Here's What Happened When India’s Government Demonetized Nearly 90% of Cash in Circulation

Digital payments saw a boon

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On November 8, 2016, India’s government did something almost no one saw coming.

In an unscheduled announcement carried live on television, Prime Minister Narendra Modi said the government would cease to recognize two high-denomination cash notes, the INR500 and INR1,000 bills, as of midnight.

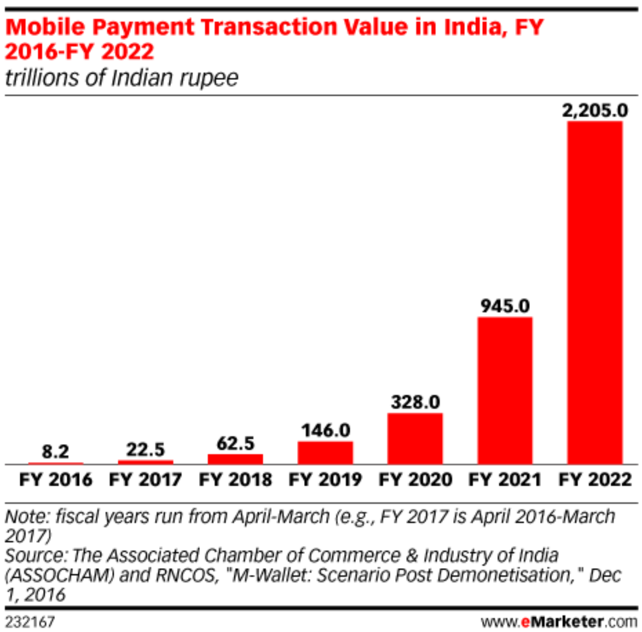
The move had the intended effect of cracking down on undeclared cash stores—often called “black money”—commonly held by the middle and upper classes to avoid taxes.

The declaration initially sowed chaos in India, a country with a low rate of credit card penetration where cash was still the predominant form of payment for a very large segment of the population. In fact, it was widely reported that the INR500 and INR1,000 bank notes made up 86% of the value of cash in circulation at the time.

But there was one segment of the business sector that stood to benefit from the demonetization move: digital payments.

Payment platforms like Paytm (which counts Chinese ecommerce giant Alibaba as one of its backers) saw an immediate and dramatic uptick in both user and transaction numbers following Modi’s announcement.

The Associated Chamber of Commerce & Industry of India (ASSOCHAM) and RNCOS released an estimate late last year that projected total mobile payment transaction value in India would climb to INR2.2 quadrillion ($32.8 trillion) by fiscal year 2022, hastened by the demonetization move.



According to figures from Counterpoint Technology Market Research, the use of mobile wallets has almost doubled over the year-long period since demonetization.

But payments are not a zero-sum game. The Reserve Bank of India, the country's central bank, reported that the amount of cash in circulation as of October was only 9% below pre-demonetization levels—a sign that consumers in the country, where cold hard cash has long been the dominant payment method, are still using bank notes.

Despite this, it seems that the government's policy has already hastened the adoption of digital payment platforms.

And moves by large players like Google will only help drive adoption of such platforms. In September, the company launched an India-specific mobile payments service called Tez, which may be aided by the dominance of the Android mobile operating system in India.

Google will have to face a growing number of competitors in the country's digital payment space, including the likes of WhatsApp. The Facebook-owned mobile messaging platform claims some 200 million active users in India, and plans to roll out its own payment service in India sometime within the next two months.

At the same time, Paytm is incorporating a messaging app into its own payment service, further blurring the lines between the two types of services.

Both platforms appear to be copying the successful strategy employed by China's dominant messaging service, WeChat. It gained a first-mover advantage as a chat app, and now boasts more than 900 million users in the Middle Kingdom. But it has also slowly expanded its offerings to encompass a wide range of things, including—of course—its own WeChat Pay service.

In the latest edition of eMarketer's "Behind the Numbers" podcast, analyst Rahul Chadha discusses the unusual developments of India's commerce market, and how adoption of mobile payments there may indicate patterns to come in other markets.