

STYLIZED FACTS ON THE EVOLUTION OF THE ENTERPRISE SIZE DISTRIBUTION IN INDIA'S MANUFACTURING SECTOR

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Key Highlights

- Micro-enterprises dominate India's enterprise landscape accounting for approximately 90% of the total in the time period between 2000-01 and 2015-16.
- The distribution of employment across enterprises of different sizes has been marked by a bi-modal distribution wherein a substantial share of employment has been concentrated in micro-enterprises (36.3% in 2015) followed by large enterprises (30.3% in 2015-16). Small and medium sized enterprises account for a lower share in stock of employment compared to micro and large enterprises at approximately 17% each.
- Over time, the distribution of employment has improved with the share of employment in medium and large enterprises in total employment rising while that of small and micro-enterprises has been falling. In particular, large enterprises have seen a significant 10 percentage point increase in their share in total employment while micro-enterprises have seen an 8.5 percentage point decline.
- The increase in the share of employment in medium and large enterprises is witnessed across both labour and capital intensive industries, across most states and across rural-urban areas.
- Amongst other factors, the shift in distribution of employment towards larger firms appears to be a consequence of the fact that there are some dynamic MSMEs which are expanding and moving up the size distribution.

EXECUTIVE SUMMARY

INTRODUCTION

Traditionally, India has supported and encouraged MSMEs as it is believed that these enterprises use labour-intensive methods of production and thereby generate the much needed employment opportunities outside the agriculture sector. Over the years, different policy initiatives have attempted to encourage MSMEs by providing them with subsidized credit, technical assistance, excise tax exemptions, and preference in government procurement (Expert Committee on MSMEs, RBI, 2019). The Small Scale Reservation Policy (1967), which attempted to shield small scale units from competition by reserving the production of a number of products for them, stands out in this context. In recent times, too, the MSME sector has continued to remain a thrust area for policymakers as it is argued that the sector is the "backbone of the Indian industry".

Data from the Annual Report of the MSME Ministry (2018-19) indicates that the sector employed 1,110 lakh persons, contributed to 29% of GDP and more than 40% of India's exports in 2015-16. However, there is little systematic data to understand how this sector has contributed to employment generation over time. In particular, two questions merit attention. One, whether it is in fact MSMEs or large firms that have been significant contributors to employment. And two, how their contributions have evolved over time, across states, across industries and across rural and urban areas.

This paper seeks to review the role of MSMEs in employment generation by examining key stylized facts and trends on the evolution of the enterprise size



distribution in India for the time period between 2000-01 and 2015-16 using the two main available establishment databases, namely the Annual Survey of Industries and the NSSO's Enterprise Survey of Unincorporated Enterprises. These surveys cover enterprises in the registered/formal and informal/unincorporated manufacturing sector respectively.

STYLIZED FACTS AND TRENDS

Distribution of Enterprises by Firm Size

Combining establishment-level data from the above-mentioned surveys, it is observed that the enterprise landscape in India has been dominated by micro-enterprises (defined as those hiring one to ten workers). Their share in total enterprises has remained flat, at approximately 90% of the total, for the entire time period under study (2000-01 to 2015-16). The next highest share is accounted for by small enterprises (i.e. those with 10 to 49 workers) at about 10%. This is followed by medium size enterprises (i.e. those with 50 to 249 workers), which account for 1-2% of total enterprises over all four time periods. Large enterprises (i.e. those with 250 or more workers) account for less than 0.5% of total enterprises during the above-mentioned time period. Thus, as

seen in Table 1, the enterprise size distribution is decreasing in firm size with a steep decline after the 1-9 worker category.

It is also worth noting that most micro and small enterprises are largely informal nature. Whilst, in the case of the former almost all are informal, in the category of small enterprises, the share of informal enterprises has remained over 70% for the entire time period under study. The medium category, on the other hand, is largely populated by formal enterprises (roughly 80% are formal in nature). In the large category, almost all enterprises are formal.

Distribution of Employment by Firm Size

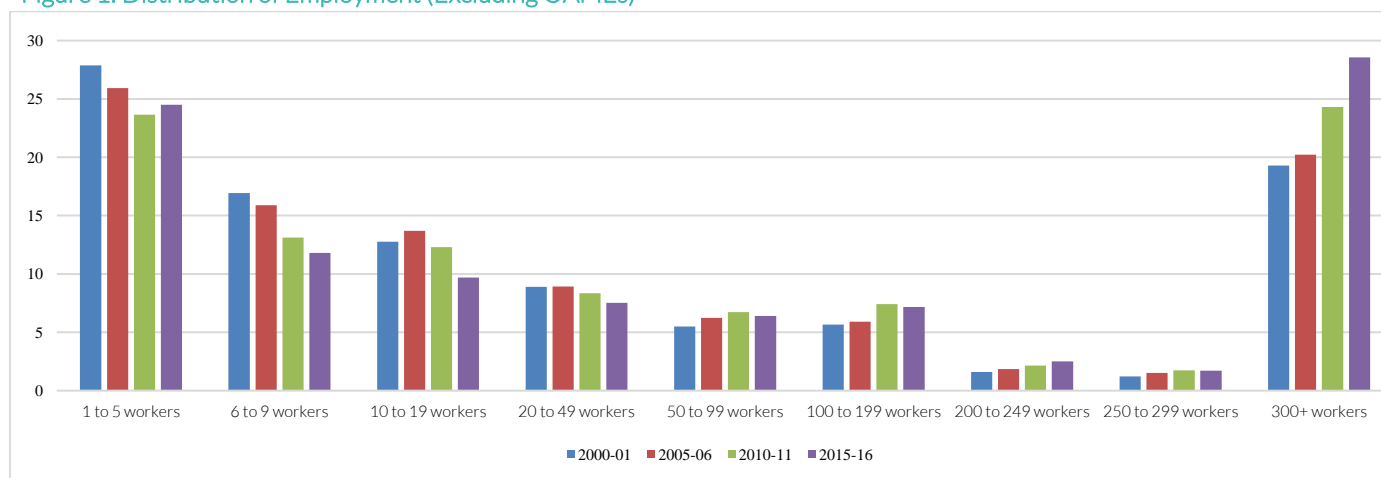
The distribution of employment has been marked by a bi-modal distribution wherein a large share of employment has been concentrated in micro-enterprises followed by large enterprises (Figure 1). Over time, there has been an improvement in the employment distribution with the share of medium and large enterprises in total employment rising, while that of small and micro-enterprises has been falling. The share of micro-enterprises in total employment has declined from 44.8% (2000-01) to 36.3% (2015-16). Despite this decline,

they remain the largest contributor to total stock of employment.

Concomitantly, the share of employment in large enterprises has increased from 20.5% in 2000-01 to 30.3% in 2015-16. The share of small enterprises in total employment has fallen from 21.6% to 17.2% over the fifteen year period while that of medium sized enterprises has risen from 12.7% to 16%.

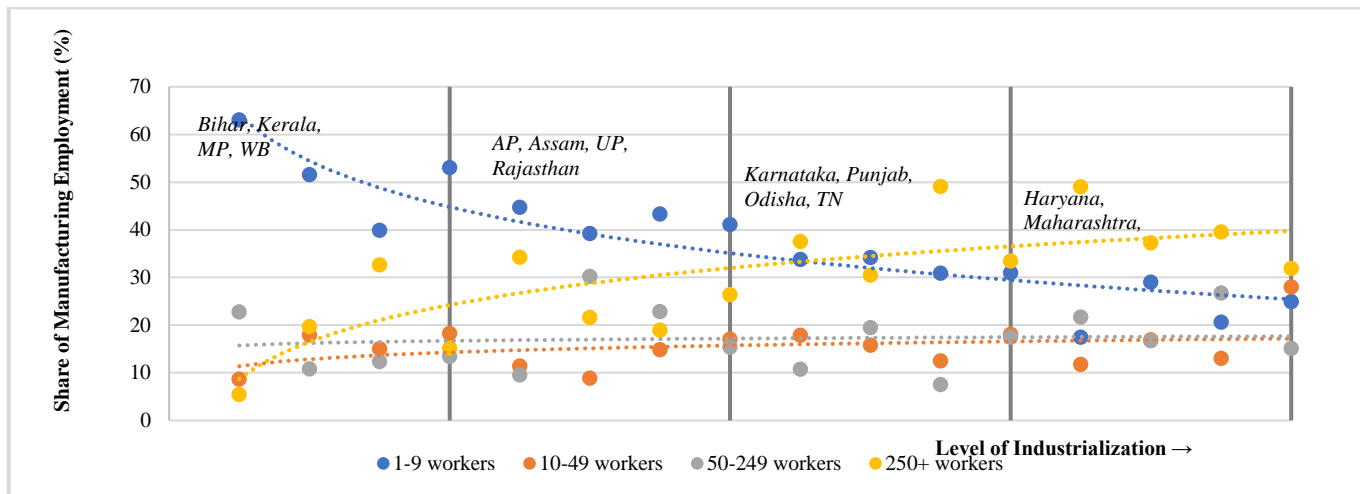
The distribution of employment has improved over time with the share of micro and small enterprises falling and that of medium and large enterprises rising. The rising employment share in large enterprises (of almost 10 percentage points over 15 years) is a positive development as these enterprises offer more productive and better paying jobs compared to smaller enterprises. Importantly, the improvement in the distribution of employment is seen not just at the aggregate level but also at a more disaggregated level- across both labour and capital intensive industries, across major states and across both rural and urban areas. Some noteworthy observations are as follows.

Figure 1: Distribution of Employment (Excluding OAMEs)



Source: Author's calculations from plant level data of ASI and NSS Unincorporated Enterprise Surveys (2000-01, 2005-06, 2010-11 and 2015-16)

Figure 2: Differences in Employment Distribution by Enterprise Size in Manufacturing Sector across States (2015-16)



Source: Author's calculations from plant level data of ASI and NSS Unincorporated Enterprise Surveys (2015-16) and RBI's Handbook of Statistics on Indian

Employment Distribution across Labour and Capital Industries

On comparing the employment distribution across select labour intensive and capital intensive industries, it is noted that across all industries, the share of employment in large enterprises has increased over time. Significantly, in the case of capital intensive industries, the increase in the share of large enterprises has been very steep. By 2015-16, over 70% of employment in auto industry was in large enterprises, up from 45% in 2000-01. In contrast, in the apparel industry the share of employment in large firms had increased from 11% to 21% over the same time period. Micro-enterprises accounted for over 50% of employment in latter, compared to just 8% in the case of the former in 2015-16. The rapid pace at which the size structure has evolved towards large enterprises in capital intensive industries appears to be a consequence of the fact that the more capital required in a production process, the greater will be the scope for reaping scale economies, and thus the larger the optimum size of enterprises.

Employment Distribution across States

All states barring five have seen an improvement in employment distribution with an increase in the share of medium and large enterprises and a concomitant decline in the share of micro and small enterprises in the period between 2000-01 and 2015-16. The more industrialized states not only have a higher share of employment in large enterprises, but have also witnessed a more substantial increase in the share of employment in large enterprises over time compared to less industrialized ones.

Further, a cross-section analysis of the distribution of employment across major states of India which are at different levels of industrialization (measured by share of manufacturing sector in the states' Gross Value Added) shows that as states industrialize, the composition of manufacturing activities, when classified according to scale, evolves with household enterprises displaced first by small factories and later by large factories (Figure 2). This is in line with the global evidence on how the size composition of enterprises

evolves with the process of structural transformation

Employment Distribution across Rural and Urban Areas

Although both rural and urban areas have witnessed an increase in employment shares in medium and large enterprises, the increase is particularly steep in the former. In rural areas, a sharp decline (of 11 percentage points) is seen in the share of micro and small enterprises in total employment over the fifteen year period. Large enterprises see a significant increase in share of total employment from 18% in 2000-01 to 34% in 2015-16. In contrast, in urban areas, the share of employment in large enterprises in urban areas increased from 22% to 28%, while that of micro-enterprises remained substantial (at over 40%). The shift observed in the distribution of employment towards relatively larger plants in rural areas appears to be broadly in line with findings on the spatial distribution of the Indian manufacturing sector in the literature. Ghani et al's (2012) find that for the period between 1994 and 2005, plants in the formal sector are moving away from urban and into

rural locations, while the informal sector is moving from rural to urban locations.

OPPORTUNITIES AND CHALLENGES

The rising share of employment in the medium and large enterprises, not just at an aggregate level, but also at a more disaggregated state and industry level, is a positive development and merits attention. Identifying the drivers of the changes in the employment distribution is important from a policy perspective. While we cannot track the life cycle dynamics of MSMEs due to the survey design of the two establishment surveys, the shift in

distribution of employment towards relatively larger enterprises appears to be driven, amongst other factors, by the fact that there are some dynamic MSMEs which are expanding and moving up the size distribution.

An important implication of the above observation is that for policies designed to support MSMEs to be effective in employment generation, they should seek to identify transformative enterprises, which have the potential to grow fast and provide them the necessary support to expand and flourish. Policy support for MSMEs should not incentivize them to remain small. They must also be cautious to avoid indefinitely subsidizing

subsistence entrepreneurs, who are unlikely to be engines of productive job growth. Ex-ante identification of the transformative enterprises from the factory level data available in India is indeed difficult. Nevertheless, it is an important exercise and warrants creative research as it is these potentially transformative enterprises (also referred to as constrained gazelles in the literature) that can build larger businesses and emerge as engines of job growth in the economy if given the right conditions and support.

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