice of digital channels by members of the informal sector. Such data is, naturally, not yet available. However, there is a fascinating category of firms whose experience during this period can provide important perspectives.

These firms have a Prepaid Payments Instruments (PPI) licence from the Reserve Bank of India (RBI) and act as business correspondents (BCs) for banks. They set up their "money transfer counters" in kirana stores, medical shops, and mobile recharge outlets. Their software platforms and logistics systems for cash collection facilitate domestic remittances that are paid in the form of cash by the remitter and deposited in the bank account of the beneficiary. Operating with relaxed KYC (know your customer) norms, they channelize small-value remittances with a limit of Rs5,000 per transaction and a monthly cap of Rs25,000 per remitter. Thus, these firms belong to an intermediate zone between the fully cash-based courier system and the entirely digital systems of a bank-to-bank transfer or a mobile-wallet transaction. Before demonetisation, Rs4,000 crore per month was remitted through this channel. With the drying up of cash and incomes in the informal sector, would this channel dry up? Does the business correspondent represent an unnecessary half-step toward fully digital remittances, or is it an important milestone in the progression towards digitization given prevailing behaviours and attitudes?

We analyse monthly transactions data from one of the leading firms in the BC industry, Eko. The average monthly growth rate that Eko experienced from April 2015 till October 2016, the period immediately following its becoming a PPI licensee and prior to demonetisation, was around 15% per month. This growth seems to have been driven by the growth of bank accounts in rural areas and the desire of users to move away from the traditional courier system, which is fraught with the risk of the loss of money.

After the announcement of demonetisation on 8 November 2016, the volume of the company remittances fell by more than 50% in November 2016, and plummeted further in December 2016. The remittance volume started picking up from January and had recovered to October 2016 levels by March this year. But is it correct to infer that things have returned to normal? No, the correct question to ask is whether the remittance volume climbed back to the level where they would have been without demonetisation.

Our forecast using time-series analysis shows that the actual remittance volumes even as late as August were trailing the values forecasted under the assumption that demonetisation had not happened. This could be due to a combination of factors. First, incomes in the informal sector have not fully recovered resulting in a reduction in remittance volumes across all channels. Second, demonetisation has forced the user of the BC channel to move up to a banking or mobile wallet channel. Third, Eko has lost business to its competitors in the BC space.

Interviews conducted by us at the money transfer counters and a survey of earlier studies on domestic remittances indicate that the users of the BC channel typically have earnings in cash and belong to the lower income segment. Even prior to demonetisation, many of these users had bank accounts but preferred to transact through the BCs. The owner of the counter helps them with paperwork, is available from early in the morning till late at night, and is friendly. These features, which are conspicuously absent from their experience at banks, seem to be valuable enough for

the user to pay a fee for remitting the money. Hence the banking channel does not appear to be a threat as of now. The experience of “Firm B” provides clues about the challenge posed by mobile wallets.

Oxigen occupied a position at the top of the BC remittances market prior to demonetisation. After demonetisation, the CEO was convinced that the aggressive build-up of payments infrastructure by the government, the growth of smartphones, and the moral suasion of the political leadership would lead to a tipping point on which he could capitalize. He therefore started transforming his company into a mobile wallet company. Subsequently, Oxigen has slipped from its position at the top of the BC remittances market and has not been able to make much headway in the mobile wallet space either. With Eko steadily increasing its market share, the role of competition in its under-recovery is not implausible.

In conclusion, the failure of incomes in the informal sector to recover to the levels they would have reached without demonetisation appears to be an important factor for the weakness in the BC remittances market. However, firm level factors have also played a role. Firms that adopted a cautious stance on the (inevitable) transformation to a greater digital footprint gained at the expense of those that underestimated the time required for behaviour change. Cash is still the oxygen of the Indian economy.

*The piece is co-authored with Vinay Singh, student at MDI.*

*Rohit Prasad is a professor at MDI Gurgaon, and author of Blood Red River. Game Sutra is a fortnightly column based on Game Theory.*

*Comments are welcome at [views@livemint.com](mailto:views@livemint.com)*

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