

Helping young Indian entrepreneurs

While efforts to improve business environment, reduce corruption, and increase efficiency of public spending are important, they are no substitute for investment in physical and human infrastructure



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ENTREPRENEURSHIP HAS ATTRACTED a great deal of attention from the policy-makers, given its importance to economic growth, job creation, and development. There is strong evidence that start-ups provide strong foundations for macroeconomic stability, create jobs, enhance productivity growth, reduce poverty, support climate change agenda, and much more.

Multiple studies have examined the links between entrepreneurship and growth in developed countries, but this work is still scanty for developing countries, which has restricted the effectiveness of public policies. Why are entrepreneurship rates—entry of new and young firms—low in the developing world? Do entrepreneurship rates differ across industries, organised and unorganised sectors, and across gender? What are the similarities and differences between India and the US? Is India's entrepreneurship rate good enough to achieve double-digit growth rates, and create 10 million new workers every year, to benefit from its demographic dividend and young population?

entrepreneurship at the district level. The list of local traits selected is comprehensive including demographics, education, quality of local physical infrastructure, access or travel time to major Indian cities, stringency of labor laws, and household banking conditions. We also examined other drivers of entrepreneurship including a district's caste population, conflict, trade levels, and general development levels (leading/lagging designations at the state and district level). Several studies on the US have linked entrepreneurship to education and skill levels, given that entrepreneurship requires a degree of creativity and handling of many tasks, which education prepares one for. But physical infrastructure is as important. Basic services like electricity are essential for all businesses, but new entrants, especially in the unorganised sector, are particularly dependent upon local infrastructure. We also examined other factors including a district's caste population, conflict, trade levels, and general development levels (leading/lagging designations at the state and district level).

India has historically been a nation of great entrepreneurs. But India's entrepreneurship rate is low compared to other countries at a similar stage of development, although it is improving. Entrepreneurship entry rates are a lot higher in services at 20% compared to manufacturing at 15%. Several enterprise surveys have shown that the new firm density—new enterprises created per 1,000 working age (16-64 years) individuals—in India is dismally low, and we create 288 times fewer number of corporations per 1,000 working age individuals compared to Hong Kong.

What explains low entrepreneurship rates in India? Two factors stand out as discouraging entrepreneurship in organised manufacturing: high population density and greater distance to the ten biggest cities. While manufacturers avoid the high costs of urban areas, they also avoid the most remote areas of India in favor of settings that are relatively near to large population centres to access customers directly or

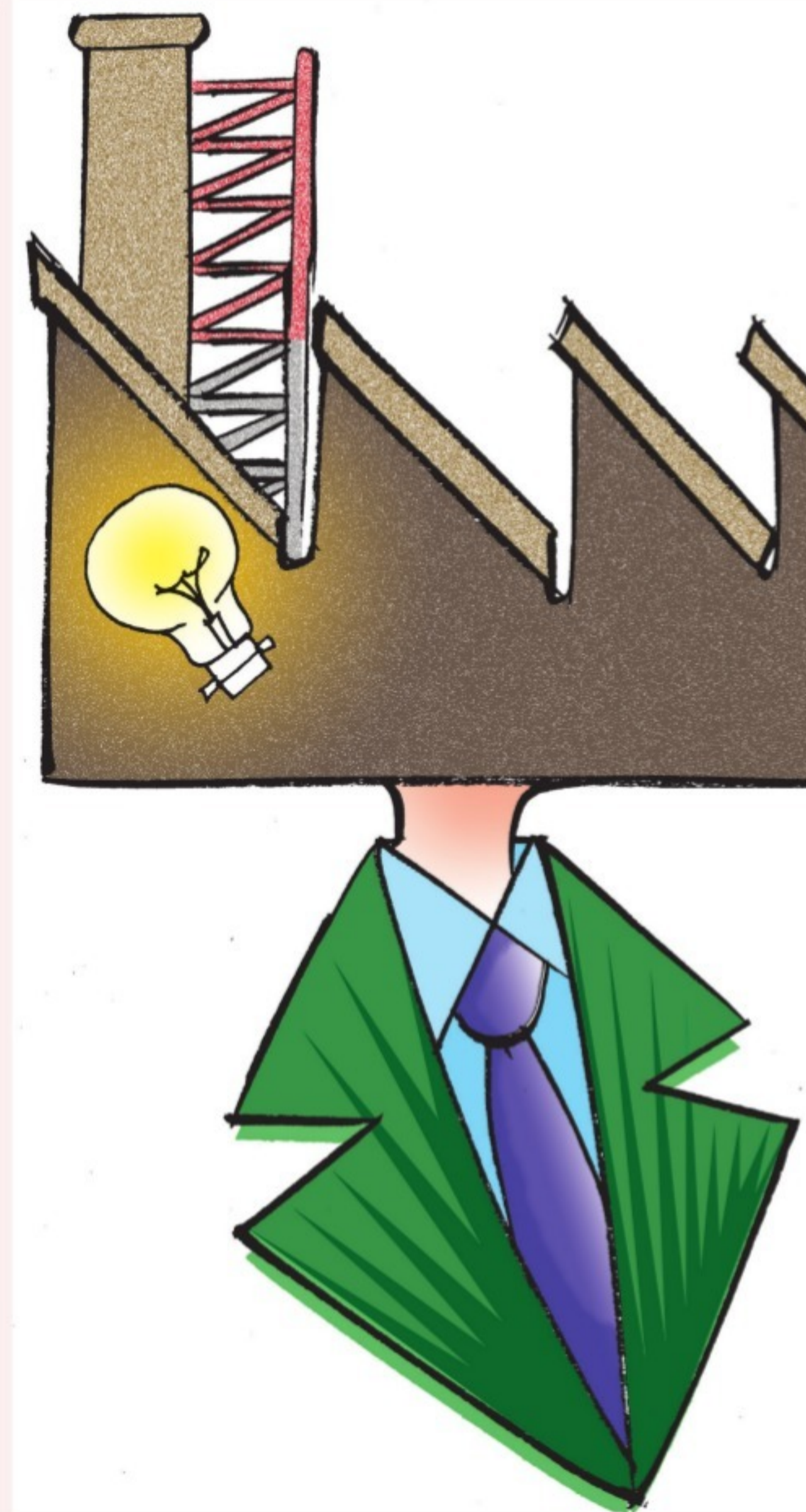


ILLUSTRATION: ROHNIT PHORE

to connect to shipping routes. While India's industrialisation and urbanisation grew together in the 1990s, the two trends have now dispersed, as new entrants are attracted to less dense districts.

Are the drivers of entrepreneurship rates in small enterprises different? Yes. First, local population and market size plays a much greater role in the unorganised sector than in the organised sector. Unorganised manufacturing conforms more closely to the overall contours of India's economic geography. The other two district traits that are associated with strong entry rates in the unorganised sector are the strength of local physical infrastructure and the strength of local household banking environment. This contrasts with organised manufacturing entry, where education stands out. An intuitive explanation is that these patterns and their differences reflect the factors on which each sector depends most. Organised manufacturing establishments have broader resources that reduce dependency on

local physical infrastructure and household finance. Likewise, the unorganised sector depends less on educated workers than the organised sector. The strength of the household banking sector is very important for the unorganised sector.

India's entrepreneurship strength is in small enterprises. They account for over 95% of establishments and 80% of employment in the manufacturing sector. They have also become much more productive. A great deal of job growth in the manufacturing sector has come in the form of small establishments in the tradable sector, while small enterprises have contracted in the non-tradable sector. This suggests that the growth in traded industries in India, unlike in China, is not due to plants achieving larger economies of scale, and shipping goods at a distance, as is often imagined. Instead, global supply chains have integrated small enterprises in India.

What about women headed enterprises? The share of women-headed enterprises has increased in small enterprises, but entrepreneurship rates are still low. Female enterprise ownership shares are 2% or less in industries related

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to computers, motor vehicles, fabricated metal products, and machinery and equipment. In the service sector, female ownership rates in major cities tend to be higher. Among service industries, female ownership shares exceed 30% in industries related to sanitation and education. The states with the highest female service sector ownership rates are Kerala and Tamil Nadu, and the lowest rates are marked for Bihar and Uttar Pradesh.

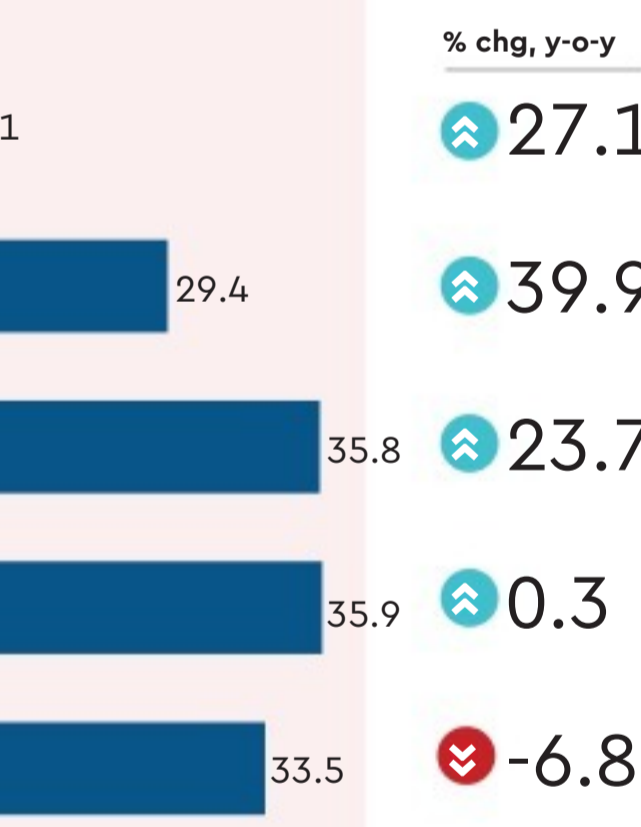
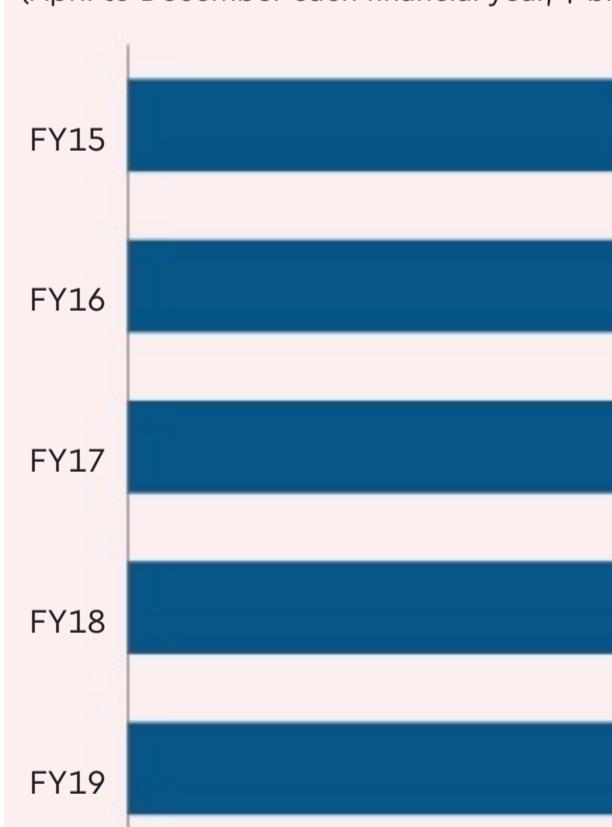
A better infrastructure and higher female-to-male ratio are most important drivers of women entrepreneurship. Transport infrastructure and paved roads play an important role. In addition, better electricity and water access reduce the burden of women in providing essential household inputs for their families and allow for more time to be directed toward entrepreneurial activities.

The similarities in the spatial locations of enterprises observed for India and those in the US are surprisingly large. Their differences are also instructive. First, the importance and role of education and physical infrastructure in promoting entrepreneurship are much greater in India than in the US. By contrast, other dimensions like population density and regional age structures behave very similarly.

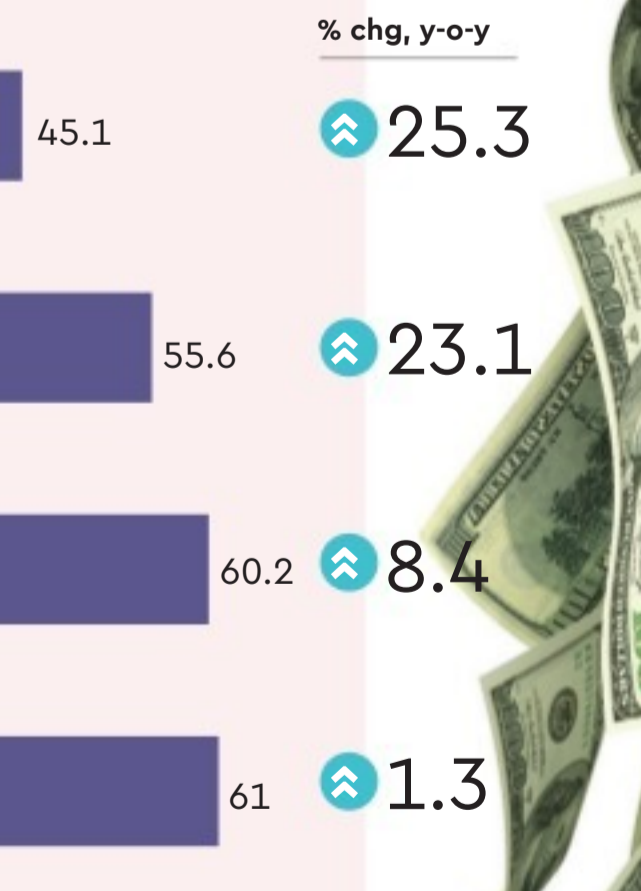
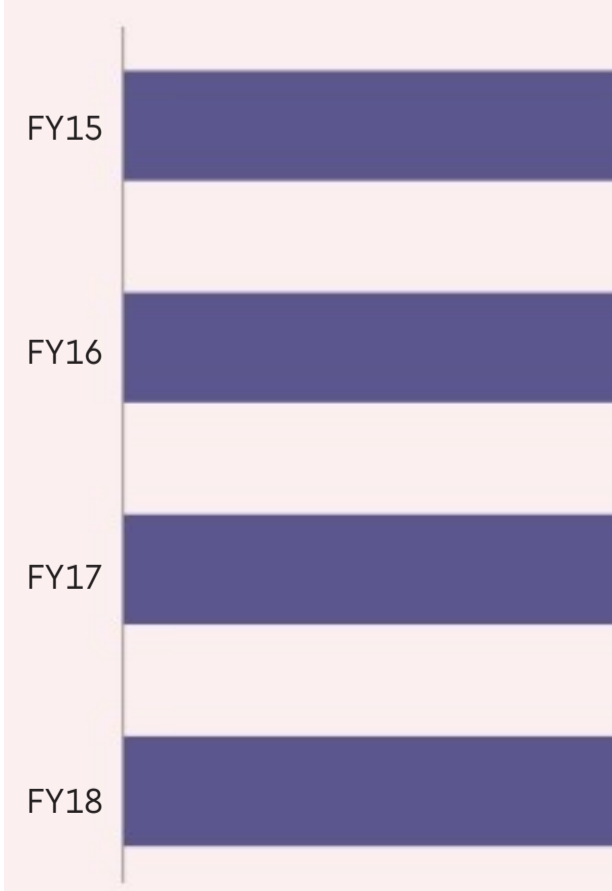
Entrepreneurship and the Indian dream of more jobs and development go hand in hand. Entry of new and young firms is low, but starting to improve, and further growth in entrepreneurship is an important stepping stone in India's continued development. Policy makers can scale up start-ups by investing more in both people and places. While the efforts to improve business environment, reduce corruption, and increase the efficiency of public sector spending are important, they are not a substitute for scaling up investments in physical and human infrastructure.

DATA DRIVE

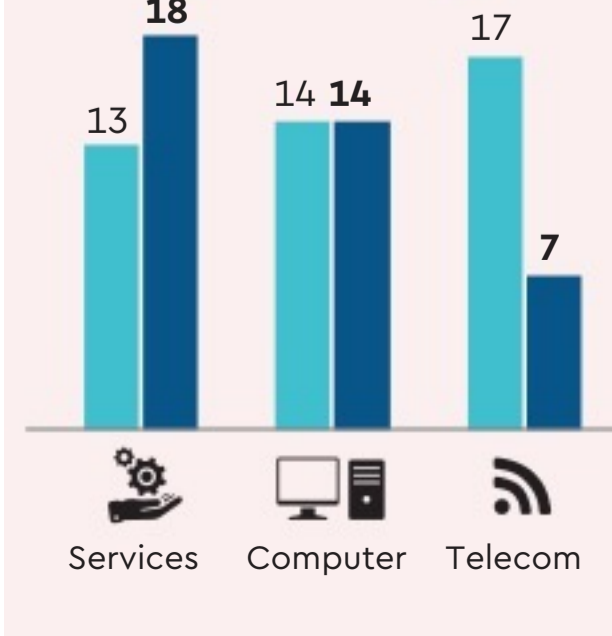
FDI equity inflows slow



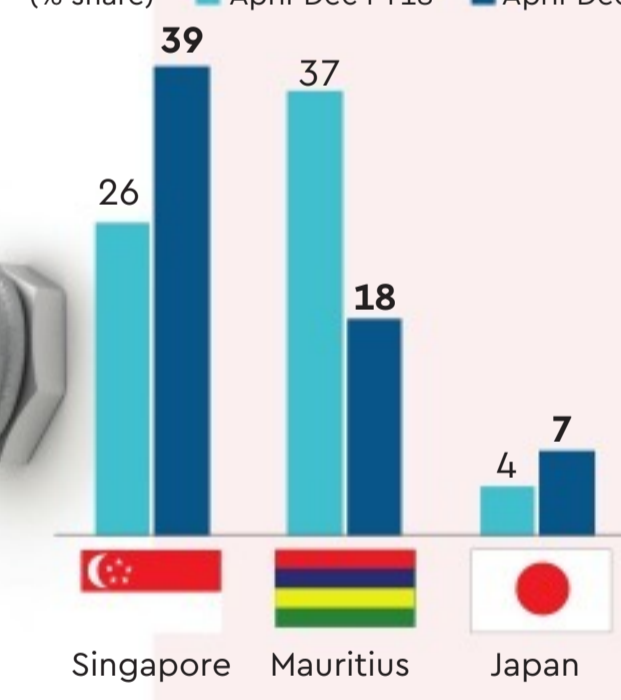
Total FDI flows moderate



Sector-wise equity FDI inflows



Singapore leads in FDI inflows



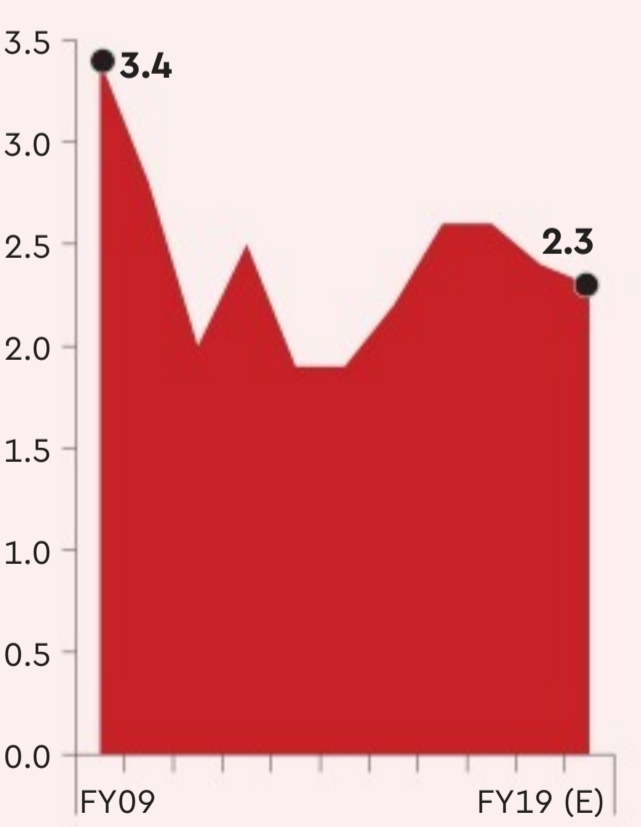
Tackling the FDI slump

AFTER HITTING AN all-time high of \$35.94 billion in nine months of FY18, FDI equity inflow has contracted 7% in the same period in the current financial year—this has happened for the first time in the past five years. Falling FDI equity inflows will put strain on the overall investment climate in the country.

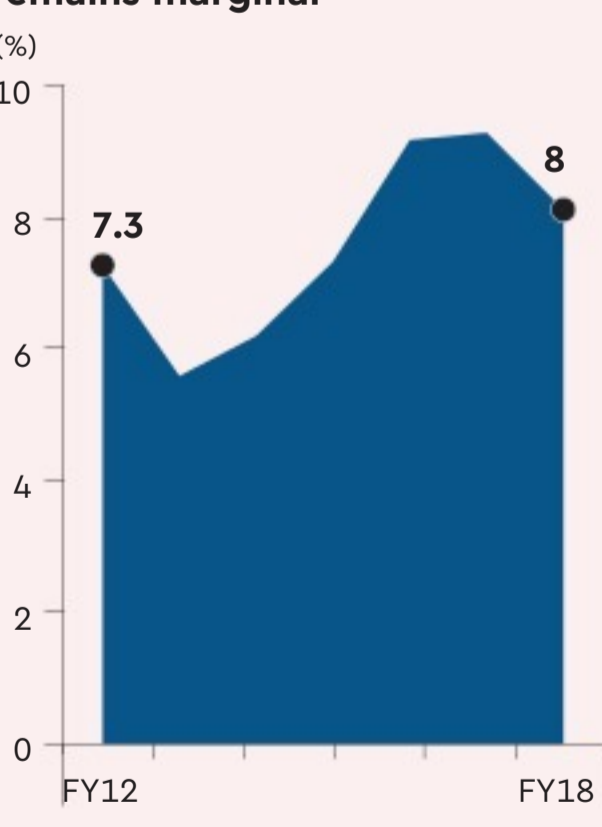
In fact, the growth in total FDI, which includes reinvested earnings, has moderated since FY17. As a proportion of GDP, FDI inflows have fallen from 3.4% of GDP in FY09 to 2.4% in FY18 and are likely to fall further to 2.3% in FY19.

Slowing global economy, US-China trade war, concerns over Brexit have impacted FDI in emerging markets, especially India. Historically, Mauritius was the top source of FDI, accounting for 35.5% of the inflows in FY18. However, in FY19 till December, Singapore has surpassed Mauritius with a share of 39%.

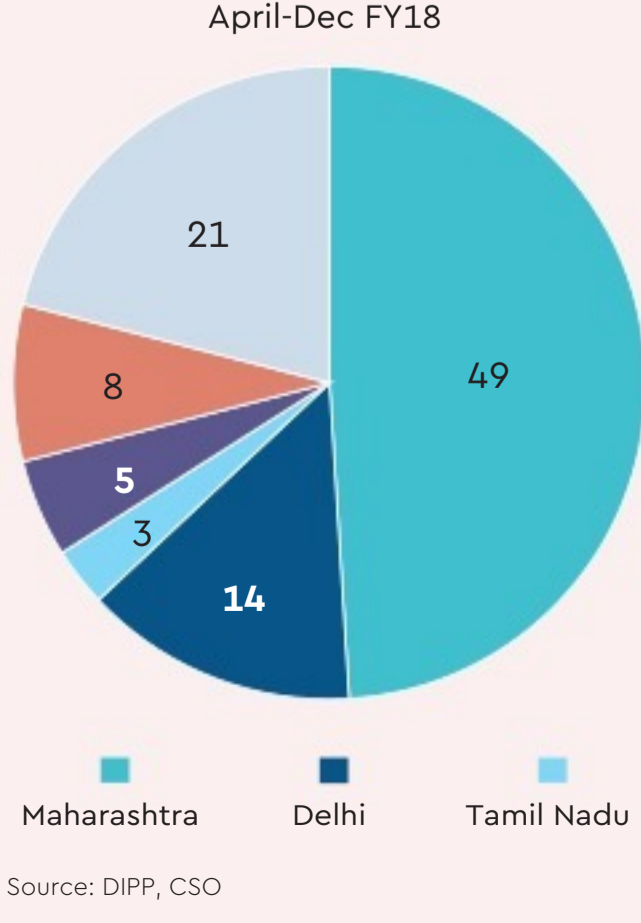
FDI as share of GDP contracts



Share of FDI in total investment remains marginal



FDI inflows in top five regions



Source: DIPP, CSO