

# Large/Small; Formal/Informal; What's the Problem? What's the Solution? The India Case

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- Multiple definitions of formal/informal or large/small. Which regulation or law to define formal/ informal? Employees, assets or turnover to define large/small?
- In India, for manufacturing, there is some confluence (although the terms organized/unorganized are also used).
- The Factories Act applies to all establishments employing 10 workers or more (20 workers or more if they use electricity). All such enterprises have to register and follow certain practices.

- Such a regulation divides enterprises into 4 types.
  - A: Those to whom the regulation applies and who comply. (Formal)
  - B: Those to whom the regulation applies and who do not comply. (Informal—Illegals)
  - C: Those who adjust out of the regulation so it does not apply to them. (Informal—Adjusters)
  - D: Those to whom the regulation does not apply at all. (Informal-Outsiders).
- How big are these categories and what are their characteristics?

<b>Table 1: Compliers, Evaders, Avoiders and Outsiders under the Factories Act, 1948, in 2009-10*</b>				
<b>Firm Characteristics</b>	<b>Firm Categories</b>			
	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>
	<b>ASI Firms</b>	<b>NSSO Firms with 10 or employees</b>	<b>NSSO Firms with 9 employees</b>	<b>NSSO Rest</b>
Number of Firms	143,452	256,993	67,249	16,900,000
Share of Firms	0.8%	1.5%	0.4%	97.3%
Total Employment**	11,500,000	4,543,668	605,245	29,700,000
Share of Employment	24.8%	9.8%	1.3%	64.1%
Mean Employment	79.9	17.7	9.0	1.8
Median Employment	21	13	9	1
Median Labor Productivity (Rupees)****	135,626	59,820	74,000	23,400

\* Usage of power is ignored and only the criteria of 10 or more employees is considered for registration under the Factories Act,1948. Excludes firms with missing or zero employment.

\*\*Includes unpaid family members/helpers working in the firm.

\*\*\*Capital here is defined as the value (market value for NSSO and book value for ASI) of assets at the end of the year

\*\*\*\*Labor productivity is total gross value added divided by total employment

- Average characteristics of workers in the informal/SME sector: more likely to be poor, have low education and training, be women, lower caste, low access to formal credit.
- BUT, increasingly, average hides big differences. At the upper end of informal/SME, small enterprises owned or run by highly paid, highly educated individuals which are linked in to large firms in a supply chain.

- Also (not fully empirically established as yet), perhaps technology is changing, certainly in some sectors, so as to make smaller enterprises the norm.
  - Example, new technology and small operations in clusters.
  - Example, electricity generators
- So, should we worry about small enterprises per se, or about business conditions in general?

- There is an argument for focusing on:
  - Empirically established costs of enterprise regulation (eg hiring and firing versus health and safety).
  - Empirically established costs of banking regulation (eg “KYC” regulations in India).
  - Business education and training for those who want it and need it, including B2B mentoring schemes.
  - Competition policy which removes effective protected markets against domestic competition.