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Impact of Demonetization on Midsize Textile Industry

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***Abstract*: ABC limited is a private limited company engaged in the production of high-quality textile products in Rajasthan, India. It is a certified manufacturer and supplier of organic Cotton Yarn, Lycra Yarn, Slub Lycra, Slub & multi count and Eli Twist Yarn. It is a high quality producer of innovative denim fabric and woven fabric with specialization in heavy canvas fabrics. Their manufacturing process follows stage-wise quality controls methods with complete traceability from yarn to finished fabrics. The company has a network of consultants around the globe, who are working in coordination with the product development cell to deliver continuously innovative products to the market.**

Cash rules critical parts of their supply chain: from farmer to yarn factory to yarn trader to power loom cloth manufacturer to wholesaler to retailer and finally to consumer. Consumers pay cash to retailers, who pay cash to wholesalers because it is convenient. Wholesalers, who place large orders with textile mills and pay through cheques or bank transfers, are not presently doing that because of the shortage of cash, driven by the drying up of retail spending.

***Keywords*: Demonetization, Midsize Textile Industry**

1. Demonetisation as an Economic Policy [1]

November 8th, 2016 was a historic day in the Indian economy, Government withdrew notes of higher denomination 500 and 1000 rupees a legal tender, i.e., they were demonetised with immediate effect except for few special purposes. These special considerations are beyond the scope of this term paper, here we consider they were completely demonetised. These notes were to be deposited in banks by December 30 and restrictions were placed on amount of withdrawal and depositing money. In financial language, restrictions were placed on domestic convertibility of money and cash deposits, i.e. liquidity of cash was squeezed or crunched. Cash as a currency has 3 main features: storage of value, unit of exchange and measure of economic value. With demonetisation it lost its purpose as storage of value and unit of exchange, as it ceased to exist as legal tender.

These notes contributed to 86% of the total cash in circulation.[1] This caused a huge crisis for cash based transactions. This paper does not include the aim of demonetisation and the long term benefits and short term benefits for the entire economy. This paper aims at observing demonetisation as an economic policy, which is an externality for business world. This paper also studies impact of demonetisation on a large scale industry, and its stakeholders. In a broad sense this policy affected the dynamics of liquidity in a business (related to our purpose in the paper). The ultimate aim of a company is to maximise the wealth of shareholders, i.e. to increase profits. How this policy affected the company, and through concepts studied in “Managerial accounting and finance management” we try to demystify the effect. Before going to that analysis we need to underline few basic facts about cash structure on Indian Economy in global scenario, we try to link that with business chain of the company of analysis with an emphasis on scale of business and impact of the policy.

Few facts about cash structure need to be underlined [1]:

- India is relatively cash dependant, even taking into account of the fact that India is a relatively poor country. Graph of Ratio of cash to GDP vs log (GNI per capita) plotted indicates that India is well above the regressed line gives the proof of higher cash circulation in the economy. Unorganised sector in India largely depends on cash transactions. Reasons for this phenomena can be attributed to low digital literacy, no bank accounts for poor people, less access to digital infrastructure etc.
- High cash doesn’t necessarily mean its used for transactional purposes, data indicated that the denomination lower the usage for transactional purposes.This may hold good for individuals, but in business this doesn’t hold true as the value of money decreases with time if stored generally medium scale and small scale industries which operate on cash uses them for transactional purposes. Cash flows are the lifeblood of a business.

2. Data from ABC Limited to calculate Liquidity Ratios

Textile industry is a manufacturing company, as balance sheet is prepared once in a year and we are trying to observe effect of demonetisation in the operation of business we will focus on how sales are changing, debtors turnover ratio, creditors turnover ratio and their payback period.

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Table 1
Data of financial parameters of ABC Ltd.

Month	Turnover	Cash Profit	EBIDTA	Inventory	Debtors	Creditors
Nov-16	33.76	-3.61	-1.56	69.53	94.90	47.93
Dec-16	31.61	-4.06	-2.09	58.63	91.42	50.02
Jan-17	30.32	-3.07	-1.12	40.85	93.55	65.67
Feb-17	33.47	-0.44	1.55	33.14	100.79	78.32
Mar-17	43.31	1.44	3.58	34.33	102.41	50.40
Apr-17	50.1	2.57	4.63	41.62	94.95	45.84
May-17	52.3	2.11	4.14	43.37	97.23	53.65
Jun-17	47.24	-0.04	1.94	56.49	90.77	45.62
Jul-17	43.15	-0.65	1.21	64.83	94.56	50.07
Aug-17	41.77	-1.15	0.85	66.06	101.38	64.08
Sep-17	32.76	-2.19	-0.26	58.29	109.26	47.84

Source: ABC Limited Company

Table 2
Calculated supplementary liquidity ratios

Month	DTR	DPB	CTR	CPB	ITR	ITP
Nov-16	0.355733	84.33292	0.70432	42.5943	0.485504	61.79144
Dec-16	0.345757	86.76605	0.631897	47.47609	0.539059	55.65249
Jan-17	0.324089	92.56706	0.4617	64.97729	0.742226	40.41898
Feb-17	0.332066	90.34348	0.42732	70.20505	1.009875	29.70666
Mar-17	0.422909	70.93718	0.859344	34.91034	1.261687	23.77769
Apr-17	0.527895	56.82952	1.093481	27.43532	1.204368	24.90933
May-17	0.537808	55.78197	0.974695	30.77887	1.205714	24.88153
Jun-17	0.520407	57.64722	1.035482	28.97203	0.836274	35.87341
Jul-17	0.456348	65.73925	0.861794	34.81111	0.665561	45.07475
Aug-17	0.412002	72.81511	0.651851	46.02282	0.632307	47.44532
Sep-17	0.299779	100.0738	0.684678	43.8162	0.561977	53.38299

3. Graphs depicting impact of demonetization

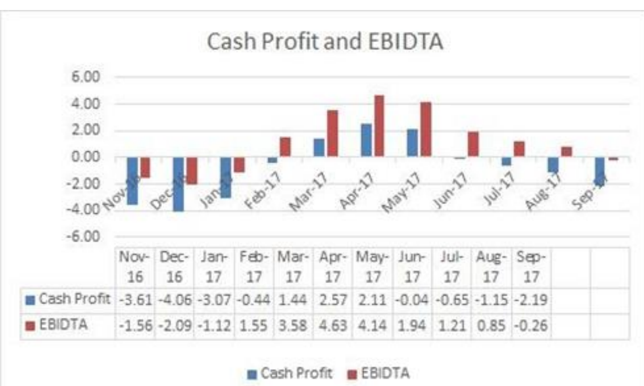

Fig. 1. Cash and EBIDT of ABC limited after demonetization (monthly data)

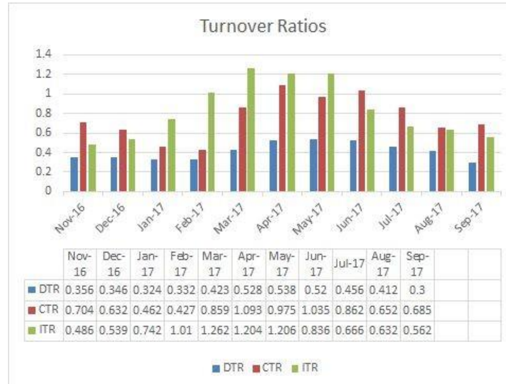

Fig. 2. Debtors, creditors and Inventory turnover ratios after demonetization (monthly data)

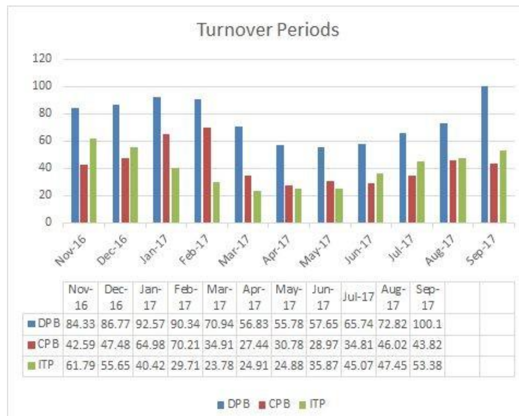

Fig. 3. Debtors, creditors and Inventory turnover period after demonetisation (monthly data)

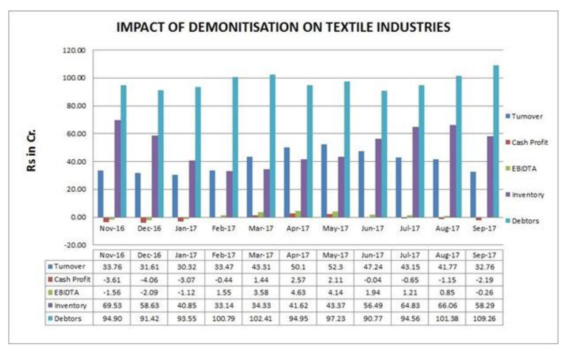

Fig. 4. Impact of demonetisation on turnover, profit, debtors, inventory and EBIDTA

4. Effects of demonetization on textile industries

The above graphs clearly indicate the problems of the industry with demonetisation. For the first four months after demonetisation cash profit and EBIDTA are negative for the company, after these four months company's profits became normal. The liquidity crunch for these four months affected the company in its financial transactions as well as its production. Debtors turnover ratio and creditors turnover ratio were decreased drastically in these four months. There was a clear indication of reduction in sales, this was due to decrease in demand at lower levels of supply chain.

Eighty percent of the Indian textile and clothing industry is in the decentralized sector. There were reports that 70-75% of power loom units had stopped production in the various textile clusters, as most of the transactions were happening in cash. For mid-size industries like ABC, financial transactions mostly occur through banks, a very little through cash transactions. It hasn't reached to a shutdown state but reduction in profit. The recovery period of the industry was also very quick i.e., 4 months. But the wholesale and retail textile dealers mostly operate on cash and due to demonetisation their business faced catastrophic effect. This data hasn't been considered in the report but an inference can be drawn from the effect on this company from the reduction in sales. This is due to demand crunch at the lower levels of value chain.

Inventory turnover rate also decreased during this period, this is due to traders and manufacturers are reported a pile up of stocks across the value chain, and companies are not in a position to collect receivables resulting in a serious impact on cash flows. Manufacturers are unable and unwilling to buy inputs, due to limited liquidity. The retail consumer too has little liquidity to splurge on clothes, which will slow down the demand downstream.

While the liquidity crunch is temporary, this could impacted the textile industry for the 2 quarters. Demand for textiles and clothing in the market even before the demonetisation was dull due to some reasons. The situation has worsened after November 8. The effect shown cannot be completely attributed to demonetisation but the shock in the turnover ratios indicate its effect.

A. *Effect on jobs in textile industries*

Almost 70-80% of the textile workers in most of the clusters were paid weekly wages in cash. Majority of these workers do not have bank accounts, are migrant labour, who stash their savings at home. Cash-strapped companies are unable to pay workers their wages. And even those who paid their workers an advance of 2-3 months to avoid changing the scrapped notes, have had to allow workers to queue in front of banks to handle cash and change notes. This has severely impacted production and productivity in the textile production clusters. Moreover, many of the migrant workers have left for their villages to take care of their money, and lay-offs are rampant too, as mills are cutting production.

"Textile retail showrooms and shops across the nation are hit by the cash crunch and low sales as customers are starving for cash and spending the rationed currency available with them only for emergency purposes," he stated.

B. *Enhancement of working capital limit*

Because of the demand slump, there was a greater need to hold the inventories till the demand starts picking up which can take at least 3-6 months. In the interim, as cotton season was also on, textile spinning industry is extremely starved for working capital because there was dire need to invest in inventories, both raw materials and finished goods.

Given this extraordinary situation, and also given the fact that banks are presently flush with cash, the ITF has requested that banks consider enhancement requests from textile spinners favourably, or grant one time working capital support finance for a period of six-nine months.

C. *Industry faces worker and liquidity crunch*

Most of the textile clusters in the country were facing not just a liquidity crunch but also a shortage of workers. Most of the workers are migrant labourers, who have gone back to their homes in their villages. Around 95% of the wages to the textile workers are paid in cash. Very few big units have opened bank accounts of their employees. Large number of migrant workers employed in the country's largest man-made fabric (MMF) sector have started moving out after the weaving and textile processing units drastically cut down production by almost 70% due to severe liquidity crisis after demonetisation.

D. *Textile mills seek measures to pay workers, even as stocks pile up*

The main demand of many of the textile mills is the need for arrangements so that the mills are able to pay the workers, especially the casual workers who get their wages in cash. The bigger mills have opened bank accounts for the workers, even the trainees, and pay the salary in the accounts. But, weavers and yarn agents do not want to lift the yarn from the mills now, especially those in the northern states. Some of the weaving centres have come to a standstill and this has hit the mills here. Yarn stocks are piling up. In the case of cotton too, the arrivals are just picking up and ginners are unable to pay farmers in cash. Hence, farmers are not bringing cotton to the markets. There is a pressure on raw material and sales front. The government should look at easing the pressure felt by businesses, the spokesperson said. In some clusters, lorry movement is hit because of the demonetisation. Very few lorry owners are willing to accept payment by cheque. Further, most mills are purchasing cotton only for their immediate needs and cotton prices have also firmed up.

5. Summary

The below mentioned points are in crisp, the effects of demonetisation on the ABC textile company. These are short term effects, company recovered easily as it doesn't depend mostly on cash transactions, but it has recoverable direct effect but huge indirect effect on the company due to demonetisation. Indirect effect is due to demand crunch in the value chain.

- Cut in Production
- Liquidity Crunch
- Reduction in Sales
- Blockage of Funds
- Reduction in Profitability

References

[1] Economic Survey of India, 2016-17.