How to promote Indian entrepreneurship

Entrepreneurship has attracted the attention of policymakers in India. A series of high-level initiatives, including Startup India, have been launched to promote private sector development. However, the role of entrepreneurship in development remains a mystery for many policy observers.

While the great economic minds throughout history have recognized the link between entrepreneurship and development, controversies have remained. Do young and small or large, established firms contribute more to job growth? Why do some cities attract more entrepreneurs than others? Are agglomeration economies and networking stronger in enterprises in developing or developed countries? What makes some local governments fiscally more entrepreneurial than others?

India has implemented many structural reforms since the early 1990s to promote private sector development. Trade reforms and investments in transport have increased global and local integration of enterprises. Conventional wisdom would suggest that these reforms should have largely helped large enterprises, given their potential to benefit from scale economies generated by trade and transport connectivity. But India's experience contradicts this conventional wisdom.

Entrepreneurship in India is still dominated by small enterprises. They account for over 95% of establishments and 80% of employment in the manufacturing sector. They have also become more productive. Much of the manufacturing sector's employment growth has come in the form of small establishments in tradable sectors; they have contracted in the non-tradable sector. This experience suggests that the growth in traded industries is not due to plants achieving larger economies of scale and shipping goods at a distance, as might have initially been imagined. Instead, global supply chains have integrated small enterprises.

A large share of new enterprises in the manufacturing sector are locating in rural areas. Districts with low population density have attracted more new enterprises than more dense districts. Two factors stand out as discouraging entrepreneurship—high population density, and greater distance to one of India's 10 biggest cities. The first pattern has been observed in many settings and reflects large manufacturers seeking cheaper environments. While they avoid the high costs of urban areas, they also avoid the most remote areas of India in favour of settings that are relatively near to large population centres, likely to access customers directly or to connect to shipping routes.

The share of women-headed enterprises, especially in small enterprises, has also increased. That said, segmentation based on gender is pervasive in both manufacturing and service enterprises. Structural reforms and market competition have not reduced this.

The spatial distribution of start-ups in India is more fluid than in advanced countries like the US. There, city population levels and city-industry employment can explain 80% of the spatial variation in entrepreneurship and the formation of new enterprises. The comparable explanatory power for new enterprises in India is very low, at 29% for manufacturing, and 33% for services (see Ejaz Ghani, William R. Kerr, and Stephen D. O'Connell; "Who Creates Jobs?", *Economic Premise*, World Bank). Some aspect of this low explanatory power of the drivers of entrepreneurship is due to India being at an early stage of development. Nevertheless, in terms of broad regularities, it is very helpful to compare India with the US to provide deeper perspective on drivers of entrepreneurship ranging from business environment to role of infrastructure.

Empirical analysis of millions of establishments in some 600 districts in India suggests that there

are two key drivers of entrepreneurship. First, the importance of a good physical infrastructure. Small and young enterprises are much more dependent on local physical infrastructure than large established firms. Second, and equally important is the role of human infrastructure. These two drivers of entrepreneurship—a good physical and human infrastructure—are much stronger in India than in the US.

Those districts in India that have developed their physical and human infrastructure have attracted many more new establishments. Entrepreneurship contributed to output growth by allocating resources more efficiently, strengthening competition among firms, supporting innovation and new product designs, and promoting trade growth through product variety. Perhaps most important, high rates of local entrepreneurship are linked to stronger job growth.

Policymakers in India have many policy levers to promote entrepreneurship and growth. Two key fiscal drivers are improved efficiency in public expenditure and increased investments in infrastructure. Many districts in India lack the basic physical infrastructure and basic services that discourage entrepreneurship. Access to roads and electricity are essential for all businesses, but new entrepreneurs are particularly dependent upon local infrastructure. Investment in people is also an easy call for policymakers. Improved education in a local area increases the supply of entrepreneurs and increases the talent available to entrepreneurs for staffing their companies.

India's economic geography is still evolving. But the changes are happening at a 100 times faster rate than what the US has experienced. At such an early point and with industrial structures not entrenched, there is room for policy to have a substantial impact by shaping where industries plant their roots. The very dynamic times ahead for India require that entrepreneurship be embraced and supported at the Central, state and district levels.

While ongoing efforts to evaluate public sector spending policies to improve expenditure efficiency and a comprehensive review of regulatory reforms to improve the business environment should be sustained, there is a need to scale up investments in physical and human infrastructure. Poor infrastructure is the biggest barrier to entrepreneurship in most developing countries. Demand for cheap capital will invariably exceed its supply, so the key is to ensure that these resources are deployed where they are needed most and can achieve effective and sustainable results.

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