



State of India's Informal Sector

A Deep Dive into Enterprises, Statistics, and Segments



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Omidyar Network India (ONI) invests in bold entrepreneurs who help create a meaningful life for every Indian, especially the hundreds of millions of Indians in low-income and lower-middle-income populations, ranging from the poorest among us to the existing middle class. To drive empowerment and impact at scale, they work with entrepreneurs in the private, nonprofit, and public sectors who are tackling India's hardest and most chronic problems. They invest in the areas of Advancing Cities, Digital Society, Education & Employability, Emerging Technologies, Financial Inclusion & Well-being, and Property Inclusivity. Omidyar Network India is part of the Omidyar Group, a diverse collection of companies, organisations, and initiatives supported by philanthropists Pam and Pierre Omidyar, founder of eBay. For more information, please visit

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About MSC (MicroSave Consulting)

MSC is a boutique consulting firm that, for 25 years, has been driving global progress toward meaningful financial, social, and economic inclusion. With 11 offices worldwide, approximately 300 staff from diverse backgrounds, and extensive expertise, they take pride in their work across 70 developing countries. They collaborate closely with stakeholders in financial services ecosystems to achieve sustainable performance improvements and create lasting value. Their clients include governments, donors, private sector corporations, and local businesses. For more information, please visit <https://www.microsave.net/>



About Decodis

Decodis is a social research company that uses tech-led, customized data capture and analysis to elevate the voices of vulnerable populations. Decodis was founded by Dr. Daryl Collins, the author of the acclaimed Portfolios of the Poor and a pioneer working at the intersection of finance and human vulnerability. With a team of 17 spread across the globe, in only four years Decodis has listened to over twenty thousand hours of audio in over 30 languages in studies spanning from impact measurement to rapid tracking, including innovative projects such as Digital Portfolios of the Poor with the Bill & Melinda Gates Foundation. For more information, please visit www.decodis.com.



About Datarivu

Founded in 2022 by Rukmini Srinivasan, an award-winning data journalist and author based in Chennai, India, Datarivu is a boutique communications firm that specializes in turning data into compelling narratives. For more information, please visit <https://www.datarivu.com/>

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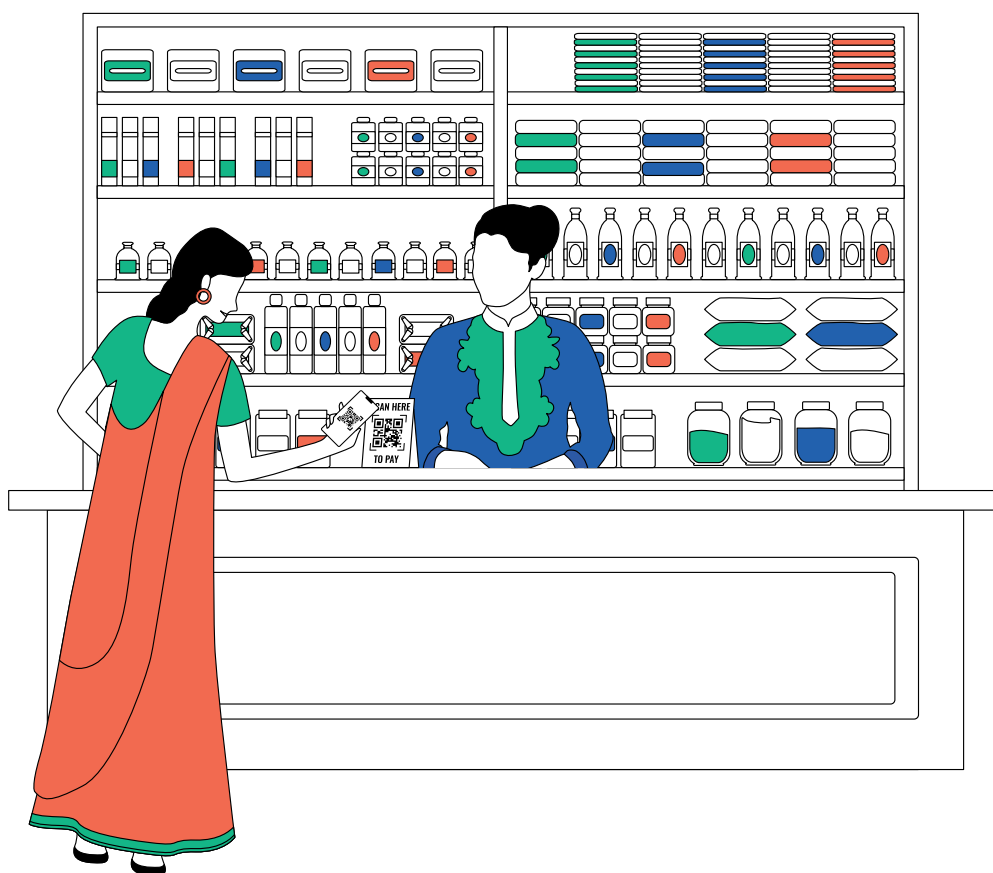
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Foreword

There are over 6.33 crore micro, small, and medium enterprises (MSMEs) spread across every nook and corner of India. These MSMEs contribute to almost 30% of India's gross domestic product (GDP)¹ and about 44% of the country's exports.² With nearly 11 crore people employed in the sector, the growth of MSMEs is critical to the Indian story. For Atmanirbhar Bharat³ to succeed, Udyami Bharat⁴ needs to succeed.

However, 97% of India's MSMEs are informal enterprises (IEs)⁵, which neither fall within the Goods and Services Tax framework nor have business Permanent Account Numbers (PAN).⁶ Yet, they employ the vast majority of India's workforce. As a result of this informality, the sector lacks an exhaustive and reliable data system to track and report the financial and operational health of IEs and the challenges they face. We believe that directing this type of data into key feedback loops is crucial for industry action and policy interventions.

1. Government of India. (2024). Ministry of Micro, Small and Medium Enterprises. Annual Report 2023–24. <https://msme.gov.in/sites/default/files/FINALMSMEANNUALREPORT2023-24ENGLISH.pdf>

2. Ministry of Micro, Small and Medium Enterprises. (2023, August 07). Role of the MSME Sector in the Country [Press release]. <https://pib.gov.in/PressReleasePage.aspx?PRID=1946375>

3. <https://cmsadmin.amritmahotsav.nic.in/aatmanirbhar-bharat.htm>

4. Prime Minister's Office. (2022, June 30). PM participates in 'Udyami Bharat' programme [Press release]. <https://pib.gov.in/PressReleasePage.aspx?PRID=1838174>

5. Behera, & Wahi, G. (2018). Mint Street Memo No. 13. How have MSME Sector Credit and Exports Fared? https://rbi.org.in/Scripts/MSM_Mintstreetmemos13.aspx

6. For the purpose of this research, informal enterprises (IEs) are defined as firms that are not registered under GST or PAN or both.

Commissioned by Omidyar Network India (ONI) and in collaboration with Datarivu and Decodis, the 'State of India's Informal Sector: A Deep Dive into Enterprises, Statistics, and Segments' report aims to address data gaps within India's informal sector. It examines various dimensions that underpin the survival and growth of informal enterprises, compiling comprehensive analysis, findings, and recommendations. The report leverages the following qualitative and quantitative data insights:

- A first-ever, independent large-scale survey with a sample size of more than 10,000 IEs, led by the World Bank and analysed by MicroSave Consulting (MSC), to derive authentic, accurate, and actionable data-driven insights.
- Financial diaries-based research on 50 microenterprises⁷ to develop a nuanced understanding of the financial and non-financial aspects of IEs in India.
- Concurrent secondary research, as well as consultations with key experts on the insights generated from the World Bank survey and the diaries research.

This research study is part of the 'Voices of India's MSMEs' project, which strives to capture the untold stories of India's MSMEs. You can get more details about the project and read or download other related knowledge pieces on a dedicated website: (<https://voicesofindiassmes.com>). For any questions or suggestions, please write to rajarshi.barua@microsave.net.

We hope this report furthers the important national conversation on what it would take to advance the journey of India's informal enterprises towards greater productivity, competitiveness, sustainable and stable livelihood generation, and financial resilience.



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7. Out of the 50 microenterprises, 49 are informal and one formal.

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List of abbreviations

ACS	Adaptive cluster sampling
ASI	Annual Survey of Industries
CSE	Centre for Sustainable Employment
CICO	Cash-in/Cash-out
CSC	Common Service Centres
EoDB	Ease of Doing Business
FIs	Financial institutions
FSPs	Financial service providers
GDP	Gross domestic product
GeM	Government e-Marketplace
GST	Goods and Services Tax
GSTIN	Goods and Service Tax Identification Number
GVA	Gross value added
IEs	Informal enterprises
IFC	International Finance Corporation
IMF	International Monetary Fund
ISBS	World Bank Informal Sector Business Survey
LLP	Limited Liability Partnerships
MBA	Master of Business Administration
MFIs	Microfinance institutions
MoHUA	Ministry of Housing and Urban Affairs
MoMSME	Ministry of Micro, Small, and Medium Enterprises
MSC	MicroSave Consulting
MSDE	Ministry of Skill Development and Entrepreneurship
MSMEs	Micro, small, and medium enterprises
MSMED	Micro, Small, and Medium Enterprises Development
NBFCs	Non-Banking Financial Companies
NCEUS	National Commission for Enterprises in the Un-organised Sector
NRLM	National Rural Livelihood Mission
NSDC	National Skill Development Corporation

NSS	National Sample Survey
NSSO	National Sample Survey Office
NTC	New-to-credit
NULM	National Urban Livelihood Mission
OBCs	Other Backward Classes
ONI	Omidyar Network India
PAN	Permanent Account Number
PFDR	Pension Fund Regulatory and Development Authority
PMJJBY	Pradhan Mantri Jeevan Jyoti Bima Yojana
RBI	Reserve Bank of India
SCs	Scheduled Castes
SDGs	Sustainable Development Goals
SHGs	Self-help groups
SIDBI	Small Industries Development Bank of India
SMEs	Small and medium-sized enterprises
STs	Scheduled Tribes
TReDS	Trade Receivables e-Discounting System
VCC	Vyapar Credit Card
WPI	Wholesale Price Index



Executive summary

India has over 6.33 crore MSMEs, which employ nearly 11 crore people and contribute to almost 30% of India's GDP⁸ and about 44% of the country's exports.⁹ MSMEs are central to the Indian growth story and form the foundation for achieving a USD 5 trillion economy. Strengthening the MSME sector means strengthening the entire society and making everyone a beneficiary of development. However, as per a 2018 estimate by the Reserve Bank of India (RBI), 97% of these MSMEs operate in the informal sector.¹⁰ Most of these MSMEs are unregistered enterprises, and their characteristics, operations, and unique challenges can be a data and policy black box.

The research presented in the “State of India's Informal Sector: A Deep Dive into Enterprises, Statistics, and Segments” report offers a glimpse into the diverse characteristics of informal enterprises in India. The purpose of the report is to provide policymakers, regulators, academia, and industry participants with a deeper understanding of the informal sector and offer recommendations for the growth and development of informal enterprises.

8. Government of India. (2024). Ministry of Micro, Small and Medium Enterprises. Annual Report 2023–24. <https://msme.gov.in/sites/default/files/FINALMSMEANNUALREPORT2023-24ENGLISH.pdf>

9. Ministry of Micro, Small and Medium Enterprises. (2023, August 07). Role of the MSME Sector in the Country [Press release]. <https://pib.gov.in/PressReleaseframePage.aspx?PRID=1946375>

10. Behera, & Wahi, G. (2018). Mint Street Memo No. 13. How have MSME Sector Credit and Exports Fared? https://rbi.org.in/Scripts/MSM_Mintstreetmemos13.aspx

This study includes quantitative data from a World Bank survey conducted with more than 10,000 informal enterprises in India, as well as qualitative insights from granular conversations and financial diaries of 50 microentrepreneurs tracked over a year.

In the quantitative study, the surveyed enterprises are from nine cities of varying sizes across nine states, thus reflecting the diversity of IEs in India.¹¹ The sampled IEs range in size from those where the owner is the sole operator with no additional employees to those with 200 employees and with annual revenues ranging from INR 1 lakh to INR 40 lakh. While most work in trade, especially food and food products, smaller shares work in the manufacturing and services industries. Most are led by men in the age group 35-45 and the median level of education is higher secondary schooling.

From this analysis, four key lessons arise:

01 Understanding the nuanced differences in informal enterprises is key to fostering their formalisation. Most informal enterprises are small, first-generation ventures that employ, at most, a few household members. However, some are larger and employ as many as 200 people. Trade businesses are dominant – with common business activities including small eateries, food stalls, and grocery units – but many vary in the degree of sophistication (i.e., the degree of advancement in their financial and operational practices). Therefore, promoting efforts towards their formalisation will require tailored solutions that can meet the needs of the different ways of operating within the informal sector.

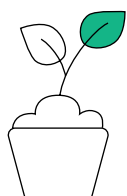
02 Sales volatility is prominent across all types of informal enterprises. Informal enterprises face significant income volatility, marked by fluctuating sales year-round. While the average monthly sales tend to be between INR 25,000 and INR 50,000, sales in the highest-performing months can be up to 2.6 times higher than the lowest-performing ones.

03 Gender disparities significantly affect women in the informal sector. Only 10% of the surveyed enterprises are owned by women. Additionally, despite working close to similar hours as their male counterparts, women-led enterprises typically earn lower monthly revenues, averaging around INR 26,674 compared to INR 40,512 for men. Moreover, safety concerns persist as a key factor keeping women homebound.

04 Informal enterprises face multidimensional challenges that hinder their growth. The growth of informal enterprises directly impacts the growth of the Indian economy. However, these enterprises encounter complex obstacles, including financial constraints, poor infrastructure, limited access to technology, inadequate human capital, and bureaucratic hurdles, which severely impair their productivity compared to formal enterprises. Financially, informal enterprises rely heavily on costly informal sources, doubling the cost of finance. Additionally, bureaucratic challenges, such as cumbersome paperwork and information asymmetry, limit their access to government support, with only 8% receiving a grant or loan from a government scheme in the past year. The lack of capital and financial support restricts their ability to scale up and innovate.

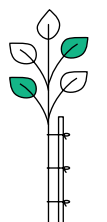
11. While the observations presented in the report reflect the universe of surveyed IEs and do not claim to represent all IEs in India, it is important to note that the World Bank survey used adaptive cluster sampling (ACS), a method that ensures the representativeness of the results within the areas surveyed.

Behind these broad brushstrokes, the story of Indian informal enterprises is far more nuanced. To better understand this complex and diverse universe of informal enterprises, the study segmented these businesses based on their financial and operational practices,¹² as well as the reasons that inhibit or motivate their owners to formalise their ventures. This analysis resulted in three segments characterised by the scale and sophistication of the enterprise.



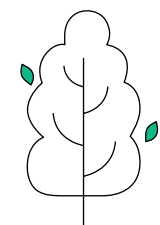
Subsisting

These enterprises comprised 31% of the sample and generated average monthly sales of INR 23,063 on a regular month. Only 8% of business owners in this group keep written records, and 14% differentiate between business and household finances. Furthermore, only 5% of them have dedicated bank accounts for their businesses, and a few (27%) use mobile phones in their business operations. In addition, within this segment, business owners cite improved access to loans or credit as the primary motivation to formalise their ventures.



Striving

These enterprises comprised 40% of the sample and generated average monthly sales of INR 41,969 on a regular month. Overall, 42% of business owners in this group keep written records, and 40% differentiate between business and household finances. Moreover, 44% have dedicated bank accounts for their businesses, and more than half (69%) use mobile phones in their business operations. Furthermore, business owners in this segment cite paying fewer bribes as the primary motivation for formalising their ventures.



Scaling

These enterprises comprised 29% of the sample and generated average monthly sales of INR 52,285 on a regular month. More than half of business owners in this group keep written records (53%) and differentiate between business and household finances (78%). Additionally, a large percentage of them have dedicated bank accounts for their businesses (74%) and use mobile phones in their business operations (85%). Business owners in this segment are driven to formalise their ventures with the aim of expanding their customer base and paying fewer bribes.


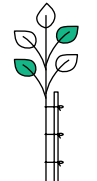
These informal enterprises play a pivotal role in sustaining the local economy. The diverse spectrum of experiences, ambitions, and needs within each category of these enterprises mirrors the story of India. These enterprises embody the country's exciting potential, and it is thus crucial to celebrate, support, and integrate them into the narrative of the country's growth and development.

To enable this, we present recommendations addressing key barriers facing informal enterprises in India. Each recommendation identifies the segment and targeted audience where it is most appropriate. These recommendations intend to provide direction to policymakers, regulators, academia, and industry participants and set a way forward for the growth and development of enterprises in the informal sector:

12. These include average monthly sales, mobile phone usage for business operations, ownership of business bank accounts, and maintenance of business financial records.


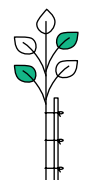

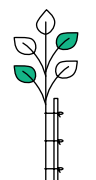

Barrier 1: Data insufficiency to monitor the informal sector.

The lack of a universally accepted legal definition of informal enterprises in India complicates their identification, making it difficult for policymakers to monitor performance and collect macro data. This hinders the formulation of effective policies for informal enterprises despite recent trends towards formalisation, such as the registration of over 4.9 crore MSMEs ¹³ on the Udyam portal (including those registered on Udyam Assist Platform), where microenterprises represent 98% of these registrations.

Recommendation	This is applicable to segments	Ownership
Create a separate category of nano-enterprises within the microenterprise segment.	  Subsisting Striving	MoMSME

Barrier 2: Information asymmetry impeding compliance with government regulations.


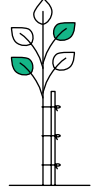

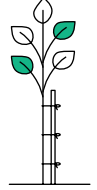

Despite efforts to digitise formalisation processes, compliance challenges remain, disproportionately affecting informal enterprises due to information asymmetry. This issue limits access to government support programmes because of negative perceptions about government processes, lack of necessary documentation, and difficulties in meeting eligibility criteria.

Recommendation	This is applicable to segments	Ownership
Create an assisted support model akin to Banking Correspondents for IEs to reduce information asymmetry about registration, tax, social security, and labour laws.	  Subsisting Striving	MoMSME
Develop a Udyog Aadhaar master app for IEs. The government, Financial Service Providers (FSPs), and other service providers should collaborate to create a one-stop solution app that informal enterprises can use to access specific information on schemes, application processes, market linkages, etc.	   Subsisting Striving Scaling	MoMSME, FSPs, Industry associations

13. As of August 2024.


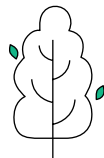


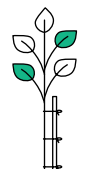
Barrier 3: Inadequate access to formal finance.

Informal enterprises struggle with inadequate access to formal finance due to both demand-side and supply-side barriers. Formal, institutional lenders are hesitant to support IEs due to perceived high risk and operational costs, while IEs often lack understanding of credit processes, credit history, and collateral. Microfinance loans from banks and non-bank financial companies (NBFCs) are often insufficient and do not align with the cash flow needs of most IEs.

Recommendation	This is applicable to segments	Ownership
Promote ideas of flexible credit products for IEs, such as the Vyapar Credit Card (VCC), through interest subvention and credit guarantee mechanisms.	  Subsisting Striving	SIDBI
Facilitate digital working capital finance for IEs under the PM SVANidhi scheme by using IEs' digital payment transaction data. The scheme itself can be extended beyond hawkers to include IEs whose requirement for credit may fall in the same range.	  Subsisting Striving	FSPs, MoHUA
Bring semi-formal credit under the data radar. The credit bureaus should cover Self Help Group (SHG) members' individual credit exposure and repayment history for SHG bank linkage programmes under the National Urban Livelihood Mission (NULM) and National Rural Livelihoods Mission (NRLM).	 Subsisting	MoMSME, Credit Information Bureaus, FSPs


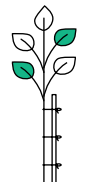
Barrier 4: Multidimensional challenges for women-led IEs.

Women-led informal enterprises face social, financial, and cultural challenges, such as societal bias and unequal family responsibilities, limiting their business expansion.

Recommendation	This is applicable to segments	Ownership
Facilitate financing to women-led startups. Lower the minimum loan amounts under StandUp India to cater to IEs with credit needs of less than INR 10 lakh.	  Striving Scaling	MoMSME
Set up exclusive business infrastructures (commonly known as “women bazaars”) specifically designed for women-led businesses. These spaces would provide a secure environment with the necessary support facilities and linkages to essential business services.	 Subsisting	MoMSME, Industry associations
Set up and promote “Udyam Sakhis”, a cadre of female agents who can provide IEs with information and help with certain processes to facilitate formalisation.	  Subsisting Striving	MoMSME

Barrier 5: Deficient skilling of IEs workforce.



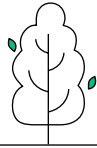


Informal enterprises are crucial channels for skill building among the unskilled population in India. However, less than 5% of the workforce in MSMEs is formally skilled ¹⁴, leading to low productivity. IEs face difficulties in providing comprehensive skills training to their workforce due to limited resources, further contributing to the skill deficit.

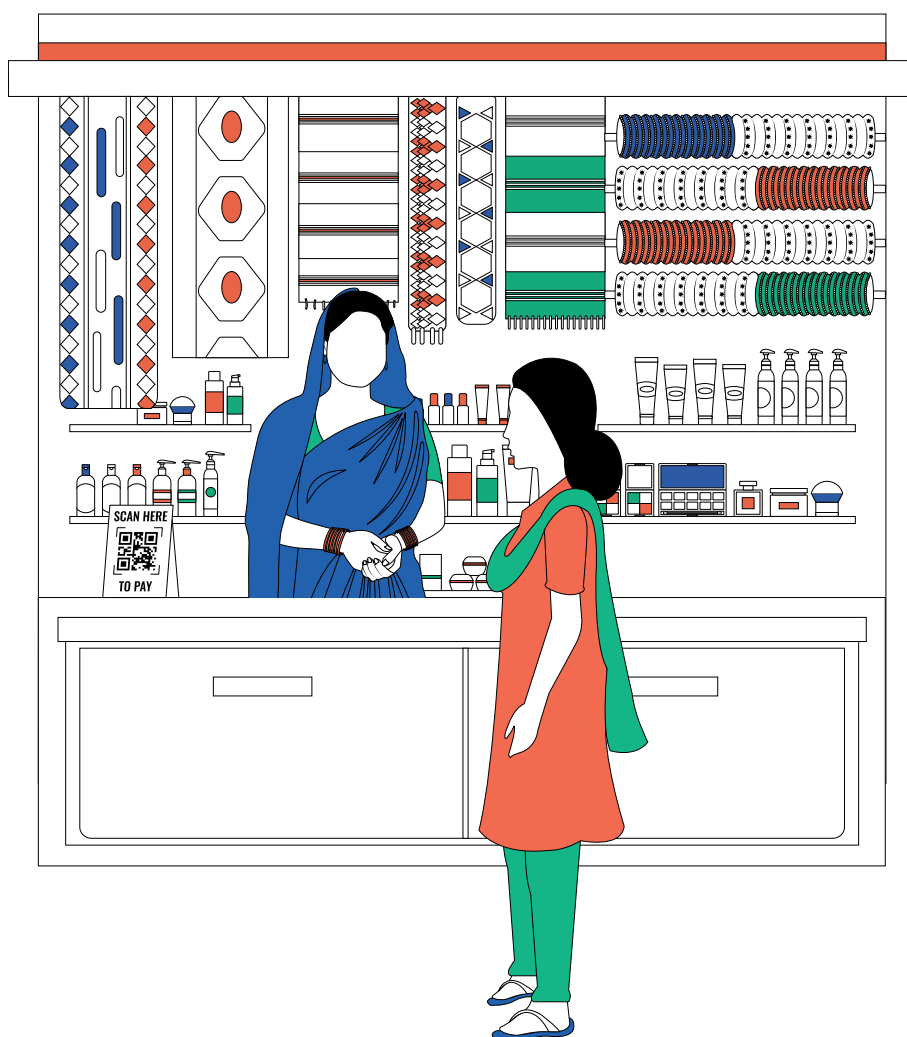
Recommendation	This is applicable to segments	Ownership
Launch skill-building courses for IEs. NSDC, in partnership with the private sector, should develop and roll out courses on entrepreneurship development targeted at IEs.	  Subsisting Striving	MoMSME, NSDC, Industry associations

14. Government of India. (2015). Ministry of Skill Development and Entrepreneurship. Annual Report 2015-2016. <https://www.msde.gov.in/sites/default/files/2019-09/Annual%20Report%202015-16%20eng.pdf>

Barrier 6: Inadequate labour practices and infrastructure support.

The absence of formal contracts for informal workers leads to exploitative labour practices and lack of social security coverage, posing significant risks. The COVID-19 pandemic exacerbated these issues, causing many IEs to close temporarily and face prolonged workforce shortages as workers relocated to villages.

Recommendation	This is applicable to segments	Ownership
Prioritise enrolling the informal sector labour force in primary government-sponsored life and health insurance and pension schemes. To achieve this, the government should incentivise IEs via monetary benefits to formalise their workers and make IEs the focal point for workers' registration.	   Subsisting Striving Scaling	MoMSME, PFDR
Celebrate and promote entrepreneurship by giving entrepreneurs legitimacy. The government should support setting up dedicated spaces for IEs to operate. This shall provide much-needed credibility to the IEs that often operate in temporary locations.	  Subsisting Striving	MoMSME, MSDE



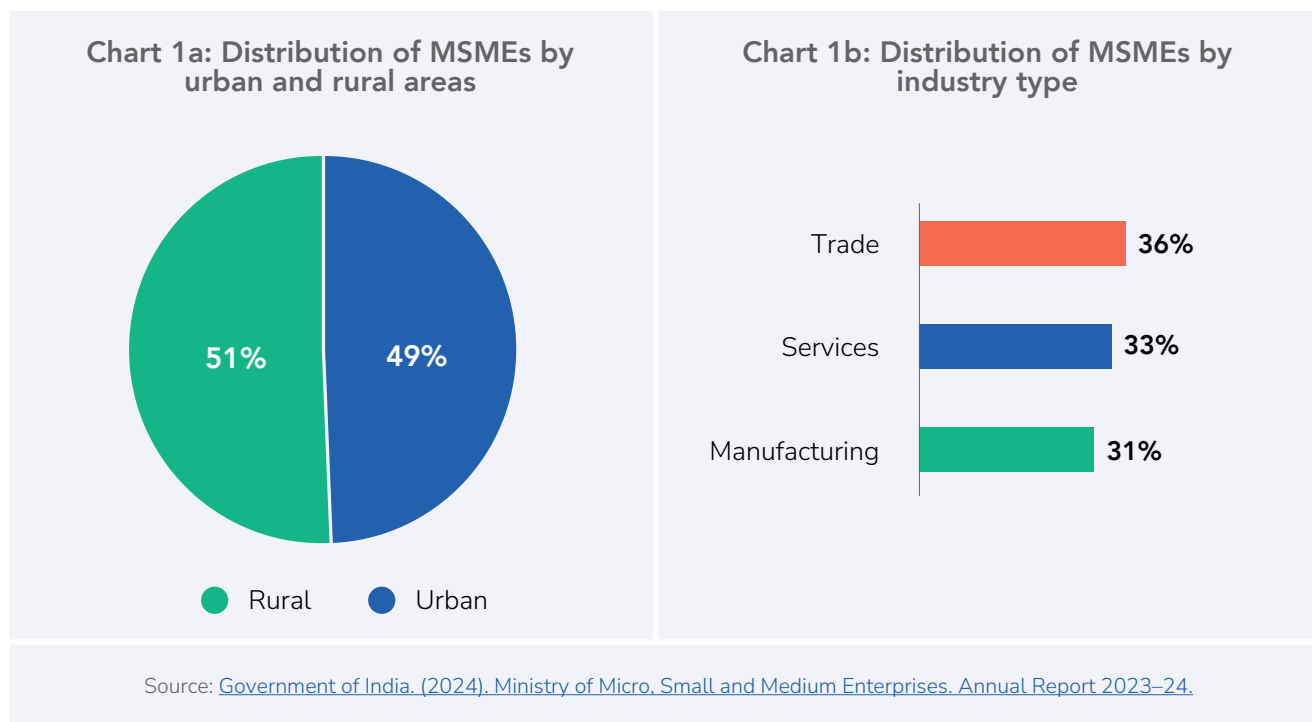
Background

Informality is a prevailing characteristic observed within the global MSME ecosystem. This section provides an overview of the MSME ecosystem and situates informal enterprises within that landscape.

An overview of the MSME ecosystem

MSMEs are one of the major drivers of India's economic development, employment, and innovation, contributing significantly to the country's entrepreneurial base and inclusive growth. According to the MSME Annual Report 2023–24 published by the Ministry of Micro, Small, and Medium Enterprises of India, there are an estimated 6.33 crore MSMEs in the country, which employ nearly 11 crore people and contribute to almost 30% of the national GDP.

MSMEs in India are heterogeneous in terms of their size, economic activity, and technological development. Out of the total 6.33 crore MSMEs in the country, 31% are engaged in manufacturing activities, 36% in trade, and the remaining 33% in other services. The number of MSME units is nearly evenly split between urban and rural areas. Only 20% of these enterprises are owned by women, and about 66% by marginalised social groups.¹⁵



In addition, most MSMEs in the country (74%) are concentrated in only 10 states: Uttar Pradesh, West Bengal, Maharashtra, Tamil Nadu, Karnataka, Bihar, Andhra Pradesh, Gujarat, Rajasthan, and Madhya Pradesh (see Annex II).

Classification of MSMEs

Global trends reveal that the definition and classification of MSMEs differ from country to country depending on government policies and the firms' structural composition. The standard parameters used to define MSMEs include workforce size, asset size, and annual sales, among other variables. Workforce size is the most acceptable basis for defining MSMEs worldwide (see Annex III).

In India, the Micro, Small, and Medium Enterprises Development (MSMED) Act, 2006 provides the legal framework to identify and classify MSMEs. Previously, MSMEs were defined based on investments in plant and machinery or equipment. However, in 2020, the definition was amended to promote the Ease of Doing Business (EoDB).¹⁶ This revision included investment and turnover criteria and removed the difference between manufacturing and service enterprises.

15. This includes SCs (12.45%), STs (4.10%), and OBCs (49.72%). Government of India (2024). Ministry of Micro, Small and Medium Enterprises. Annual Report 2023–24. <https://msme.gov.in/sites/default/files/FINALMSMEANNUALREPORT2023-24ENGLISH.pdf>

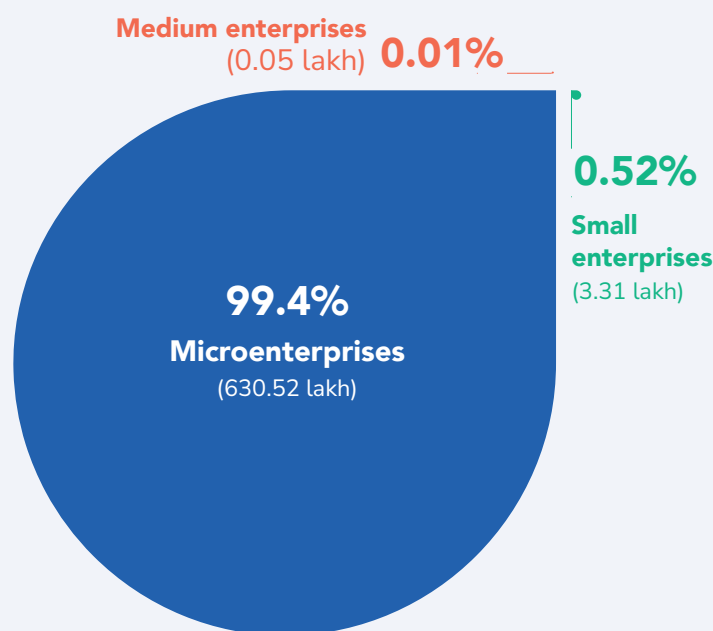
16. Ranking system developed by the World Bank in which economies are evaluated based on their ease of doing business. <https://indianembassyintheunitedkingdom.org.uk/page/ease-of-doing-business-in-india/>

As per the [revised definitions](#), an enterprise is classified as a micro, small, or medium enterprise based on the following criteria:

- **Microenterprise:** where the investment in plant and machinery or equipment does not exceed INR 1 crore and annual turnover does not exceed INR 5 crore.
- **Small enterprise:** where the investment in plant and machinery or equipment does not exceed INR 5 crore and annual turnover does not exceed INR 50 crore.
- **Medium enterprise:** where the investment in plant and machinery or equipment does not exceed INR 50 crore and annual turnover does not exceed INR 250 crore.

Based on this definition, microenterprises constitute 99.4% of the 6.33 crore MSMEs in India, while small and medium enterprises account for 0.52% and 0.01%, respectively.

Chart 2: Distribution of MSMEs by size



Source: [Government of India. \(2024\). Ministry of Micro, Small and Medium Enterprises. Annual Report 2023–24.](#)

The same pattern is observed in the share of employment generated by each of the three types of enterprises. Microenterprises provide employment to 10.76 crore individuals, constituting about 97% of the total workforce in the sector. Meanwhile, small and medium enterprises provide employment to 31.95 lakh (2.88%) and 1.75 lakh (0.16%) individuals, respectively.¹⁷

Informality within MSMEs

The extent of informality within the global MSME ecosystem varies significantly across economies, with developing nations exhibiting the highest levels. According to a [report](#) published by the International Finance Corporation (IFC), an estimated 80% of all enterprises in developing economies – approximately 28 to 34 crores in number¹⁸ – are informal and absorb around 60% of the labour force.

17. Government of India. (2024). Ministry of Micro, Small and Medium Enterprises. Annual Report 2023–24. <https://msme.gov.in/sites/default/files/FINALMSMEANNUALREPORT2023-24ENGLISH.pdf>

18. Stein, P., Ardic, O.P., & Hommes, M. (2013). Closing the Credit Gap for Formal and Informal Micro, Small, and Medium Enterprises. <https://documents1.worldbank.org/curated/en/804871468140039172/pdf/949110WP0Box380p0Report0FinalLatest.pdf>

India is no exception to this trend. According to a 2018 estimate by RBI, 97% of the country's 6.33 crore MSMEs operate in the informal sector.¹⁹ There is still no consensus in India on a single definition of the informal sector. Some efforts to present a unique standard definition are given below:

Economic Survey 2018-2019	National Commission for Enterprises in the Unorganized Sector (NCEUS)	National Sample Survey Office (NSSO), 61st round
<p>The Economic Survey defined the informal sector as the absence of formality. The survey states that when companies extend social security to their employees, typically measured by data from the Employee Provident Fund Organization, the Employees' State Insurance Corporation, or any company registered under GST, they are considered as being "formal." In this context, all individuals identified as employees within such companies fall within the formal sector. According to this criterion, 87% of firms, accounting for 21% of total turnover, fall outside both the definitions of formality and are purely informal.</p>	<p>The unorganised or informal sector consists of all unincorporated private enterprises owned by individuals or households. These enterprises are engaged in the sale and production of goods and services, operated on a proprietary or partnership basis, and have fewer than a total of 10 workers.</p>	<p>Household unincorporated enterprises with fewer than 10 persons engaged (agriculture excluded)</p>

However, a key characteristic of businesses in this sector is that they operate without formal registration with government authorities and outside the scope of national legislation and regulations, including those related to tax, labour, and social security. Furthermore, these enterprises exhibit significantly lower levels of productivity compared to formal businesses (see Annex IV).

Other relevant characteristics of these firms include that they:²⁰

- Are involved in non-agricultural activities.
- Are unincorporated with a separate legal entity and maintain limited to no written accounts.
- Are labour-intensive, with low modernisation and thus low productivity.
- Operate in unregulated and competitive markets.
- Are small-scale and individually or family owned.
- Have limited or no access to institutional credit or other government support, schemes, and protections.
- Have limited visibility and are rarely recognised.
- Are limited in scope in terms of women's participation and entrepreneurship.
- Have limited access to formal recourse against delayed payments and other legal wrongs.
- Are excluded from the formal market, including public procurement, and business networks and associations.

19. Behera, & Wahi, G. (2018). Mint Street Memo No. 13. How have MSME Sector Credit and Exports Fared? https://rbi.org.in/Scripts/MSM_Mintstreetmemos13.aspx

20. The Global Development Research Center. (n.d.). Distinguishing Characteristics of the Informal Sector. Employment, Enterprise, Habitat and Credit. https://www.gdrc.org/informal/1-is_characteristics.html

Although most of the workforce in India is employed in the informal sector, informal enterprises have not been subjected to a detailed assessment to gain deeper insights into their practices, limitations, and needs. Informality goes hand in hand with low levels of economic prosperity and productivity and induces poverty and a low standard of living in the economy. Therefore, addressing the pain points of businesses operating in the informal sector should be a key focus area for policymakers and development practitioners.

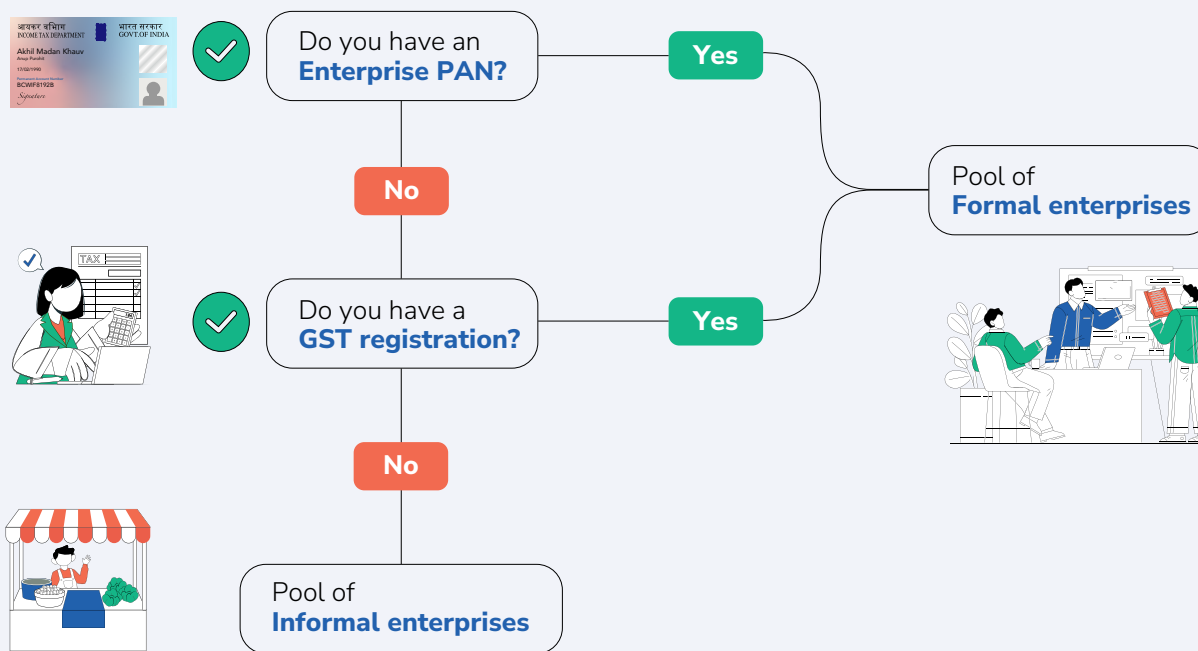
This report has defined formality based on two criteria, aligning broadly with those used by NCEUS and NSSO:

- **Availability of enterprise PAN:** PAN is a 10-character alphanumeric identifier issued by the Income Tax Department to an individual or a business entity. An enterprise PAN is required for corporates, one-person companies, limited liability partnerships (LLP), partnerships, trusts, society or Section 8 companies, and cooperative societies, among others.

OR

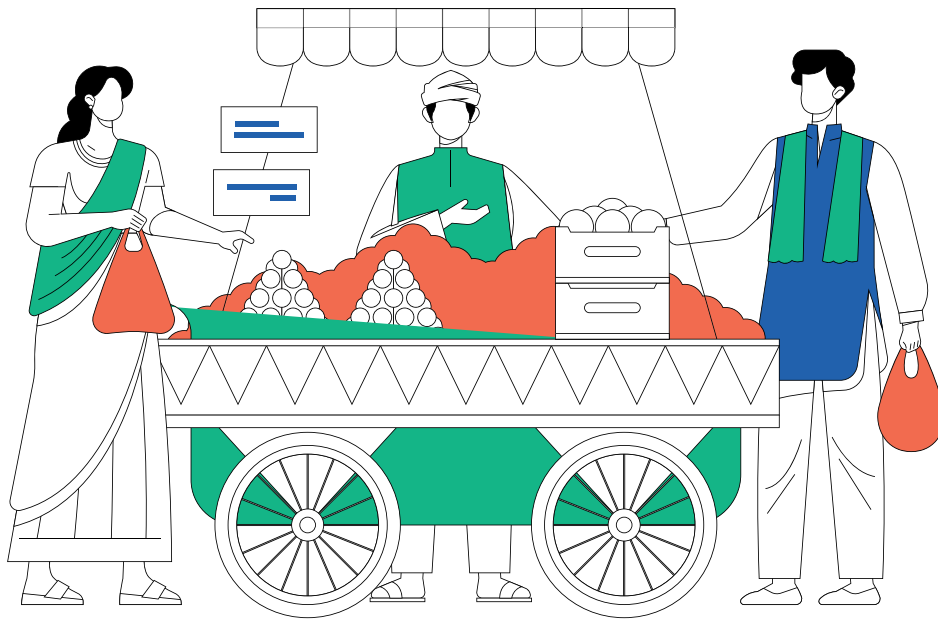
- **Availability of Goods and Service Tax Identification Number (GSTIN):** A GSTIN is a 15-digit, PAN-based unique identification number allotted to every registered person or entity under GST. Any business whose annual turnover exceeds INR 40 lakh (for the supply of goods only) and INR 20 lakh (for the supply of services) must register under GST. For special category states,²¹ the threshold limit for GST registration is an annual turnover of INR 20 lakhs (for the supply of goods only) and INR 10 lakhs (for the supply of services).

Diagram 1: Defining informal enterprises for this research



Source: ONI and MSC.

21. For GST purposes, special states include Assam, Nagaland, Himachal Pradesh, Manipur, Meghalaya, Sikkim, Tripura, Arunachal Pradesh, Mizoram, Uttarakhand and Telangana.



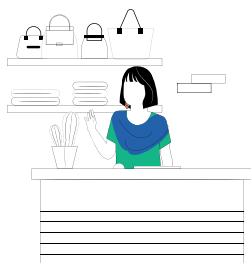
Informal enterprises: State of the sector

The following section of the report²² outlines the profile of the informal enterprises examined in this study and provides insights into the key thematic areas related to these firms, as well as the key events that have impacted their operations. These insights integrate data from the World Bank's primary research and MSC's secondary research.

Key findings

Key finding 1: Understanding the nuanced differences in informal enterprises is key to fostering their formalisation.

Our research began by analysing a sample of over 10,000 small informal firms and 100-plus questions. Our initial findings revealed the following:



Most IEs are small and have a single owner.

Close to 60% of IEs are sole proprietorships or have one employee only, with less than 1% having more than five employees. When they have one employee, it is often a household member. In more than 40% of IEs with two or more employees, one or more of the employees are household members. The “mom-and-pop store” is an Indian staple.

22. “IEs” in this section refer to surveyed informal enterprises



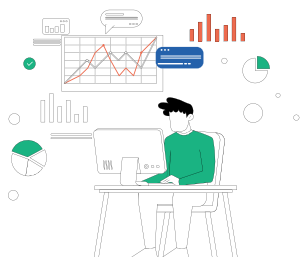
Trading dominates the IE landscape.

About 68% of IEs are involved in trading. An additional 22% work in services, while 9% work in manufacturing. Trade businesses typically include small eateries and food stalls that sell food (24%), shops that resell groceries or packaged food products (19%), and stalls that sell fruits and vegetables (19%).



Most IEs are stories of fledgling entrepreneurship.

Roughly 80% of IEs are first-generation-owned businesses, meaning the businesses were not inherited. Only 10% of the firms' owners had a form of higher education, such as a college degree or technical qualification. To compensate for the absence of legacy support, the owners acquire practical knowledge on the job. Approximately 39% of entrepreneurs owned or were employed in a similar business before launching their current business.



Business management practices are rudimentary for most IEs.

Only 32% of IEs maintained written business records, such as profit and loss statements, and less than a third had prepared a budget for the upcoming year. Only 16.4% reported having some business insurance.

However, these initial findings provide only a broad overview of the Indian informal enterprise sector. Our in-depth cluster analysis reveals that the depth and diversity of informal businesses may only be evident with a deeper segmentation. Using a custom algorithm, we categorized the sample into three segments based on their financial and operational practices—such as monthly sales, mobile phone usage, business bank account ownership, and financial record-keeping—and the factors influencing owners to formalise their ventures. The resulting three segments are: **subsisting, striving, and scaling**.

For instance, although only 32% of all informal enterprises maintain written business records, 53% of the scaling segment and 42% of the striving segment do. Similarly, while only 40% of informal businesses in the sample manage to separate business financials from household financials, nearly 80% of firms in the scaling segment do.

The use of technology in business offers an additional perspective on the varying levels of sophistication among the different segments. Approximately 60% of informal enterprises use digital tools such as mobile phones and computers. However, 85% of businesses within the scaling segment use mobile phones or smartphones, compared to 69% of those in the striving segment and only 27% in the subsisting segment.

By segmenting the informal enterprises sector, we gain insights into diverse practices and uncover patterns highlighting varying degrees of development and aspiration among different groups of firms. This nuanced understanding will pave the way for more targeted and effective solutions.

Key finding 2: Sales volatility is prominent across all segments of informal enterprises.

A prominent characteristic of the surveyed informal enterprises is their level of sales volatility. On average, monthly sales across the sample in a regular month were INR 39,044. Slightly over 50% of the enterprises recorded sales below INR 25,000, while approximately 30% reported sales ranging between INR 25,000 and INR 50,000. However, the fluctuation in sales throughout the year was significant, with sales in the highest-performing months being 2.6 times those in the lowest-performing months.

Similarly, as shown in the table below, we observe variations across the different segments when examining average sales. Businesses in the subsisting segment exhibited the lowest average sales in a regular month, slightly over INR 23,000. These enterprises also experienced the lowest income volatility in absolute terms, with sales differing by approximately INR 17,000 between their busiest and slowest months. In contrast, businesses in the scaling segment reported the highest average sales in a regular month, around INR 52,000, along with high volatility, with a difference of approximately INR 46,000 between their busiest and slowest months. However, when considered in percentage terms, the striving segment exhibited the highest volatility at around 92.8%.

Segment	Average sales (in INR)				Volatility (%)
	Regular month	Lowest month	Highest month	Difference (highest – lowest)	
Subsisting	23,063	14,135	31,187	17,053	73.9%
Striving	41,969	21,164	60,122	38,959	92.8%
Scaling	52,285	29,457	75,186	45,729	87.5%
Total sample	39,044	21,368	55,436	34,067	87.2%

These insights underscore the importance of understanding the diverse economic circumstances of informal enterprises. Notably, the availability and accessibility of finance could be influenced by this volatility.

Seed capital is typically bootstrapped across the IE space

Among entrepreneurs who start their businesses, 97% rely on personal funds or loans from family and friends. Larger informal enterprises were, however, more inclined to seek financing from formal sources for their day-to-day operations. Our findings show that 61% of enterprises with over INR 1 lakh in monthly sales accessed bank loans to support their operational finances. In contrast, only 8% of smaller enterprises with monthly sales below INR 25,000 sought formal financial assistance. However, larger enterprises also considered other loan options, with about 62% borrowing from friends and family.

Key finding 3: Gender disparities significantly affect women in the informal sector.

Gender disparities persist within the informal sector, as reflected by the sample in which 90% of informal enterprises are owned by men, compared to only 10% owned by women. Additionally, despite working close to similar hours to their male counterparts, women often achieve lower monthly sales. On average, women-owned enterprises operate for approximately 41 hours per week and earn about INR 23,400, while male-owned businesses operate for 46 hours per week and earn an average of INR 38,700.

Moreover, safety concerns confine women to their homes, with twice as many women (24%) citing safety considerations for working from home compared to men (11%). A similar gender disparity is observed when informal enterprise owners are asked if household responsibilities lead them to work from home.

Key finding 4: Informal enterprises face multidimensional challenges that hinder their growth.

According to the World Bank, the productivity of informal enterprises in emerging markets is only one-quarter that of formal enterprises.²³ This significantly affects the long-term sustainability, growth, innovation, and risk-taking capacity of informal entrepreneurs.

Informal entrepreneurs are mostly born out of necessity rather than by choice, and they face several challenges throughout their entrepreneurial journey. The key challenges faced by informal entrepreneurs are as follows:

- **Financial:** Informal enterprises depend heavily on informal sources of finance such as moneylenders, chit funds, relatives, and friends, which cost twice as much as formal finance. In addition, only 16% have some form of insurance coverage for the business, and 13% have a loan. Of those who have a loan, 75% had to offer collateral. The lack of capital may deter informal enterprises from scaling up and adopting innovative business ideas, forcing them into a risk-averse survival mode. Moreover, some IEs struggle to get financial help and support from government schemes due to their unregistered status.
- **Infrastructural:** Informal entrepreneurs compete with formal and larger enterprises but struggle because they have poor access to infrastructure. Land disputes, erratic water supply, frequent power disruptions, and inadequate warehousing facilities obstruct the growth of informal enterprises. Our research revealed that 43% of IEs experienced power outages for a specific month, and 45% reported having to contend with an insufficient water supply. Most IEs tend to operate from their own homes.
- **Technological:** Enterprises must embrace the latest technology to compete in both domestic and global markets effectively. However, informal entrepreneurs face numerous barriers to digitalisation, such as limited financial capacity, concerns about safety, security, and privacy, as well as low digital literacy. Furthermore, many IEs continue to operate with cash due to persistent demand from customers and suppliers, which makes them hesitant to adopt digital payments. Nevertheless, the pandemic has prompted positive changes. Among the 46% of surveyed IEs using digital payments, 43% either started or increased their usage since the pandemic. While this increased adoption and usage demonstrates a positive trend, addressing the barriers to IEs' digitalisation should be a priority policy concern.
- **Human capital:** The limited capacity of entrepreneurs coupled with a low-skilled workforce creates a self-perpetuating cycle that ensures IEs remain small. About 34% of IEs are one-person operated businesses, i.e., they do not have any paid workers. About 16% of IEs do not know what skills will help their workers perform better. Others have limited knowledge of the skills required but no avenues to upskill.
- **Bureaucratic:** The opacity of paperwork and information asymmetry pose significant barriers to the expansion and formalisation of IEs. Businesses in our dataset emphasised the need for a better understanding of government paperwork and procedures. Many shared experiences of having their applications for government schemes or loans rejected due to actual or perceived deficiencies in their paperwork. Moreover, most enterprises pointed out a lack of sufficient information about government schemes and the application process. These challenges have resulted in only 8% of IEs – mostly high-earning firms with average monthly sales exceeding INR 1 lakh – surveyed receiving a grant or loan from a government scheme in the past year.

23. Yu, S., & Ohnsorge, F. (2019). The challenges of informality. <https://blogs.worldbank.org/en/developmenttalk/challenges-informality>

Profile of informal enterprises

Who are the owners? Typically, men with low levels of education.

- **Men owned 90% of the surveyed IEs.** A third of the owners were under the age of 35.
- **About 10% of the owners had some form of higher education,** such as a technical degree, a non-technical degree, or a graduate degree. About 60% of owners with bachelor's degrees or higher have businesses in the trade industry.
- **Owning a business in India doesn't rule out the option of wage employment.** About 12% of business owners are concurrently employed, while around 7% were employed previously in the last two years. In addition, around 6.6% are actively looking for a job with a temporary or permanent contract.

Stories from the field



Sarita Raut from Bhopal deals in mobile accessories and operates a common service centre (CSC). At the same time, she juggles a salaried job in a private firm.



Himanshu Dubey is involved in his family business that makes home décor items in Delhi. However, he does not intend to do this all his life. If all goes to plan, Himanshu wants to do a Master of Business Administration (MBA) and get a job.

What motivated their conception? The owners' stories defy easy narratives.

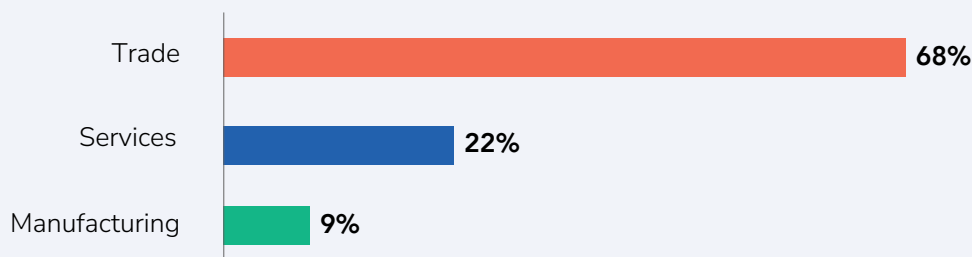
- Approximately 44% of business owners said they could not secure a job but needed to earn money for their families as the reason for starting their business. This response was most prevalent among owners with lower levels of education and those whose monthly sales typically amounted to less than INR 25,000. On the opposite end of the spectrum, businesses with monthly sales surpassing INR 1 lakh exhibited an ambitious drive fuelled by a spirit of entrepreneurship.
- Some owners said their primary motivation was running a profitable enterprise.
- For women, starting a business represents an opportunity to add household income even as they care for household needs.
- Approximately 37% of owners indicated that their businesses served as supplementary sources of income, and 11% of these were female-owned enterprises.
- Over 39% of owners had prior experience as a business owner or employee in a similar activity before embarking on their current endeavour.

Occupations of informal enterprise owners before starting their business or activity	Percentage of sample
Worked for someone else in the same type of business or activity	39%
Unemployed	19%
Worked for someone else in a different type of business or activity	16%
Self-employed in the same type of business or activity	9%
Self-employed in a different type of business or activity	8%
Other (e.g. homemaker, student, etc.)	6%
Do not know (spontaneous)	2%

What do they do? For the most part, they trade in goods and services.

Most IEs surveyed (68%) are engaged in trade, 22% in services, and only 9% in manufacturing. Notably, the sample surveyed has a lower representation of services and manufacturing enterprises than the overall MSME sector. According to the MSME Annual Report 2023–24,²⁴ around 31% of MSMEs are in manufacturing, 36% in trade, and 33% in other services. An explanation for this disparity is that trade enterprises require less capital or specific skills, are easy to set up, and have a shorter gestation period.

Chart 3: Distribution of IEs by industry type; % of total sample



Note: Based on responses to the question 'What is the main observed business activity?' (n=10,672)

What do they look like

- **Small-scale grocery stores** that stock fast-moving items, such as milk, biscuits, wafers, cigarettes, and small-value cosmetics, among other items.
- **Manufacturing enterprises** that produce pickles, handicrafts, soaps, incense sticks, and furniture, among other items.
- **Street vendors**, such as fruit sellers, vegetable sellers, ice cream sellers, and sellers of daily-use items, such as plastic goods and clothes.
- **Repair shops**, such as car garages, cycle and bike repair, shoes or bags repair, electrical items repair, and utensils repair.
- **Shops that sell hardware or sanitary items or electrical and electronic goods.**
- **Sweets shops or eating stalls.**

24. Government of India. (2024). Ministry of Micro, Small and Medium Enterprises. Annual Report 2023–24. <https://msme.gov.in/sites/default/files/FINALMSMEANNUALREPORT2023-24ENGLISH.pdf>

Some enterprise owners surveyed are particularly nimble and are quick to respond to seasonal needs or emerging business opportunities. For instance, Subedar Thakur runs a barber shop in Lucknow, but during the summer months, he runs a side gig selling soft drinks. Thus, existing occupational categories and financial products may not adequately address the extent of his hustle or volatility, as they do for larger Indian enterprises.

How much money do they make in sales? More than half earn less than INR 25,000 per month.

- About 54% of the informal enterprises surveyed generated less than INR 25,000 in a regular month, while 8% generated more than INR 80,000 during the same period.
- Enterprises that have operated longer tend to exhibit higher revenues; however, establishing whether this is correlation or causation is not straightforward.
- About 25% of informal enterprises are at an early stage, meaning they have been operating for a year or less. Most of these enterprises have an average monthly gross revenue of INR 15,519.
- Businesses operating for about 2–5 years generate an average monthly revenue of INR 24,263.
- The monthly revenue for mature businesses (6–10 years) is INR 33,508, and for stable and sustainable businesses (>10 years), it is INR 62,260.
- In a regular month, enterprises run by men earn an average of INR 40,512 compared to women-run enterprises' average of INR 26,674. The highest earnings are in manufacturing, with an average of INR 47,777, followed by services, with INR 43,402, and trading, with INR 39,246.
- About 61% of enterprises reported a decrease in sales in the subsequent month due to COVID-19, including women-owned enterprises in manufacturing and businesses run by young people early in the business cycle.

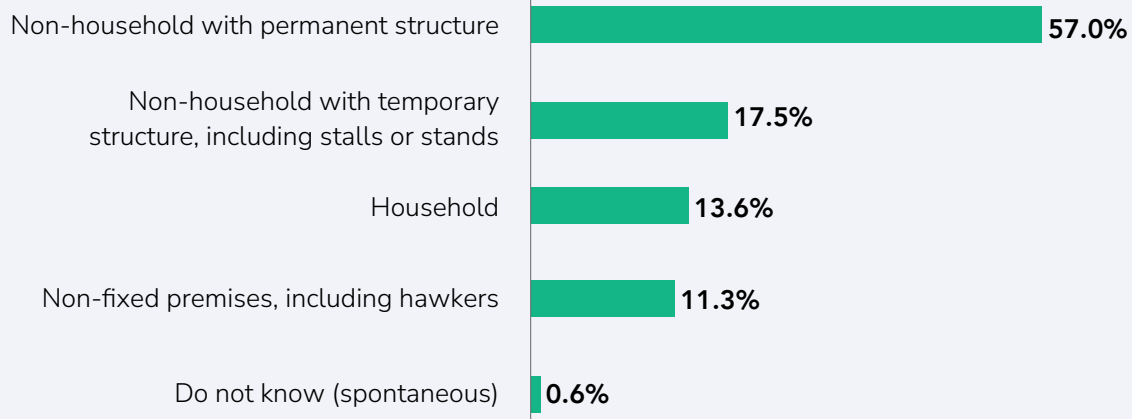
Stories from the field



Insights from the financial diaries highlight the volatility in the financial performance of informal enterprises. For instance, **Ravi Ranjan's** clay pot business flourished in October as the Diwali Festival approached. Because of this, Ravi could cover significant business expenses and even double his regular monthly loan repayments of INR 2,500. However, the following month saw his income plummet to just a fifth of the high recorded in October.

Where do they operate from? Most run from rented premises.

Chart 4: Distribution of IEs by type of business premises; % of total sample



Note: Based on responses to the question 'Indicate the type of premises where business takes place' (n=10,672)

- Informal entrepreneurs prefer to operate their businesses from a premise they own as they do not have to pay rent, reducing overall costs. Yet, more than half of them (55%) do not own a place and run their businesses from rented premises.
- Approximately 25% of women in informal enterprises operate from their residences, compared to the overall rate of 13.6%. Most women's decision to work from home is driven by safety, privacy concerns, and domestic responsibilities.
- About 84% of informal enterprises choose a business location based on easy customer access.

Factors influencing informal enterprises' selection of business location	Percentage of sample
Access to customers	84%
Access to electricity	6%
Access to food and toilets	3%
Access to water	3%
Freedom from harassment	2%
Do not know (spontaneous)	2%
Safety	1%

- About 28% of informal enterprises in manufacturing operate from their residence, compared to 12% of enterprises in trading and 13% in services.
- About 90% of informal enterprises earning an average of INR 20 lakh annually generally operate from established locations away from residential premises.
- Women-owned informal enterprises operate for an average of 41 hours per week, 5 hours less than businesses run by men. This disparity may suggest the influence of unpaid work burdens and social norms on women.

Key thematic areas

A. Business management practices

Overview

Robust business management practices ensure clarity and transparency in financial operations, enabling better decision-making and strategic planning. For instance, maintaining written business records allows firms to track profitability and manage cash flow efficiently. Using dedicated business bank accounts helps maintain financial discipline and ensures accurate financial reporting, which is crucial for building credibility with stakeholders. Additionally, formal contracts with suppliers and customers set clear expectations, reduce disputes, and foster long-term business relationships.

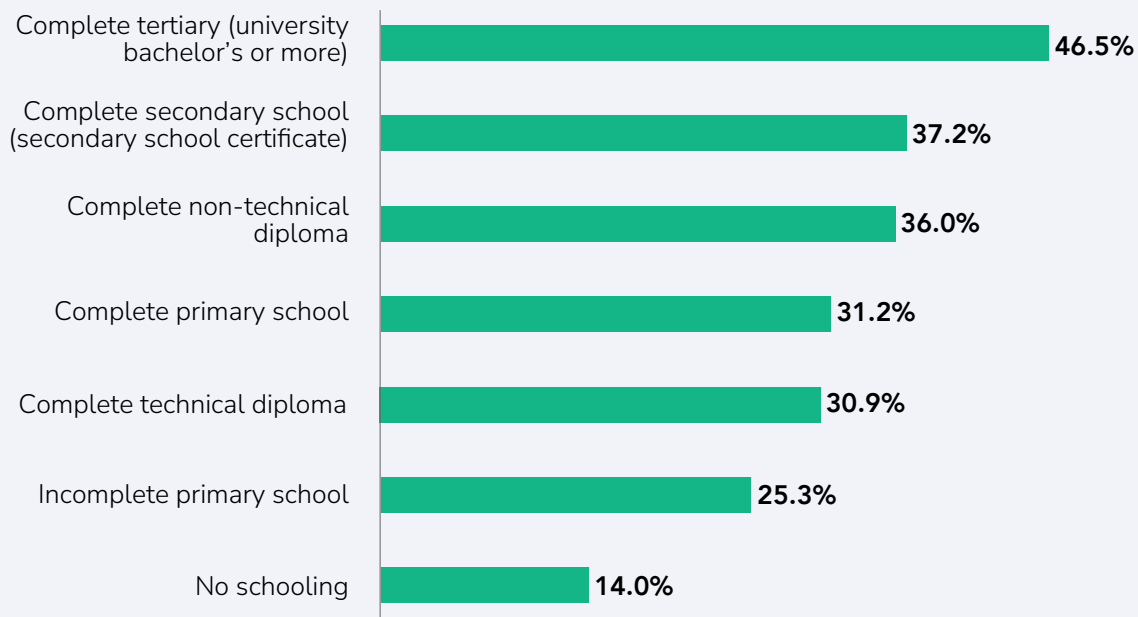
Adopting these practices is beneficial for IEs, not only because it can help improve their operational efficiency but also because it establishes a solid foundation for growth and resilience in increasingly competitive markets.

Research findings

Business practices among India's informal enterprises remain largely rudimentary, reflecting low levels of education and technology adoption:

- **About 32% maintain written business records, such as profit and loss statements.** This practice is most widespread in the manufacturing industry (36%), followed by the trading industry (32%), and the service industry (28%). In addition, fewer than one-third projected the anticipated costs for the following year.
- **Businesses with older and more educated owners exhibit better recordkeeping practices.** About 47% of those with tertiary education maintain business records, while this figure is only 14% for those with no formal schooling.
- **Nearly 75% of women owners do not keep business records.**
- **39% keep separate bank accounts for their business operations.** The trading industry leads with 40% of enterprises practising this, followed by the manufacturing industry at 39% and the services industry at 36%.
- **Informal enterprises rely heavily on established relationships with their customers and suppliers.** Most informal enterprises lack formal contractual agreements with their customers; only 18% of those surveyed have such agreements. Additionally, only 20% of informal enterprises procure supplies with any accompanying paperwork or under a formal contract.

Chart 5: Distribution of IEs that maintain business records by owner's education level; %

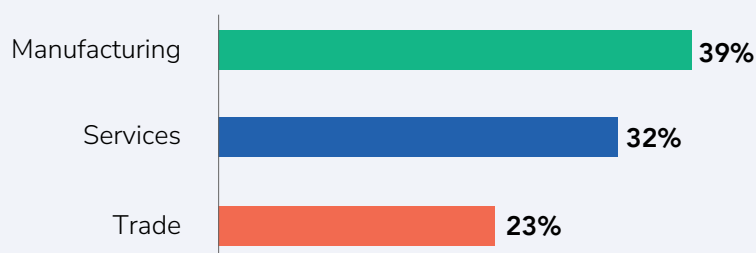


Note: Based on responses to the question 'Does this business or activity keep written accounts?' (n=10,605)

Assets

About 27% of informal enterprises employ machinery or equipment in their operations. Even within the manufacturing industry, only 39% reported using machinery for business, as most rely on handmade or traditional tools.

Chart 6: Use of machinery among IEs by industry type; % of total sample



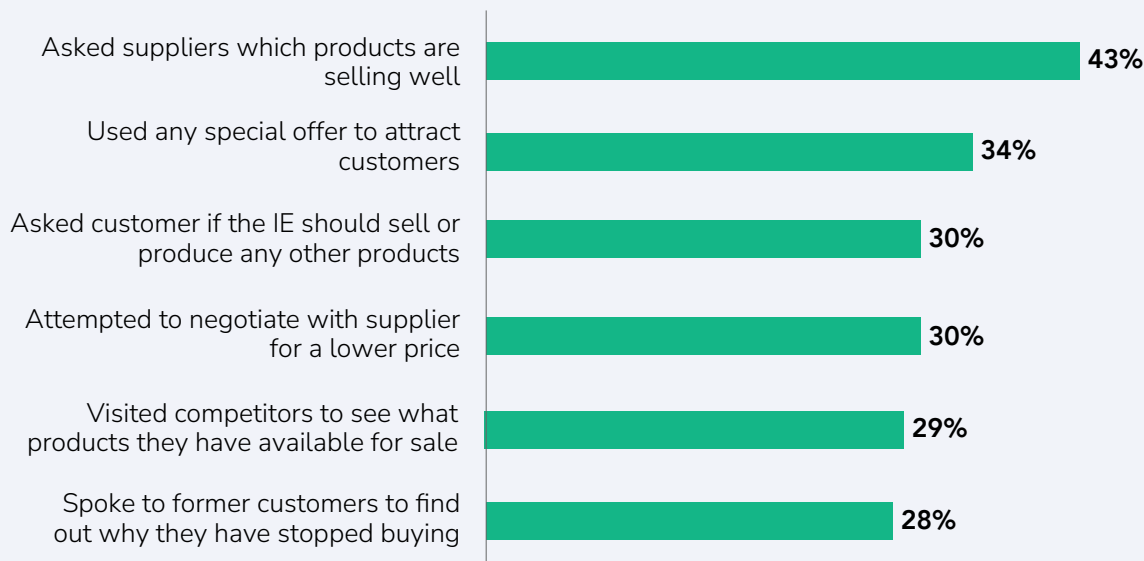
Note: Based on responses to the question 'In the last three years or since the beginning of operations, [whichever is more], did this business or activity buy any new or used machinery or equipment, vehicles or other means of transport' (n=10,672)

Insufficient capital and limited access to credit are significant contributors to manufacturing IEs' relatively low machine use. Moreover, the lack of capital also results in enterprises operating with outdated or previously owned machinery, restricting their productivity and the quality of goods produced. Some manufacturing IEs that do not have their own machinery accept product orders and outsource the manufacturing to larger enterprises.

Strategies

About 30% of IEs negotiate prices with suppliers, and 43% seek suppliers' feedback regarding the popularity of products. Close to one-third of enterprises actively try to improve their business, incorporating strategies such as extending special offers, collecting feedback from current and former customers, and visiting their competitors. Notably, women are more inclined to rely on suppliers for suggestions, while men are more likely to seek customer feedback and negotiate with suppliers.

Chart 7: Strategies adopted by IEs to improve the business; % of total sample



Note: Based on responses to the question 'In the last three months, has this business or activity done any of the following [strategy]' (n=10,672); responses are non-exclusive.

B. Access to formal finance

Stories from the field



Irfan runs a medical shop in Prayagraj. He borrows money from friends or from the owner of a neighbouring shop when needed. The maximum amount he has borrowed so far is INR 20,000, and he generally repays it in 7–10 days. Sometimes, he gets 7–10 days of supplier credit to purchase stock. This is usually for around INR 10,000–20,000. However, Irfan has bigger dreams. In the past, he inquired about a bank loan but was asked to get a GSTIN for his business before he could apply for a loan. Later, he was offered a loan of INR 3 lakh from a FinTech app. However, he remained apprehensive of such players and did not opt for a loan on a mobile application.



Sarita Raut sells mobile accessories, operates a CSC, and works in a salaried job at a private firm in Bhopal. She had tried to get a loan from a bank to finance her business requirements. However, her application was rejected, as the bank deemed her employment salary insufficient.



Naved Khan runs a CSC and works as a cash-in/cash-out (CICO) agent for a payments bank. He also runs a money transfer agency. He took a loan from a bank to start this business. He believes that his locality needs a good mobile shop and plans to open one. He wants to display a range of mobile phones and offer his customers easy financing options as people in the area buy phones in equated monthly instalments.

Overview

Among all the aspects needed to run an enterprise, finance accessibility, and affordability are crucial to the inception, growth, and sustainability of the business. Adequate and timely access to finance allows firms to invest in growth and sustain day-to-day operations.

Poor access to formal finance is one of the biggest challenges for capital-deficit informal enterprises with limited access to equity funding. Does the lack of access to formal finance discourage formalisation, or is it the other way around – does informality deter access to formal finance? Irfan and Sarita show that both can be true.

Research findings

India's informal enterprises are essentially bootstrapping themselves. 78% of the enterprises surveyed reported starting their business with their own funds, while only 3% managed to access credit from formal sources, such as banks, microfinance institutions (MFIs), and NBFCs to start their operations.

Major sources of finance to start or acquire a business	Percentage of sample
Own funds	78%
Friends or relatives	12%
Moneylenders	3%
Not applicable (spontaneous)	3%
Banks	2%
Microfinance institutions, or non-bank financial companies	1%
Do not know (spontaneous)	1%

Note: Based on responses to the question 'What was the main source of money to [start or acquire] this business or activity' (n=10,672)

Larger enterprises were more likely to access formal sources to finance daily operations. Overall, 75% of informal enterprises with annual revenues greater than INR 20 lakh also reported obtaining credit from formal sources. In contrast, only 7% of informal enterprises with annual revenues less than INR 1 lakh accessed formal finance. Nonetheless, for larger businesses, all options were on the table; three out of four enterprises with revenues more than INR 20 lakh annually also reported credit from informal sources.

About 38% of female-led and trading-oriented enterprises reported using informal finance for their day-to-day operations.

Friends and family, along with moneylenders, continue to be a major source of finance for day-to-day operations. Easier access and flexibility in repayment make this the preferred source. Deepa Chauthani, a tailor in Bhopal, is a good example.

Stories from the field



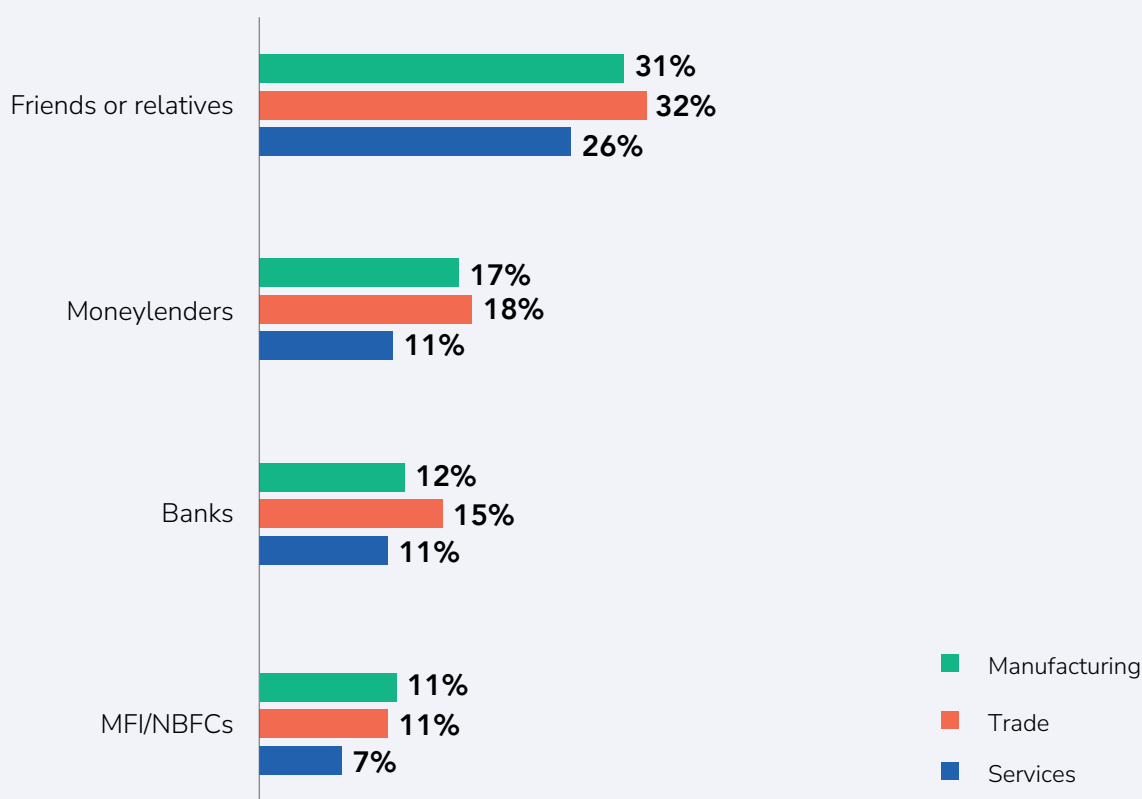
Deepa Chauthani is a tailor in Bhopal. She operates within narrow profit margins and prioritises her family's needs. In the past, she took a loan of INR 2 lakh from the municipal corporation but struggled to repay the total amount. She also took a loan from a Self-Help Group (SHG) but defaulted on this loan. Currently, Deepa relies on borrowing from friends and/or relatives for short-term business requirements, committing to repay within 7–10 days.

The points of access to finance – both in terms of the enterprise's needs at different stages of the business cycle, as well as from the perspective of sources of finance – could be differentiated as follows:

Day-to-day management

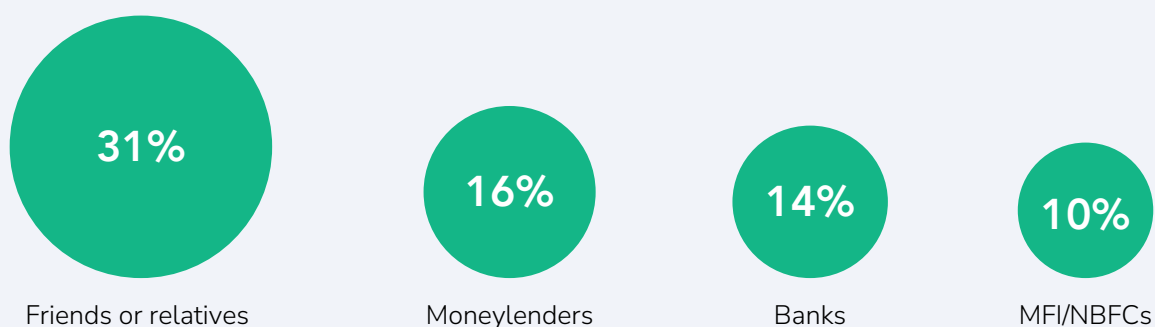
In the past year, 40% of IEs accessed finance from external sources to manage their day-to-day operations. This is most common in the trading industry with 42%. This trend is most prevalent among men (42%) compared to women (33%). As shown in the charts below, typical external sources include:

Chart 8: Financial sources for IEs' day-to-day operations by industry type; %



Note: Based on responses to the question 'In the last year, did this business or activity finance its day-to-day operations by using [financial source]' (n Manufacturing=882; n Trade=7,647; n Services=2,143)

Chart 9: Financial sources for IEs' day-to-day operations; % of total sample

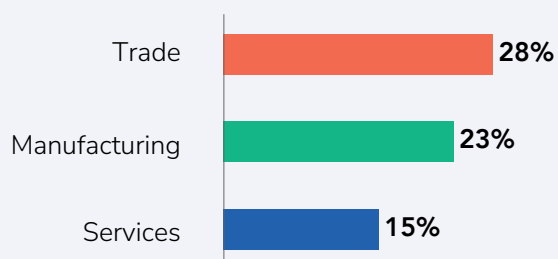


Note: Based on responses to the question 'In the last year, did this business or activity finance its day-to-day operations by using [financial source]' (n=10,672); responses are non-exclusive.

Supplier and customer credit

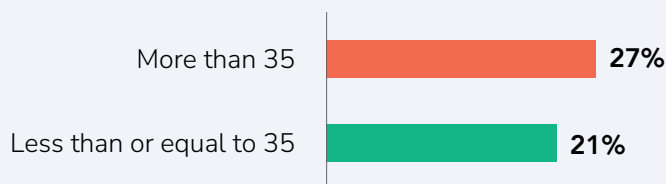
- In the past year, 25% of enterprises bought inputs, goods, or supplies on credit.
- This was most prominent in the trading industry, at 28%, followed by manufacturing, at 23%, and services at 15%. This phenomenon was more likely among men, at 26%, than women, at 17%. The non-youth segment, at 27%, was more likely to access supplier credit than the youth segment, at 21%.

Chart 10: Access to supplier credit among IEs by industry type; %



Note: Based on responses to the question 'In the last year, did this business or activity buy inputs, goods or supplies on credit?' (n Manufacturing=882; n Trade=7,647; n Services=2,143)

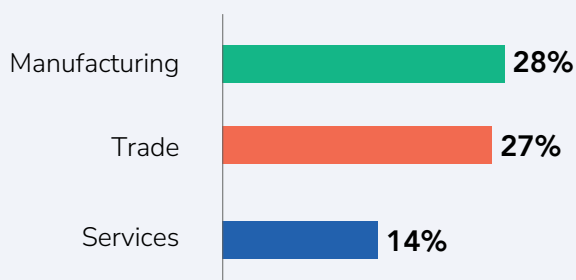
Chart 11: Access to supplier credit among IEs by owner's age; %



Note: Based on responses to the question 'In the last year, did this business or activity buy inputs, goods or supplies on credit?'
(n Less than or equal to 35=3,135; n More than 35 =7,172)

IEs also sold on credit, a practice that was frequently adopted by newly established businesses aiming to establish a clientele in a competitive market. Approximately 24% of them sold goods or services on credit, with the manufacturing industry leading at 28%, closely followed by the trading industry at 27%. At 14%, the service industry exhibited a lower prevalence in terms of delivering services based on deferred payments.

Chart 12: Credit sales among IEs by industry type; % of total sample.

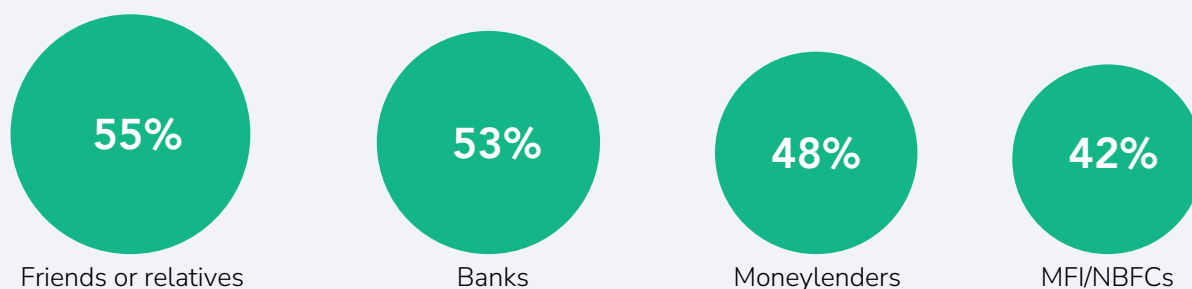


Note: Based on responses to the question 'In the last year, did this business or activity sell goods or services on credit?'
(n Manufacturing=882; n Trade=7,647; n Services=2,143)

Purchase of assets

- About 16% of enterprises purchased machines/equipment/vehicles, and 80% of them sought finance from external sources for the purchase of assets.
- Finance for the purchase of assets was most prominent in the trading industry (83%), followed by manufacturing (77%) and services (72%).
- Access to finance to purchase assets is higher among men (83%) compared to women (52%).
- Interestingly, 55% of enterprises had to use multiple sources of finance to acquire assets, which indicates that products and/or credit limits from any one source were inadequate.

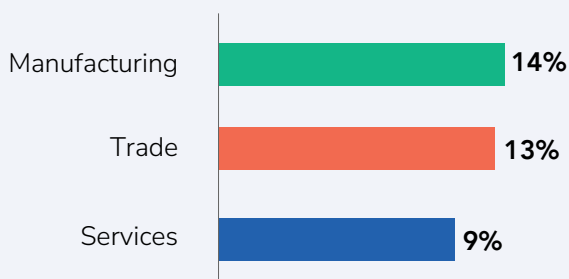
Chart 13: Financial sources for machinery and equipment purchases among IEs; % of total sample.



Note: Based on responses to the question 'In the last three years or since the beginning of operations, [whichever is more], has this business or activity financed the purchases of machinery or equipment, vehicles or other means of transport?' (n=10,672); responses are non-exclusive.

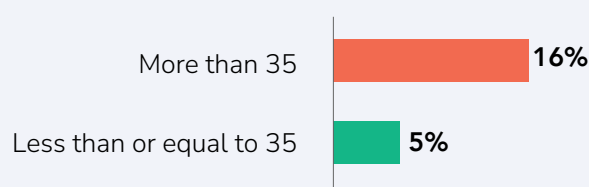
- About 13% of the surveyed IEs had a current outstanding loan for their business. Among these, 67% sourced the loan from banks, 6% from non-banking entities such as NBFCs and MFIs, 18% from moneylenders, and the remaining 9% from other sources.

Chart 14: Ongoing business loans among IEs by industry type; %



Note: Based on responses to the question 'At this time, does this business or activity or the [owner] have a loan for the business or activity?' (n Manufacturing=882; n Trade=7,647; n Services=2,143)

Chart 15: Ongoing business loans among IEs by owner's age; %



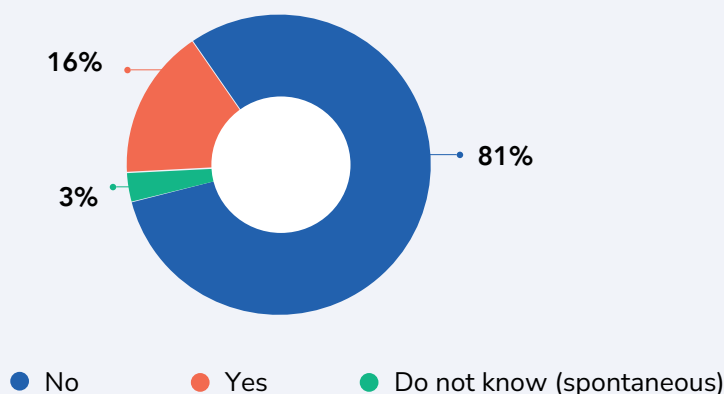
Note: Based on responses to the question 'At this time, does this business or activity or the [owner] have a loan for the business or activity?' (n Less than or equal to 35=3,135; n More than 35=7,172)

- Among the IEs with an outstanding loan, 75% reported offering collateral to access the loan.

Insurance coverage

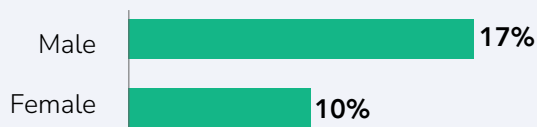
Only 16% of informal enterprises or their owners have some form of insurance coverage for their businesses, with the highest number being enterprises with substantial monthly sales. Given that female-owned enterprises tend to be concentrated in the lower rank, their likelihood of having insurance is diminished, with only 10% having insurance, compared to 17% for men. Most enterprises lack awareness regarding insurance products and the associated benefits, often perceiving insurance as an additional expense.

Chart 16: IEs with business insurance coverage; % of total sample.



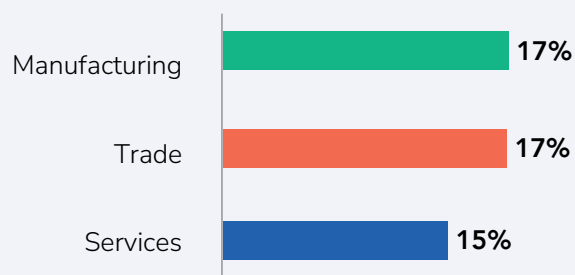
Note: Based on responses to the question 'Does this business or activity have any insurance product in case of emergencies?' (n=10,672)

Chart 17: IEs with business insurance coverage by owner's gender; %



Note: Based on responses to the question 'Does this business or activity have any insurance product in case of emergencies?' (n Female=985; n Male=9,104)

Chart 18: IEs with business insurance coverage by industry type; %



Note: Based on responses to the question 'Does this business or activity have any insurance product in case of emergencies?' (n Manufacturing=882; n Trade=7,647; n Services=2,143)

C. Digitalisation

Overview

Digitalisation opens avenues for informal enterprises to increase their revenues through improved quality of goods and services, an expanded customer base, or a combination of these factors. It enables businesses to surpass local markets, extending beyond geographical boundaries, both domestically and internationally. This allows them to cater to a more diverse and geographically dispersed clientele. Additionally, technology facilitates easier access to market information and provides a broader range of choices for suppliers of goods and services. Significantly, digitalisation has the potential to offer better access to finance for informal enterprises, compensating for the lack of collateral, as financial institutions can leverage digital data to assess credit risk more reliably.

Research findings

Although digital usage is on the rise among informal enterprises, most of it is driven by consumer demand to pay digitally. For instance, Rashmi Rani, who operates a tailoring business in Delhi, has installed QR codes as digital payment channels with help from her tech-savvy elder brother. In her case, customer demand is the push factor toward adopting digital payments.

Many informal enterprises still need cash to run their daily operations because most supply chains linked to these IEs predominantly operate in cash, with a few exceptions, such as mobile phone recharge businesses. Consequently, IEs exhibit reluctance to depend too much on digital payments. Additionally, concerns about fraud deter IEs from fully adopting digital payments.

Nonetheless, our study found encouraging developments. About 13% of enterprises use computers or tablets for their business operations, while a substantial 60% use mobile feature phones or smartphones to conduct their businesses. Some observed use cases include:



Supply chain management

About 49.7% of IEs use a phone or computer to purchase inputs and 46% use a phone or computer to keep track of inputs and outputs. Usage is highest among trade enterprises (46.8%), followed by services (45.7%) and manufacturing (44.6%).



Marketing

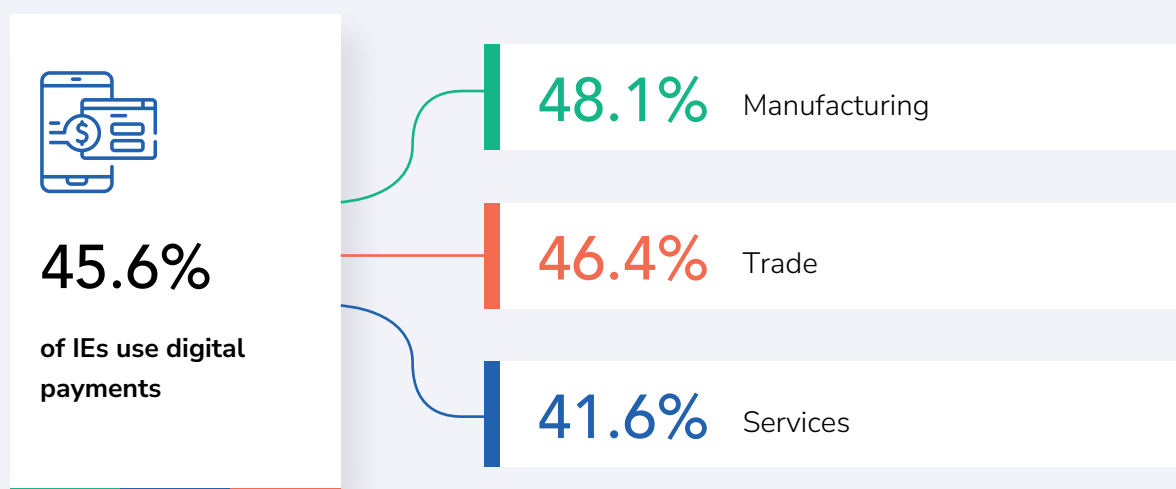
More than one in five IEs reported that they reach out to customers using digital channels.



Payment

Approximately 46% of enterprises reported using digital payments, with 43% indicating that they either started or increased their use of digital payments amid the COVID-19 pandemic. Significantly, enterprises owned by graduate degree holders or above exhibited increased digital adoption in the post-pandemic period.

Chart 19: Digital payment usage among IEs by industry type; %



Note: Based on responses to the question 'Does this business or activity use digital payments?' (n Manufacturing=882; n Trade=7,647; n Services=2,143)

D. Formalisation

Stories from the field



Deepthi Chauthani has contemplated formalising her tailoring business in Bhopal. However, she is hesitant, and will only consider formalising it after her business has grown. Currently she does not feel that she is financially secure enough to formalise.



Himanshu Dubey runs a home decor business in Delhi, primarily conducting transactions in cash. He is hesitant to formalise his business, citing concerns about GST. He prefers to stay off the radar of tax authorities.



Abrar runs a garage in Surat. He is interested in registering and formalising his business to scale it up. However, he struggles to understand the registration process including the requirements for GSTIN.



Deepu Awasthi runs a tea cart in Lucknow, which he has not considered formalising. He believes that registration is not essential for his business and will not increase his revenue or income.



Nadim Choudhary runs a flex banner business in Delhi. He is not willing to formalise his business as it will attract GST.

Overview

The story of informal enterprises is far from simple. There is no singular narrative and certainly no one-size-fits-all solution. It is crucial to understand the diverse lived experiences of informal enterprises. At face value, the formalisation of enterprises is important for their financial stability and sustainability. Yet, the path becomes more complex when seen from the perspective of an entrepreneur managing tight budgets, lacking familiarity with government systems, and singlehandedly juggling numerous tasks.

The implications of informality are diverse for different stakeholders.



For enterprises

While costs are certainly involved, informality prevents enterprises from accessing a range of benefits and privileges. Informal enterprises without MSME registration are ineligible for government subsidies, rebates, exemptions, concessions, and schemes specifically designed for MSMEs. Many government initiatives, including the credit guarantee scheme, public procurement through the Government e-marketplace (GeM), the Trade Receivables e-Discounting System (TReDS), SAMBANDH, reservation policies, and safeguards against delayed payments, among others, require formal registration. Furthermore, IEs are excluded from bidding for government contracts and fear potential harassment from law enforcement agencies.



For government

At a macro level, assessing the contribution of informal enterprises to the country's GDP is difficult. It is also not easy for the government to structure schemes and programmes for IEs. Informality also hinders the government's efforts to achieve Sustainable Development Goals (SDG target 8.3 focuses on decent jobs and the formalisation and growth of MSMEs). The government's databases lack comprehensive information on IEs, presenting difficulties in tracking and responding to their emergency needs during health or economic crises, such as demonetisation or the COVID-19 pandemic.



For customers

Informal enterprises' customers lack avenues for legal recourse in the case of issues or fraud. Transactions with informal enterprises do not come with guarantees or legal protections.



For employees

Employment with informal enterprises is not driven by choice but by sheer necessity. Informal enterprise employees lack access to a social security net and endure harsh working conditions that can be deemed as occupational and safety hazards. In many instances, informal enterprise employees are stuck at these lower levels, with limited prospects for career growth and development.

Research findings

Our research reinforced the analysis above. In defining formal enterprises, we considered two criteria: (a) Business PAN or (b) GSTIN. Given that all businesses included in our research were informal, none possessed either of these two documents. Among our sample, 40% of informal enterprises (33% women-owned and 42% men-owned) were aware of the business PAN, and 45% (36% women-owned and 46% men-owned) were aware of GSTIN. These enterprises did not see any benefits of acquiring either document because of potential tax implications. Moreover, some informal enterprises were either unaware of or intimidated by the application procedures.

The most perceived benefit of formalisation among IEs (27%) was the potential for reduced bribes and the opportunity to tap into a broader customer base. Overall, 19% of informal enterprises reported paying bribes to remain operational. This group represents a potential segment that might be open to the prospect of formalisation. In addition, entrepreneurs such as Abrar, who recognise potential benefits but require guidance to navigate the complex application process, exemplify another group that could contemplate formalisation.

E. Access to government schemes

Overview

Government schemes play a crucial role in supporting business growth. Grants and loans – offered at subsidised rates or with favourable repayment terms – can significantly alleviate IEs' financial barriers and promote investment, enabling them to enhance productivity and competitiveness. Moreover, having access to advisory services and capacity-building programmes is vital to equip informal entrepreneurs with the skills and knowledge to improve their operations. These support mechanisms are instrumental in fostering IEs' sustainable growth and thus contribute to their path toward formalisation.

Research findings

Approximately 8% of the enterprises surveyed mentioned receiving a grant or loan from a government scheme in the past year. Notably, these were mostly high-earning enterprises with average monthly sales exceeding INR 1 lakh.

Two-thirds of these recipients reported that the government had introduced the schemes in response to COVID-19. Over a quarter of those who obtained a grant or loan from the government did not know the scheme's name. Among the beneficiaries, 67% reported using government-awarded money to finance their business.

Although 92% of informal enterprises reported not receiving any government aid, this figure does not tell a complete story. Within this sample, 16% applied for aid but were rejected, 33% did not apply, 31% were unaware of the available government schemes, and 20% were deemed ineligible for assistance by the provider institution.

Those who had not applied for a government grant or loan said they did not need it. Some interventions could target 27% of enterprises that either said the amount was too small or they felt they were unlikely to receive support.

Most informal enterprises do not have sufficient information about government schemes. The most widely recognised scheme is the Pradhan Mantri Garib Kalyan Yojana, the initiative through which pandemic-period welfare benefits were delivered to individuals and households.

Impact of key external events

Overview

India has witnessed major economic changes in the past seven years. MSMEs, and IEs, in particular, have had to weather three tectonic shifts: demonetisation, GST implementation, and COVID-19.

This section provides a brief overview of the impact that demonetisation, GST, and COVID-19 have had on the overall financial and operational stability and survival of informal enterprises.



Demonetisation

The announcement of demonetisation in November 2016 rendered INR 500 and INR 1,000 banknotes non-legal tender. Upon this, 86% of currency notes in circulation had to be withdrawn, and new INR 2,000 denomination notes were introduced. This abrupt transition resulted in an acute liquidity shortage that significantly affected informal enterprises' sales. However, it also drove these enterprises to adopt digital payment methods.



Goods and Services Tax (GST)

In 2017, GST was introduced as an indirect tax reform with the principle of "One Nation, One Tax". It consolidated various indirect taxes, establishing a uniform nationwide indirect tax structure. This comprehensive, multistage, destination-based tax aims to eliminate the cascading effect of other indirect taxes. Its impact on informal entrepreneurs has been variable, with both positive and negative outcomes depending on the industry and scale of operations. Since its introduction, it has promoted formalisation and digitalisation to some extent, reduced the overall tax rate and logistics cost, and fostered the ease of starting or doing business. However, informal enterprises continue to face challenges due to the low awareness of the long-term benefits of formalisation and the increased compliance cost.

When asked about the rationale for not registering for PAN, 99% of enterprises cited concerns about taxes that would be incurred upon registration, and 97% said they did not see the benefits of registering. Similarly, when asked about the rationale for not registering for GST, 99% expressed concerns about taxes they would need to pay after formalisation, while an additional 98% cited cost and time as obstacles to registration (with reasons not being mutually exclusive).



COVID-19

Although COVID-19 was initially a health crisis, it swiftly evolved into a global economic crisis. The pandemic and subsequent lockdowns significantly decreased income, customer demand, and foot traffic for informal enterprises. Nearly two-thirds of the surveyed enterprises reported declining revenues due to the pandemic lockdowns. Many enterprises had to resort to drastic measures to cope with the challenges. About 26% had to cut down on paid workers, 22% of those who reopened had to change their business location and 21% had to change their products and services. The immediate impact on revenue reduction was more pronounced for women-owned IEs, newer IEs (less than five years old), and those in the manufacturing industry.

COVID-19 disrupted supply chains and labour markets and increased the cost of supplies, especially transportation costs. Most IEs reported drawing down on personal savings to sustain business operations. The credit period from suppliers narrowed, and payments were frozen from receivables due from customers. Limited operating hours and the inability to operate and adopt a work-from-home model, along with low digital presence, brought their business to the verge of closure. Additionally, lower profitability led to the non-payment of workers' salaries and wages and led to forced migration and job losses. It also threatened the occupational health and safety of owners and employees.

Research findings

- About 72% of IEs temporarily closed their businesses during COVID-19. Closure rates were the highest among trading units (73%), followed by manufacturing (71%) and services (69%). The 28% of units that operated during COVID-19 were largely involved in essential services, such as the manufacture of food items, trading units that sell perishable goods or groceries, and services, such as cleaning and sanitising, etc., hairdressers, and barber shops.
- Approximately 20% to 25% of IEs had to change their business location or their portfolio of products and services.
- About 12% had to sell assets as a coping method, and more than a quarter had to reduce the number of paid employees.

The research indicates the scale of challenges that enterprises have faced and their ability to adapt quickly. Just as demonetization hastened digital adoption, the pandemic encouraged a quarter of enterprises to adopt no-contact sales methods. A forward-thinking, data-driven vision for enterprises would acknowledge their precarity and harness their nimbleness and resilience.

Segmentation framework

After diving deep into the landscape of informal enterprises in India, our findings reveal that the country's informal sector is comprised of a vast mosaic of business profiles. These profiles exhibit a broad range of characteristics, spanning from different firm sizes and economic activities to financial and operational processes. The inherent diversity among informal enterprises in India presents a challenge for policymakers and institutions working to foster their growth and formalisation since implementing cross-cutting policies fails to address the needs and constraints of each segment. Given this, ONI commissioned Decodis to understand their nuances and identify common patterns to develop a segmentation framework that could facilitate the design and implementation of tailored interventions.

Methodology²⁵

Decodis developed a custom hierarchical clustering algorithm to classify the businesses into groups based on two classes of input variables: those describing aspects of the enterprises, such as years of operation or the number of employees, and those of business owners, such as age and experience. The following table details the variables considered for each class.

Input variables	
Enterprises	Business owners
Number of years in operation, number of employees, number of female owners, premises and activity of the business, financial sources for the business, sales, and profits.	Age and experience of the owner(s), owner's occupation prior to starting the business, the degree to which the business contributes to the household, and the owner's understanding of PAN and GST.

The resulting groups were combined into three segments by identifying common patterns based on the key thematic areas outlined in this report. The following table details these variables and their corresponding values within the three segments.

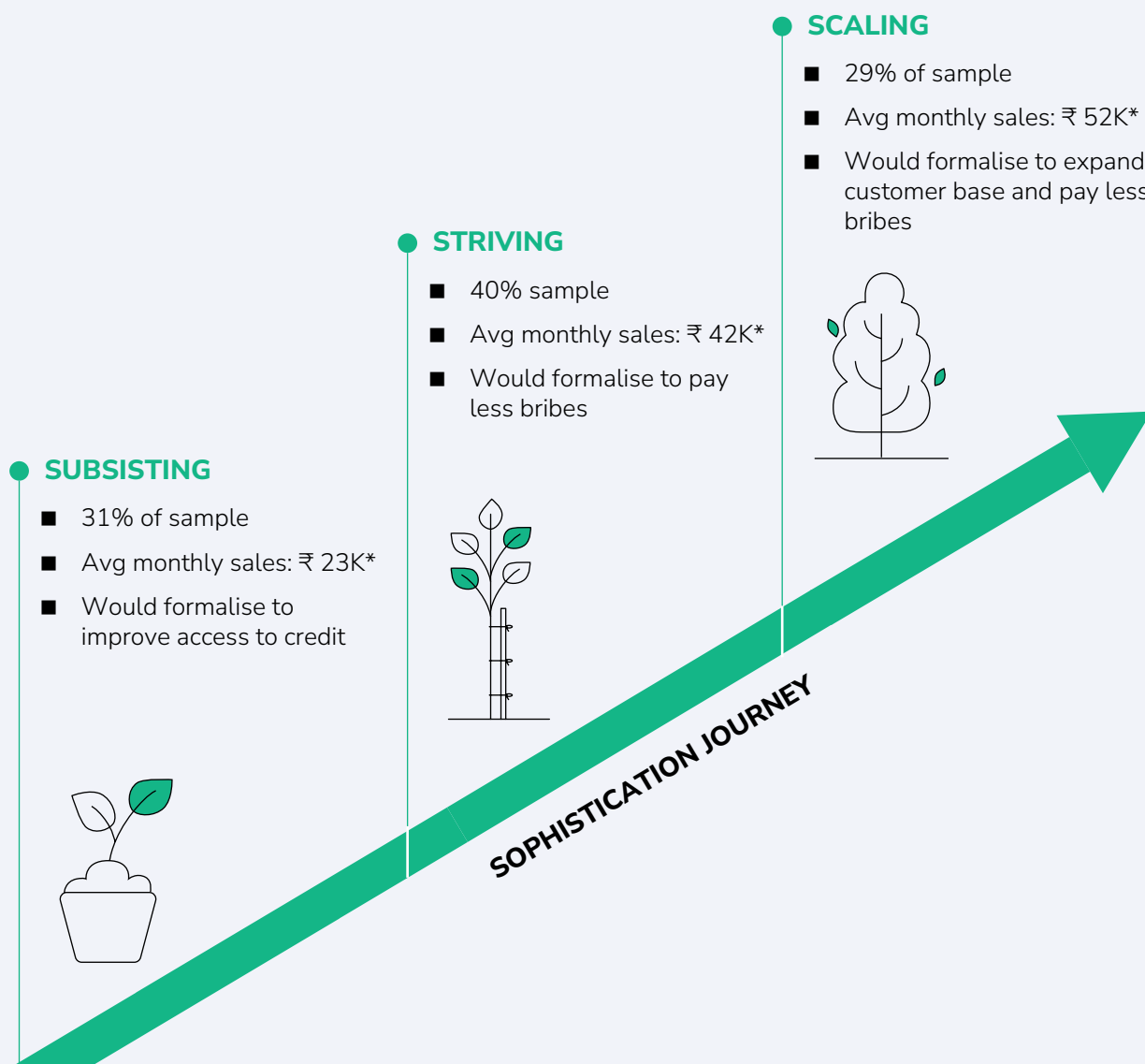
Key thematic areas	Variables	Segments		
		Subsisting	Striving	Scaling
Sales	Avg. monthly sales (regular month)	INR 23,063	INR 41,969	INR 52,285
Business management practices	% of IEs that keep written records	8%	42%	53%
	% of IEs that keep business financials separate from household financials	14%	40%	78%
Access to formal finance	% of IEs with a bank account for the business	5%	44%	74%
Digitalisation	% of IEs who use a mobile phone or smartphone for business operations	27%	69%	85%
Formalisation	Reason for not registering on PAN and GST	Paying taxes	Paying taxes	Paying taxes & inspections and meetings with govt. officials
	Motivation for registering on PAN and GST	Better access to financing or loans	Less bribes to pay	Better access to potential customers & less bribes to pay

25. See Annex V.

Segmentation

Informal enterprises were grouped based on the level of advancement of their financial and operational practices and the factors influencing their owners' decisions to formalise their ventures. As illustrated in the diagram below, these characteristics delineate a spectrum of "sophistication" comprising three segments: subsisting, striving, and scaling.

Diagram 2: Spectrum of sophistication for IEs in this research



* On a regular month

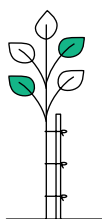
Source: MSC and Decodis.



Subsisting

These enterprises comprised 31% of the sample and record low monthly sales, averaging INR 23,063 on a regular month. Only 8% of business owners in this group keep written records, and 14% differentiate between business and household finances. Furthermore, only 5% have dedicated bank accounts for their businesses and 27% use mobile phones in their operations. In addition, within this segment, business owners cite improved access to loans or credit as the primary motivation to formalise their ventures.

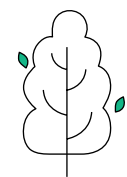
Babita Nagar, 40, is a mother of three and operates a corner store in Machhrouli village in Panipat district, Haryana. She sells food and other items such as milk, snacks, cosmetics, and cigarettes. On average, her monthly sales range between INR 5,000 and INR 8,000, and she uses it to support her husband, the primary income earner. Babita does not keep any business records or keep separate business financials and does not think it's necessary to do so. She has never taken a loan from any formal financial provider and relies on friends and family for capital inputs when needed. She does not have a dedicated business bank account or her own individual bank account and has not considered opening one. She uses WhatsApp to communicate with family and friends but does not use it – or any other digital tools – to communicate with her customers or suppliers. During the pandemic, her sales averaged INR 5,000, but despite that, she has successfully saved INR 10,000.



Striving

These enterprises comprised 40% of the sample and record average monthly sales of INR 41,969 on a regular month. Overall, 42% of business owners in this group keep written records, and 40% differentiate between business and household finances. Moreover, 44% have dedicated bank accounts for their businesses and 69% use mobile phones in their operations. Furthermore, business owners in this segment cite paying fewer bribes as the primary motivation for formalising their ventures.

Deepu, 34, is a father of three who runs a street-side tea kiosk in Lucknow, Uttar Pradesh. He started his business in 2006 using capital he had borrowed from his family. On average, his monthly sales range between INR 30,000 and INR 42,000, but his business can earn up to INR 46,000 in the busiest months. He is the primary income earner for his household, with supplementing income from his brother, who drives for Ola. Deepu keeps written business records and separate business financials but is not consistent in keeping these practices. He opened a bank account for his business but does not use it regularly. He does not prefer to use WhatsApp for business communication but uses it when he feels it is necessary. He considered borrowing from formal financial providers but is hesitant because of his difficulty in repaying a loan he had previously taken from a moneylender. He now relies on his relatives for interest-free capital. Deepu is aware of PAN and GST but is wary of the high tax burden of formalisation.



Scaling

These enterprises comprised 29% of the sample and record average monthly sales of INR 52,285 on a regular month. More than half (53%) of business owners in this group keep written records and differentiate between business and household finances (78%). Additionally, a large percentage of them have dedicated bank accounts for their businesses (74%) and use mobile phones in their operations (85%). Business owners in this segment are driven to formalise their ventures with the aim of expanding their customer base and paying fewer bribes.

Santoshi Devi, 39, runs a cosmetic shop and a clothing shop in Chack Chiriya Gandhi village, in Hanumangarh, Rajasthan. She started her business in 2016 using her own capital. Her monthly sales average INR 50,000 – 60,000 depending on the season. She is the primary provider for her family and uses her income to sustain her household. Santoshi has a bank account that she uses regularly and a mobile phone and computer that she uses to manage and communicate with her clients and suppliers. She keeps written business records regularly and thinks it is essential to separate business finances from household finances. Santoshi typically borrows an average of INR 20,000 from moneylenders at a rate of 2% per month, for a six-month tenure. For smaller amounts, she relies on friends. Despite her financial progress, Santoshi has never applied for a bank loan because she lacks collateral. She is aware of PAN and GST but is hesitant to formalise her business due to the tax implications and required inspections with government officials.



Recommendations

Informal enterprises present exciting opportunities for India's growth.^{26,27} However, the extensive prevalence of informality poses a significant challenge to the national economy and regulatory framework.^{28,29} Thus, it is crucial to integrate these firms into India's growth and mainstream economy. To achieve this, the government, private sector, and financial service providers must align their efforts to engage with informal enterprises across the spectrum of scale, ambition, and current level of formalisation.

Leveraging the segmentation framework developed in this study, the following section provides a set of recommendations, each tailored to address the needs and limitations of the different segments of IEs. Some recommendations apply to all segments regardless of their sophistication level, while others are targeted at specific groups. These recommendations aim to assist policymakers, regulators, academia, and industry participants in overcoming the structural barriers to the growth of IEs in the country.

Barrier 1: Data insufficiency to monitor the informal sector.

The absence of a universally accepted and legal definition of informal enterprises in India hampers their accurate and consistent identification. Consequently, policymakers face challenges monitoring their performance and obtaining macro data related to the sector. According to a 2017 estimate by the International Monetary Fund (IMF), 90.7% of India's workforce is engaged in the informal sector. However, the lack of a credible database

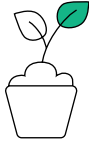

26. Observer Research Foundation. (2020). Future of unemployment and the informal sector of India. <https://www.orfonline.org/expert-speak/future-of-unemployment-and-the-informal-sector-of-india-63190>

27. International Labour Organization (ILO). (n.d.). Informal economy in South Asia. <https://www.ilo.org/regions-and-countries/asia-and-pacific-deprecated/ilo-india-and-south-asia/areas-work/informal-economy-south-asia>

28. Yu, S., & Ohnsorge, F. (2019). The challenges of informality. <https://blogs.worldbank.org/en/developmenttalk/challenges-informality>



29. International Labour Organization (ILO). (2015). Informal economy: A hazardous activity. <https://www.ilo.org/resource/informal-economy-hazardous-activity-0>

poses difficulties in formulating effective policies for IEs. Recent trends show positive developments. Based on the most recent data on the MoMSME portal,³⁰ more than 4.9 crore MSMEs have been registered on the Udyam portal (including Udyam Assist Platform). Notably, microenterprises account for 98% of these registrations. This trend underscores a growing inclination toward formalisation.

Recommendation 1A	This is applicable to segments	Ownership
Create a separate category of nano-enterprises within the microenterprise segment	 	MoMSME
<p>Enterprises with a turnover below INR 5 crore or investments of INR 1 crore are classified as microenterprises. However, this classification overlooks the distinct characteristics and unique needs of informal enterprises, which are typically much smaller in scale. Establishing a separate sub-segment for nano-enterprises would facilitate the government in identifying informal enterprises within the microenterprise category. The criteria for this definition can follow the turnover criteria used by the MoMSME for the broader classification of MSMEs.³¹ However, given that most microenterprises may fall in the nano-enterprises category, additional verifiable criteria, such as the number of paid workers and the size of the business establishment, could be considered.</p>		

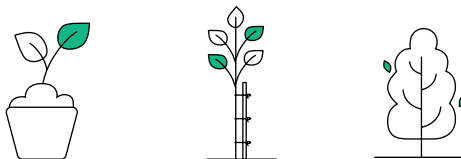
Barrier 2: Information asymmetry impeding compliance with government regulations.

Government initiatives aimed at digitising specific formalisation processes, including registration, have successfully lowered both costs and time requirements. However, they have not fully addressed the persistent compliance challenges inherent in formalisation. This issue disproportionately affects informal enterprises, which already face disadvantages due to information asymmetry and lack of awareness. Additionally, this problem impedes IEs' access to government support programmes, primarily due to negative perceptions about government processes, lack of necessary documents, and challenges in meeting eligibility criteria.

Recommendation 2A	This is applicable to segments	Ownership
Create an assisted model of support for IEs	 	MoMSME
<p>Banking correspondents, particularly those with extensive reach like MFIs, present an opportunity to be enlisted as corporate agents to support formalisation. Equipping their personnel with tailored training can allow them to solve queries on formalisation procedures, such as GSTIN registration, Udyam registration, and obtaining a business PAN, among other processes, for a nominal fee. This strategy would address the current information asymmetries concerning formalisation and its advantages for informal enterprises, thus enhancing accessibility and convenience. As a result, it facilitates the smooth transition of informal enterprises to the formal sector.</p>		

30. Retrieved on August 2024. <https://udyamregistration.gov.in/Government-India/Ministry-MSME-registration.htm>

31. Ministry of Micro, Small and Medium Enterprises. (n.d.). <https://msme.gov.in/faqs/q1-what-definition-msme>





Recommendation 2B	This is applicable to segments	Ownership
Develop a Udyog Aadhaar master app for IEs	 Subsisting Striving Scaling	MoMSME, FSPs, Industry associations
<p>The government, FSPs, and other service providers should collaborate to develop a comprehensive master app as a one-stop solution for informal enterprises. This app would help IE owners access specific information regarding government schemes, registration processes, application procedures, market linkages, and more. For example, the app could allow business owners to assess their eligibility for government schemes and easily apply through integrated links to scheme portals. Moreover, the app could offer personalised government scheme recommendations based on the IEs' profiles, document availability, and relevant data. This comprehensive tool would also provide essential FAQs, important news, and updates related to government schemes directly to IEs.</p>		


Barrier 3: Inadequate access to formal finance.

One of the fundamental challenges of informal enterprises is inadequate access to formal finance.³² Both demand and supply side obstacles hinder formal finance access for these enterprises, leaving entrepreneurs dependent on informal sources. Formal, institutional lenders are reluctant to provide financial support to informal enterprises due to information asymmetry, perceived high risk, and substantial operational costs to serve this segment. Conversely, IEs face difficulties engaging with formal financial institutions due to a lack of understanding of formal credit processes, absence of credit history, struggles with paperwork, and a typical absence of unencumbered assets for collateral. As a result, IEs find themselves significantly constrained in accessing formal credit.

While banks and NBFCs provide microfinance loans to informal enterprises, these offerings have notable limitations in their design and delivery. Microfinance loan amounts are often small and come with standardised repayment terms. Our field research shows that such loans usually do not match the cash flow needs of most informal enterprises. Given the reluctance of formal financial institutions to provide larger loan amounts, IEs often start with minimal loan amounts. They must persist for years before reaching loan limits that can adequately meet their business needs.






32. International Labour Organization (ILO). (2016). Role of Finance in Driving Formalization of Informal Enterprises. <https://researchrepository.ilo.org/esploro/outputs/encyclopediaEntry/Role-of-finance-in-driving-formalization/995219223402676>

Recommendation 3A	This is applicable to segments	Ownership
Promote ideas of flexible credit products for working capital, such as Vyapar Credit Card (VCC) or Women's Credit Card	 	SIDBI
<p>The Small Industries Development Bank of India (SIDBI) is gearing up to introduce the Vyapar Credit Card, drawing inspiration from the Kisan Credit Card. This initiative aims to facilitate affordable and collateral-free loans for small traders. Moreover, it can serve as a pilot to develop commercially viable credit solutions and offer flexibility regarding repayment frequency, disbursement timing, repayment methods, and loan tenures. The cost of credit to customers can vary based on the verifiable data and documents that informal enterprises can provide, as well as the terms (e.g., tenure, repayment frequency) of the required loan. To incentivise IEs to formalise and access credit through the VCC, the government should establish interest subvention and credit guarantee mechanisms. These initiatives would encourage the formalisation of IEs and facilitate the flow of credit to this segment of enterprises.</p>		
Recommendation 3B	This is applicable to segments	Ownership
Facilitate digital working capital finance for IEs under PM SVANidhi	 	FSPs, MoHUA
<p>Leveraging digital payment transaction data from IEs, financial institutions (FIs) can implement digital credit underwriting models to assess business loan applications and deliver tailored products and solutions. The PM SVANidhi scheme could be expanded beyond hawkers to encompass IEs with credit needs within a similar range. The ministry should use Microfinance Institutions (MFIs) networks and industry associations to access IEs. Establishing a dedicated credit guarantee pool for this scheme would incentivise more FIs to engage with this segment. Additionally, a communication campaign should be initiated to promote responsible repayment behaviour among IEs and reduce instances of default.</p> <ul style="list-style-type: none"> ■ The adoption of digital payments is on the rise among microenterprises and informal enterprises. Our diaries research suggests that consumer-facing IEs in metros like Delhi and Mumbai can receive up to 50% or more of their payments digitally. ■ To support informal enterprises, the government and the industry should promote the adoption of data-driven credit assessment and non-asset-backed loan underwriting. Lenders should create or collaborate with partners to implement data-driven algorithms that evaluate repayment capacity and assess the creditworthiness of informal enterprises. This shift aims to move away from collateral-based lending and transition towards a cashflow-based lending model. 		

Recommendation 3C	This is applicable to segments	Ownership
Bring semi-formal credit under the data radar	 Subsisting	MoMSME, RBI, Credit Information Bureaus, FSPs
<p>Credit bureaus should include the individual credit exposure and repayment history of Self-Help Group (SHG) members. Approximately 8 crore SHG members have consistently repaid their loans for decades, but despite their diligent repayment, they lack credit histories, rendering them invisible to the formal banking sector. It is crucial for credit bureaus to incorporate the credit history of SHG members participating in programmes like the SHG bank linkage initiatives of the NULM and the NRLM.</p>		

Barrier 4: Multidimensional challenges for women-led IEs.

Women face a range of social, financial, and cultural challenges, including societal bias, unequal distribution of family responsibilities, poor access to financial resources, discrimination, and limited information, all of which restrain the expansion of their businesses. For example, compared to the average IE operating for 45 hours per week, women-owned IEs operate for only 41 hours per week. This disparity highlights the additional burden of unpaid work, numerous responsibilities, and societal norms restricting women's working hours.

Recommendation 4A	This is applicable to segments	Ownership
Facilitate financing to women startups	  Striving Scaling	MoMSME
<p>The government should facilitate affordable loans to women-owned IEs to promote women's entrepreneurship. Promoting women's entrepreneurship can increase their participation in the workforce. Under the Standup India programme, a credit facility is provided for women MSMEs. However, loan amounts start at INR 10 lakhs. To target women-led IEs, loans of smaller value (INR 1 lakh to 5 lakh) should be made available.</p>		
Recommendation 4B	This is applicable to segments	Ownership
Set up women "bazaars"	   Subsisting Striving Scaling	MoMSME, Industry associations

The government should support the creation of dedicated physical infrastructure for women-owned microenterprises, including IEs, where they can operate their businesses. Our field research shows that women are concerned about their safety and prefer to work from home or a nearby location. This impedes access to customers and other support services required to operate a business. Essential facilities in a marketplace will encourage women to conduct their businesses without apprehensions about safety.



Several regions in the world offer examples of successful models where providing dedicated spaces for women's businesses has contributed to women's entrepreneurship. A women's market "Mercado de Mujeres" was established by the government in Mexico City in 2016 as part of an initiative to promote women's economic empowerment. Similarly, a women's market (Women's Economic Empowerment Market) was set up in Kampala, Uganda in 2017 with the government's support. A women's market is being planned in Lucknow. Such infrastructure has helped create a sense of community among female entrepreneurs and fostered a supportive environment for them to network and share resources. Business facilities exclusively for female entrepreneurs will provide a secure environment for women and at the same time eliminate proxy women's MSMEs, i.e., businesses set up in the name of women but operated by a male member of the family.

Recommendation 4C	This is applicable to segments	Ownership
Set-up and promote "Udyam Sakhis	 Subsisting	MoMSME

A cadre of support centres will help fill a known gap in support services for women IEs. Udyam Sakhis, the female managers of these centres, can provide information about government schemes and credit access from formal sources. This network of women-led service points can help fill forms, conduct transactions, and provide guidance for a nominal fee.

Barrier 5: Deficient skilling of IEs workforce.

Informal enterprises play a crucial role as the primary avenue for skill acquisition among the unskilled population. This sector also represents an aspiration for individuals seeking entry into the job market in India. With 90.7% of the Indian workforce engaged in the informal sector, building an IE is a gateway to job opportunities. According to a 2015 report by the Ministry of Skill Development and Entrepreneurship (MSDE), less than 5% of the workforce in India's MSMEs is formally skilled³³. Due to their limited resources, IEs face challenges in independently providing comprehensive skills training to their employees. The insufficient skills among the staff also contribute to low productivity within the realm of IEs.



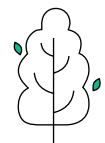
Recommendation 5A	This is applicable to segments	Ownership
Launch skill-building courses for IEs targeted at entrepreneurship development	  Subsisting Striving	MoMSME, NSDC, Industry associations

33. Government of India. (2015). Ministry of Skill Development and Entrepreneurship. Annual Report 2015-2016. <https://www.msde.gov.in/sites/default/files/2019-09/Annual%20Report%202015-16%20eng.pdf>

A more demand-driven and bottom-up approach is essential for addressing informal enterprises' basic and specialised skill requirements. Although the National Skill Development Corporation (NSDC) offers comprehensive skill training modules for workers, there is a need to develop and implement courses specifically focused on entrepreneurship development tailored for IEs. IEs typically face challenges due to a lack of record-keeping and business management skills. The IE owners should be targeted for basic business management training that helps them increase profitability and efficiency and scale up their businesses. Training on the use of digital tools will also help the IEs build essential digital footprints. Training on the use of digital payment solutions is needed to nudge more IEs towards the adoption and safe usage of digital payments. The use of digital business management solutions and participation in digital platforms can also be encouraged via targeted training. NSDC can partner with payment and solution provider firms to design training modules suitable for the different segments of IEs.

Barrier 6: Inadequate labour practices and infrastructure support.



According to an IMF estimate,³⁴ 90.7% of the workforce in India is informal (working without a contract). For the unorganised sector, 85.5% of the workforce comprises informal workers, and the organised sector has 5.2% informal workers. The absence of formal contracts often leads to exploitative practices by employers, resulting in a diminished quality of life for informal sector workers. The lack of social security coverage places these workers at significant risk. During the COVID-19 pandemic, many informal enterprises temporarily closed, leading to wage challenges and causing workers to relocate to villages. As the economy reopened, IEs faced prolonged workforce shortages.

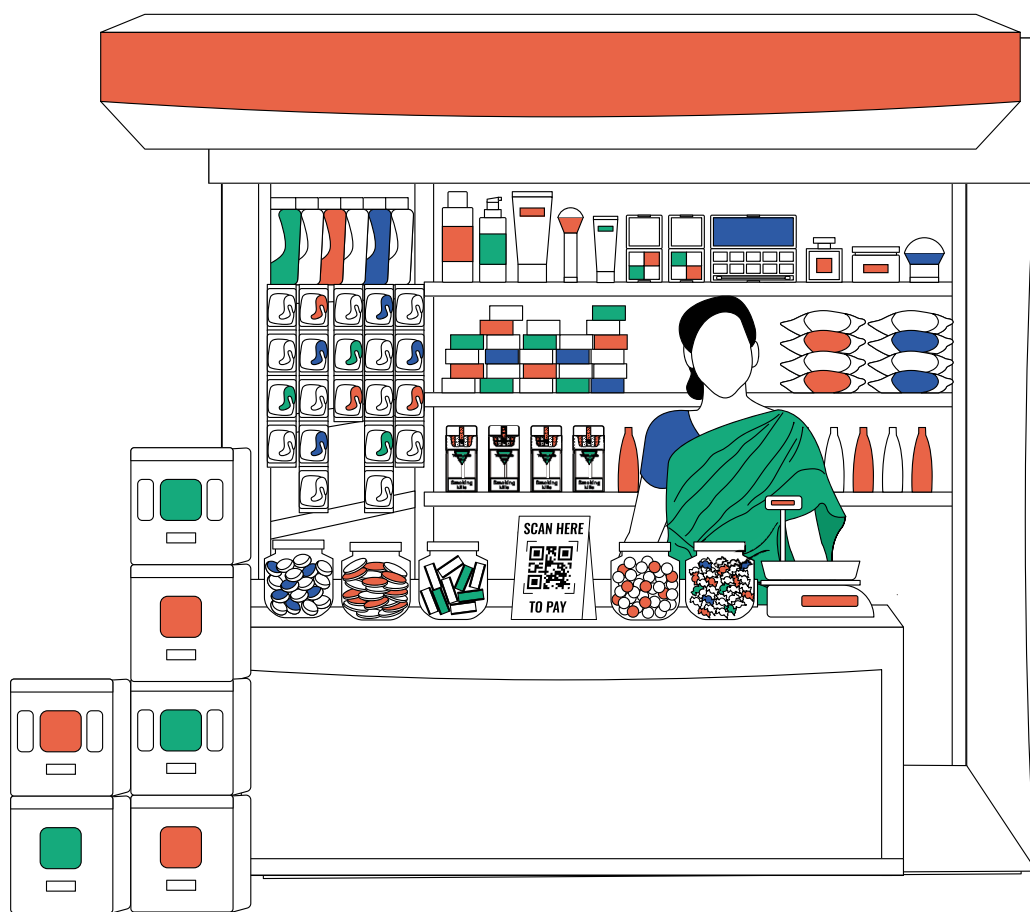
Recommendation 6A	This is applicable to segments	Ownership
Expedite risk coverage of IE workers	   Subsisting Striving Scaling	MoMSME, PFDR
<p>The government should prioritise enrolling the labour force engaged in the informal sector in the primary government schemes for life and health insurance. The government can incentivise IEs to register their employees under social benefit schemes. This will also help develop a database for informal workers in IEs. IEs registered under Udyam Assist Platform should be encouraged to enrol workers under social security schemes, especially Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY)³⁵ and Ayushman Bharat Pradhan Mantri Jan Arogya Yojana.³⁶</p>		

34. Murphy, R. (n.d.). Measuring Informal Economy in India_Indian Experience. <https://www.imf.org/-/media/Files/Conferences/2019/7th-statistics-forum/session-ii-murthy.ashx>

35. <https://financialservices.gov.in/beta/en/pmjjby>

36. <https://ayushmanbharat.mp.gov.in/>

Recommendation 6B	This is applicable to segments	Ownership
Celebrate and promote entrepreneurship by giving entrepreneurs legitimacy – dedicated spaces for IE	<div> Subsisting</div> <div> Striving</div>	MoMSME, MSDE
<p>Small-scale entrepreneurs are often compelled to operate from a non-permanent place without essential infrastructure and safety measures. Moreover, authorities routinely force them to close their shops or move away. This translates into a lack of legitimacy for entrepreneurship in the general mindset of society. Providing fixed places for the businesses can offer informal enterprises a much-needed sense of legitimacy. Therefore, the government should support the creation of dedicated physical market spaces where IEs can operate without the fear of prosecution by authorities.</p>		



Conclusion

The flex-banner seller in Delhi wants to digitise customer payments but struggles due to a lack of technological expertise. The tailor in Surat dreams of opening a fashion boutique, yet market volatility forces them to work night shifts in a side gig to keep the business afloat. The garage mechanic in Lucknow is determined to obtain a GSTIN to access a bank loan but finds the process daunting and complex. These stories highlight the challenging landscape of India's informal sector, characterised by the unique aspirations and limitations of its entrepreneurs.

This report presents an analysis based on data from a World Bank survey of over 10,000 informal enterprises and financial diaries of 50 microenterprises, providing a glimpse into the intricate world of informal enterprises in India. Our findings reveal that most informal enterprises are small, household-run ventures started by first-generation entrepreneurs who built them from the ground up, relying on skills not taught in universities but honed through diligence and resourcefulness. Although critical to India's economy, these enterprises face multifaceted challenges that hinder their growth and, consequently, the nation's development. Among the primary barriers affecting these enterprises are high sales volatility, limited access to formal capital, and insufficient government support, which not only impede their expansion but also their path to legal compliance. Moreover, gender disparities are evident, as women-led informal businesses earn significantly less than those run by men. While these challenges pervade the informal sector, each entrepreneur faces unique obstacles. Utilising a custom algorithm, this report presents a segmentation that reveals important differences among these enterprises, not only in terms of sales but also in the advancement of their financial and operational processes, as well as the factors inhibiting and motivating their formalisation.

Given the pivotal role of informal enterprises in the local economy, it is crucial to support and integrate them into the broader economic narrative. Key factors such as access to formal finance, government support schemes, and business skills development initiatives, and the establishment of conducive business environments, especially for women-led firms, are essential to promote their growth. However, addressing these issues will require creative and innovative solutions tailored to their unique characteristics and challenges.

We hope this report serves as a blueprint for better understanding and supporting informal enterprises and inspires future research that can enrich the sector's knowledge. It is crucial to build a high-quality data system to track and report on the financial and operational health of these enterprises and the challenges they face. Only then can we make informed decisions that truly promote their development.

Despite significant challenges, informal enterprises have kept the wheels of the local economy turning. It is time for India to support them as they take their next leap.

About the study

The purpose of this study is to provide a deeper understanding of the informal sector focused on the growth and development of the enterprises within it. To this end, this study addresses three key objectives:

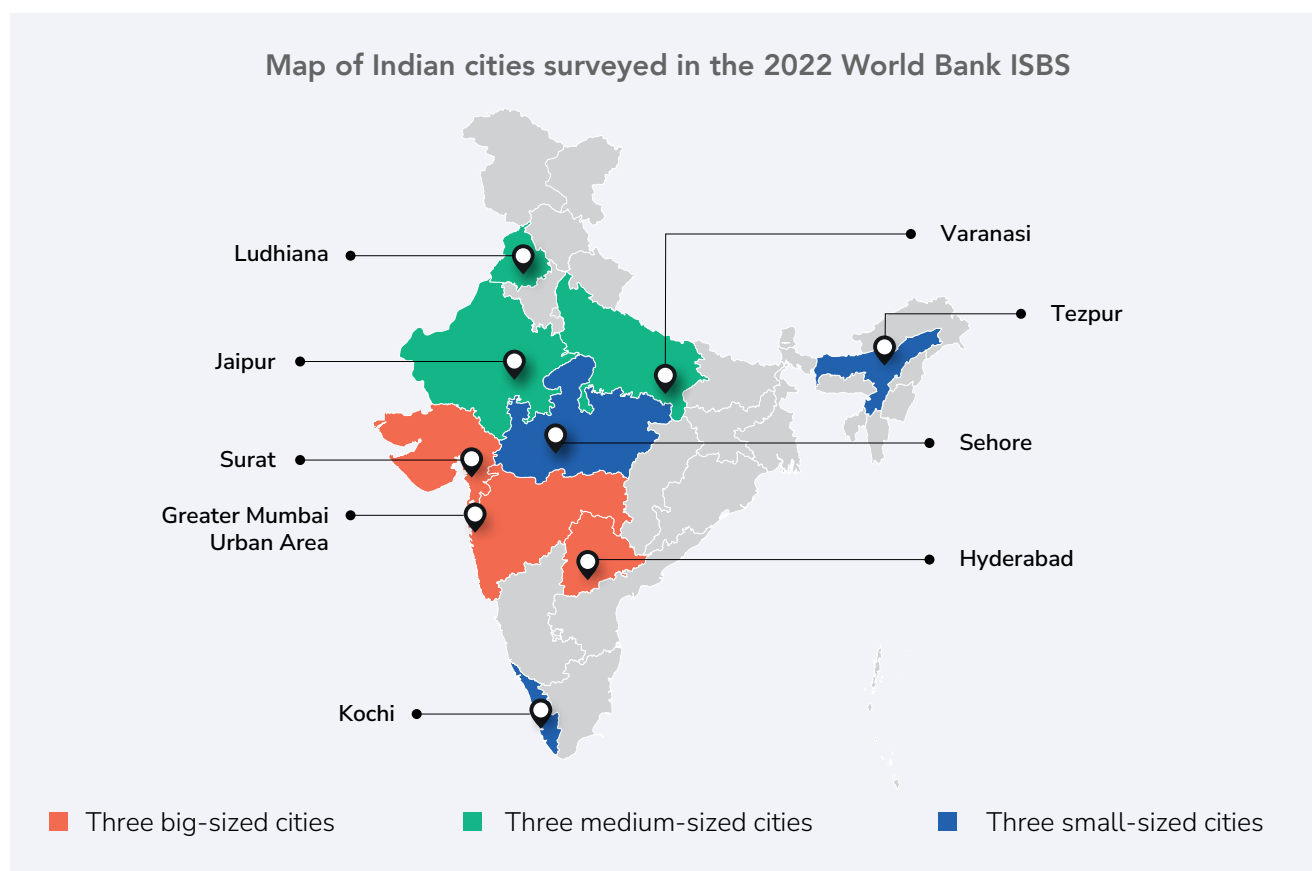
- To assess the status of IEs and the challenges they face in business operations and growth, formalisation, digital adoption, access to finance, and access to government schemes.
- To assess their level of skill and knowledge and understand its impact on enterprise health.
- To assess the performance and impact of policy, regulatory, and market development initiatives.

Methodology

The study relied on two core primary research components alongside secondary research.

World Bank Informal Sector Business Survey (ISBS)

The report collects information from the 2022 World Bank ISBS conducted in India. The World Bank used an Adaptive Cluster Sampling³⁷ (ACS) method for the surveys, covering a total sample of 10,672 IEs across nine cities in India.



37. World Bank Group. (n.d.). <https://thedocs.worldbank.org/en/doc/755991612882158825-0050022021/DAY-5-Adaptive-sampling-design>

The survey tool covered the following thematic areas. These thematic areas served as the pillars for analysis during the research:

- Screening questions to identify informal enterprises
- Law and order environment
- Finance
- Registration
- General information about the business
- Sales and supplies
- Access to government schemes
- Assets
- Location and infrastructure (electricity, water supply, etc.)
- Business practices
- Labour

A few cross-cutting areas covered in the tool are:

- Use of digital technology
- Gender
- Impact of COVID-19

Financial diaries

While single-point surveys can offer a snapshot of the microenterprise landscape at a specific point of time, additional tools can assist in understanding the complex lives of informal entrepreneurs, particularly in terms of aspects like income, expenses, savings, and credit that tend to fluctuate over time. MSC employed financial diaries to document how informal enterprises' financial conditions fluctuate and understand how external factors, such as regulations, shifts in socio-political situations, and seasonal variations, affect them over time.

Using this method, MSC tracked the daily financial transactions of 50 IEs and microenterprises for 12 months:

- Income from the business, as well as from other sources
- Business expenses (raw material, rent, electricity, internet, staff salary, purchase of assets for business, etc.)
- Types of personal expenses (grocery, vegetables, fish/eggs/meat, milk, and dairy products, education, health, household assets, religious expenses, etc.)
- Savings across avenues (bank accounts, SHGs, savings groups, etc.)
- Savings withdrawals from various sources
- Loans availed of (from financial institutions, moneylenders, SHG, etc.)
- Loans repaid

Besides the financial transactions, we had in-depth qualitative discussions with the diarists. The financial diaries offer insights into the factors contributing to variations in income and expenses and the diarists' financial decision-making process.

MSC collected data for a year, from July 2021 to July 2022. We chose 25 informal enterprises for this research from five locations:

1. Delhi NCR
2. Surat (Gujarat)
3. Lucknow (Uttar Pradesh)
4. Patna (Bihar)
5. Hyderabad (Telangana)

Additionally, we tracked 25 IEs, starting in October 2020 to the end of 2021, from five locations:

1. Allahabad (Uttar Pradesh)
2. Bhopal (Madhya Pradesh)
3. Hanumangarh (Rajasthan)
4. Kolkata (West Bengal)
5. Panipat (Haryana)

For more details on the financial diaries' methodology and examples, please refer to [Corner shop diaries - MicroSave.](#)

Annexes

Annex I

Just as the definitions to classify MSMEs differed for different nations, the definitions used to segment informal enterprises also varied. The table below depicts the definitions of informal sector enterprises used by selected countries and organisations:

Country or organization	Source	Definition
Brazil	Urban informal economy survey	Household unincorporated enterprises with fewer than six employees and without a complete set of accounts (agriculture excluded)
Mexico	National survey of occupations and employment	Household unincorporated enterprises that have no complete set of accounts and are not registered (agriculture excluded)
Panama	Household survey	Household unincorporated enterprises with fewer than five employees (agriculture excluded)
AFRISTAT	1-2-3 surveys	Household unincorporated enterprises that are not registered with the national statistical institute or other administrations, and/or that do not have formal written accounts according to the standard plan
Ethiopia	Urban employment/unemployment survey	Household unincorporated enterprises without an accounts book that have fewer than 11 employees or no licence (agriculture included)
Mali	Labour force survey, 2007	Private enterprises with fewer than 11 persons engaged that are not registered with the National Institute for Social Protection and do not have accounts (agriculture excluded)
United Republic of Tanzania	Integrated labour force survey	Household unincorporated enterprises with fewer than 10 employees and without a complete set of accounts (agriculture excluded)
Russian Federation	Population survey on employment problems	Household unincorporated enterprises that are not registered as a legal entity or have no legal status (agriculture included)
Turkey	Household labour force survey	Household unincorporated enterprises paying a lump-sum tax or not paying any tax, and with fewer than 10 persons engaged (agriculture excluded)
Pakistan	Labour force survey	Household unincorporated enterprises owned and operated by (a) own-account workers or (b) employers with fewer than 10 persons engaged (agriculture excluded)

Source: [International Labour Organization \(ILO\). \(2013\). Measuring informality: A statistical manual on the informal sector and informal employment.](#)

Annex II

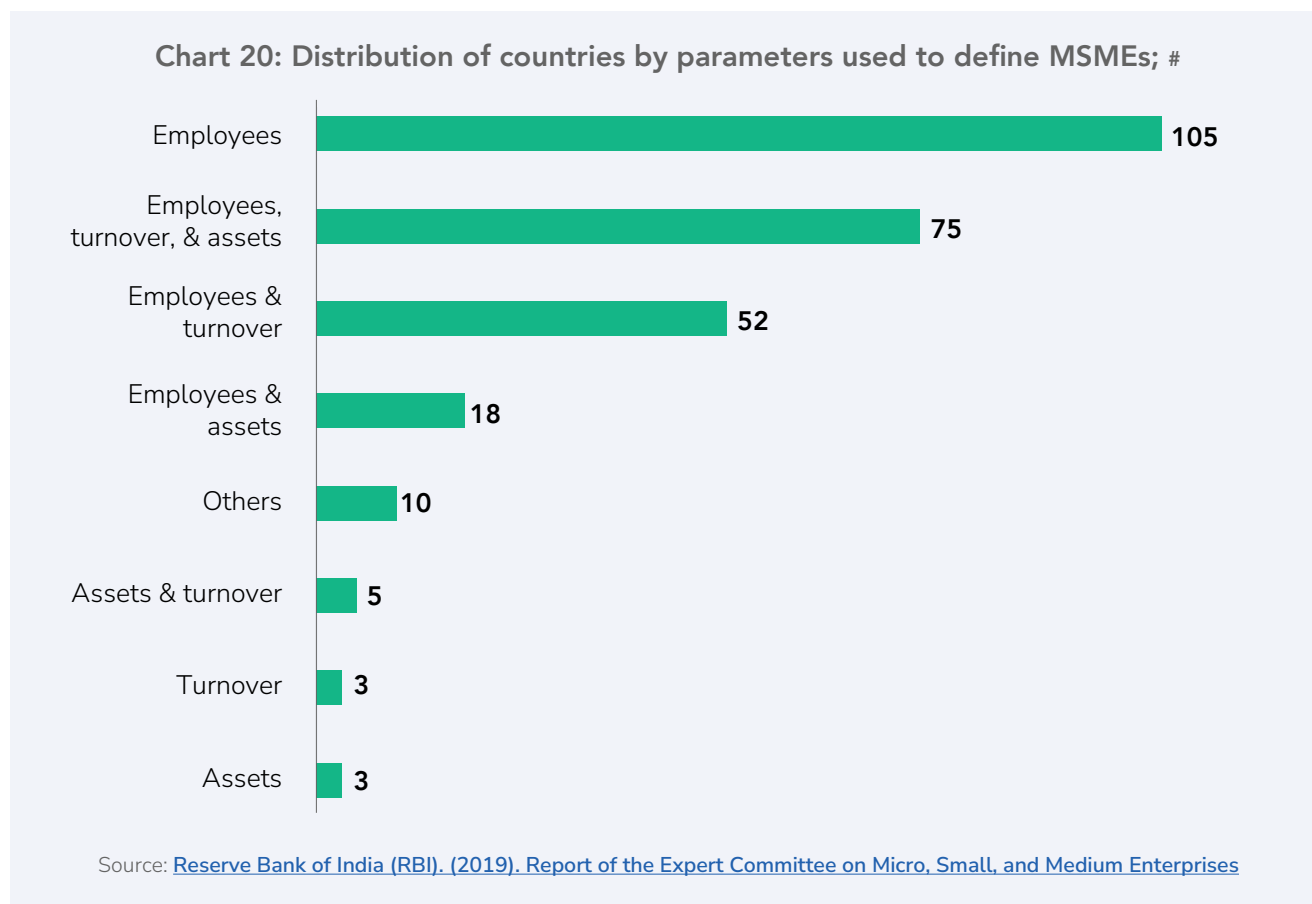
The following table describes the states with the highest number of MSMEs and their respective share in the total MSME count.

Top MSME states	Number (in lakh)	Share (in %)
Uttar Pradesh	89.99	14%
West Bengal	88.67	14%
Maharashtra	49.48	8%
Tamil Nadu	47.78	8%
Karnataka	38.34	6%
Bihar	34.46	5%
Andhra Pradesh	33.87	5%
Gujarat	33.16	5%
Rajasthan	26.87	4%
Madhya Pradesh	26.74	4%
Other State/UTs	164.52	26%
All	633.88	100%

Source: [Government of India. \(2024\). Ministry of Micro, Small and Medium Enterprises. Annual Report 2023–24.](#) Percentages may not total 100% due to rounding.

Annex III

The figure below shows the distribution of several countries by the parameters used in their definition of MSMEs.



Annex IV

The table below shows the average productivity in rupees of registered firms versus unorganised firms in India.

Type of firms	Average productivity (in INR) per worker*			
	Formal (ASI)		Informal (NSS)	
	2014-15	2010-11	2015-16	2010-11
Micro	5,17,046	4,23,692	86,700	60,544
Small	3,63,091	3,22,278	2,37,617	2,27,340
Medium	5,15,499	3,90,445	3,02,148	2,04,050
Large	6,64,897	6,10,926	3,08,089	2,75,503
Total	5,40,007	4,11,811	91,728	61,091

Source: [Centre for Sustainable Employment \(CSE\). \(2019\). CSE Working Paper #25. The Size Structure of India's Enterprises: Not Just the Middle Missing.](#)

(*) Productivity per worker was calculated by dividing the Gross Value Added (GVA) by the number of workers. Both GVA and productivity figures were adjusted for inflation using the Wholesale Price Index (WPI), with 2011-12 set as the base year (index value of 100).

Annex V: Segmentation methodology overview

Hierarchical clustering

For this segmentation exercise, Decodis developed a custom hierarchical clustering algorithm to classify the businesses in the sample into groups.

Hierarchical clustering is an unsupervised machine learning algorithm that groups similar objects with identical characteristics into the same clusters. This method ensures that objects within a cluster are homogeneous while objects between clusters are heterogeneous. The 2022 World Bank ISBS survey data contained a diverse range of variables, including continuous (e.g., total sales and profit), discrete (e.g., the number of business owners and household members), and categorical variables (e.g., use of computers or tablets, which have binary responses, and type of business premises, which have multicategory responses). Hierarchical clustering was chosen for its ability to accommodate all these variable types effectively. Additionally, it handles clusters of varied sizes and densities, as well as missing and noisy data. The cluster dendrograms provide insights into the hierarchical structure of the data, revealing relationships among clusters.

There are two hierarchical clustering techniques: agglomerative and divisive. In this segmentation exercise, the agglomerative technique was used, where each data point is initially considered an individual cluster. The algorithm then iteratively merges the closest clusters until a final or specified number of clusters is formed. The basic steps of the agglomerative clustering technique include treating each point as a single cluster, calculating the proximity matrix, and then merging the two closest clusters. This process continues until the desired number of clusters is created. To calculate the proximity matrix, Gower's distance was used—a similarity measure that accommodates diverse data types within the same dataset.

Input variables

The input variables were derived from the survey using the hierarchical clustering process. These included all variables that could presumably affect business revenue generation. The input variables were divided into two categories:

- Business operation variables: These describe the business operations, such as the number of employees, total monthly sales, and profit.
- Business owner(s) variables: These describe the business owner(s), including age, years of experience, and use of digital payments.

Output variables

The output variables were used to evaluate the hierarchical clustering algorithm. Key characteristics that defined the businesses, such as revenue generation and sophistication, were considered output variables. These included total and average monthly sales, hours of operation, use of digital tools, PAN and GST awareness, and more.

Significant differences in the output variables indicated varying levels of sophistication among businesses in different clusters, thereby validating our algorithm.

Tailored segmentation process

The hierarchical clustering process initially produced six clusters, which were later combined into three segments: Subsisting, Striving, and Scaling. This combination was based on identifying common patterns across relevant variables linked to the key thematic areas outlined in the report:

- Business management practices: % of IEs that keep written records and % of IEs that separate business financials from household financials.
- Access to formal finance: % of IEs with a business bank account.
- Digitalisation: % of IEs using mobile phones or smartphones for business operations.
- Formalisation: business owners' reasons for not registering on PAN and GST, as well as motivations for registering on PAN and GST.

These characteristics delineate a spectrum of sophistication based on the level of advancement in the businesses' financial and operational practices and scale. Consequently, the segment names were chosen to reflect this progression.

