

How Selling Online is Affecting Informal Firms in South Asia

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INTRODUCTION AND MOTIVATION

Key research questions: Is engagement with e-commerce helpful (↑ sales and productivity) to informal firms in South Asia? And how?

Informality has remained stubbornly high in South Asia

While e-commerce has expanded at a fast pace

Expectations that digital economy will positively impact development by *better connecting the informal sector with markets* are reflected in the e-commerce expansion plans that many governments have.

INFORMALITY AND DIGITAL ECONOMY

Informal firms share some common traits:

- Small size
- Restricted geographic reach
- Limited access to credit (so unskilled labor intensive and not capital intensive)
- Basic (or absent) management practices

Literature divided on potential explanations for emergence of these traits

- Optimizing choices by the informal firms (Levy, 2010 and Maloney, 2004)
- Entry barriers or some other forms of exclusion (de Soto, 1989 and Djankov et al., 2002)

Expansion of digital economy (e-commerce platforms) can either:

- Shift the incentives or make the barriers less effective

Or

- Exacerbate the gap between formal and informal firms

POSITIVE VS NEGATIVE IMPACTS

Digital technologies affect economic activity (and informal firms) by reducing costs (and barriers) related to search, replication, transportation, tracking and verification (Goldfarb and Tucker, 2019), more in details:

- Reduce capital inputs;
- Reduce matching and verification costs;
- Facilitate implementation of management practices;
- Facilitate market access.

But they can also work in the opposite direction:

- E-commerce platforms' market power may polarize countries' industrial structures (Iacovone et al., 2015 and World Bank 2018)

And even if digital platform reduce *logistical* barriers some *transactional* barrier may remain (Couture et al., 2021)

MAIN FINDINGS

Results for our Chaldal and Daraz case studies are encouraging. They are tilting the balance of evidence towards a *positive* impact on small, informal firms.

Direct impacts (and mechanisms):

- Access more customers;
- Expansion (of sales) after joining the platform.
- Other:
 - Adoption of new or improved business practices and technologies,
 - Better access to finance
 - Flexibility in balancing home and work life.
- Increased incentives to register business (and visibility to tax authorities).

No evidence of increasing gap between formal and informal firms

- Reported impacts do not vary significantly by firm size and degree of formalization

Generalization from these results is not easy

- Firms using e-commerce (incl. small ones) are from a selected group owned by more educated and younger individuals;
- Selective use of e-commerce (potentially because of limited development of digital infrastructure)

01.

**THE CASE STUDIES:
CHALDAL AND DARAZ**



CHALDAL AND DARAZ

Chaldal is an online grocery service operational in four cities in Bangladesh. Established in 2013, it offers 1-hour delivery on over 6,000 products. Its business is growing quickly and plans to expand to 15 markets and offer about 30,000 products in the near future.

Chaldal has over 350 suppliers, including large multinationals. It also sources goods directly from farmers and manufacturers and works with smaller-sized wholesalers. Chaldal plays an active role in identifying and selecting suppliers.

Daraz is an e-commerce marketplace established in 2015 which operates in Pakistan, Bangladesh, Myanmar, Nepal, and Sri Lanka. Daraz reports some 35 million customers and 100,000 vendors.

Daraz offers multiple advantages for even very small or new businesses. The platform aims to make selling on the site accessible to anyone with a smart phone, and provides a quick, three-step online process to start a store on the platform. No office, start-up capital, or employees are needed.

CHALDAL AND DARAZ

	Chaldal		Daraz	
	mean	St. dev.	mean	St. dev.
Country				
Bangladesh	1.0		0.3	
Pakistan			0.4	
Nepal			0.1	
Sri Lanka			0.2	
Firm characteristics				
Years in business	16.5	15.1	3.4	5.2
In business 2 years or less	0.04	0.2	0.3	0.5
Number of employees	749.2	2098.4	3.5	14.1
Firms with 20 or fewer workers	0.4	0.5		
Firms with 5 or fewer workers			0.9	0.3
Firm registration				
Has formal legal structure	0.95	0.2	0.7	0.4
Has VAT registration	0.9	0.3	0.3	0.4
Relationship with platform				
Years with platform	3.2	2.6	1.6	1.3
Less than 25 percent sales on platform	0.8	0.4	0.4	0.5
More than 75 percent sales on platform	0.1	0.3	0.2	0.4

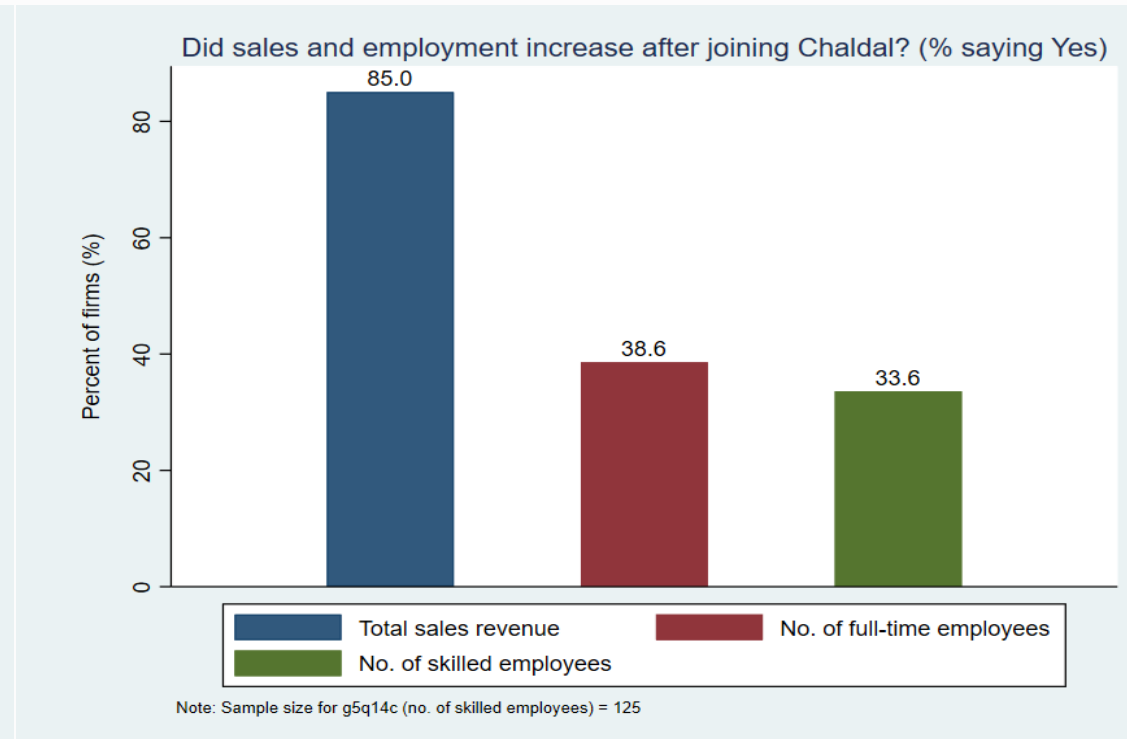
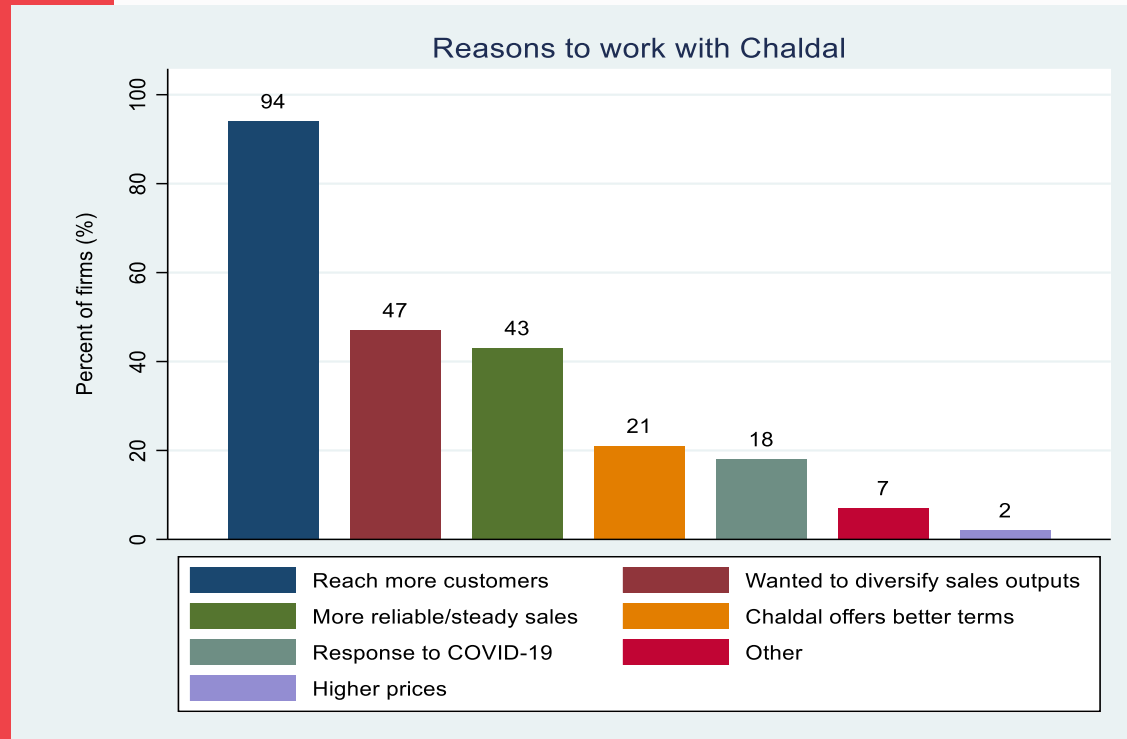
02.

**IMPACTS AND
HETEROGENEITY**



CHALDAL: MARKET ACCESS

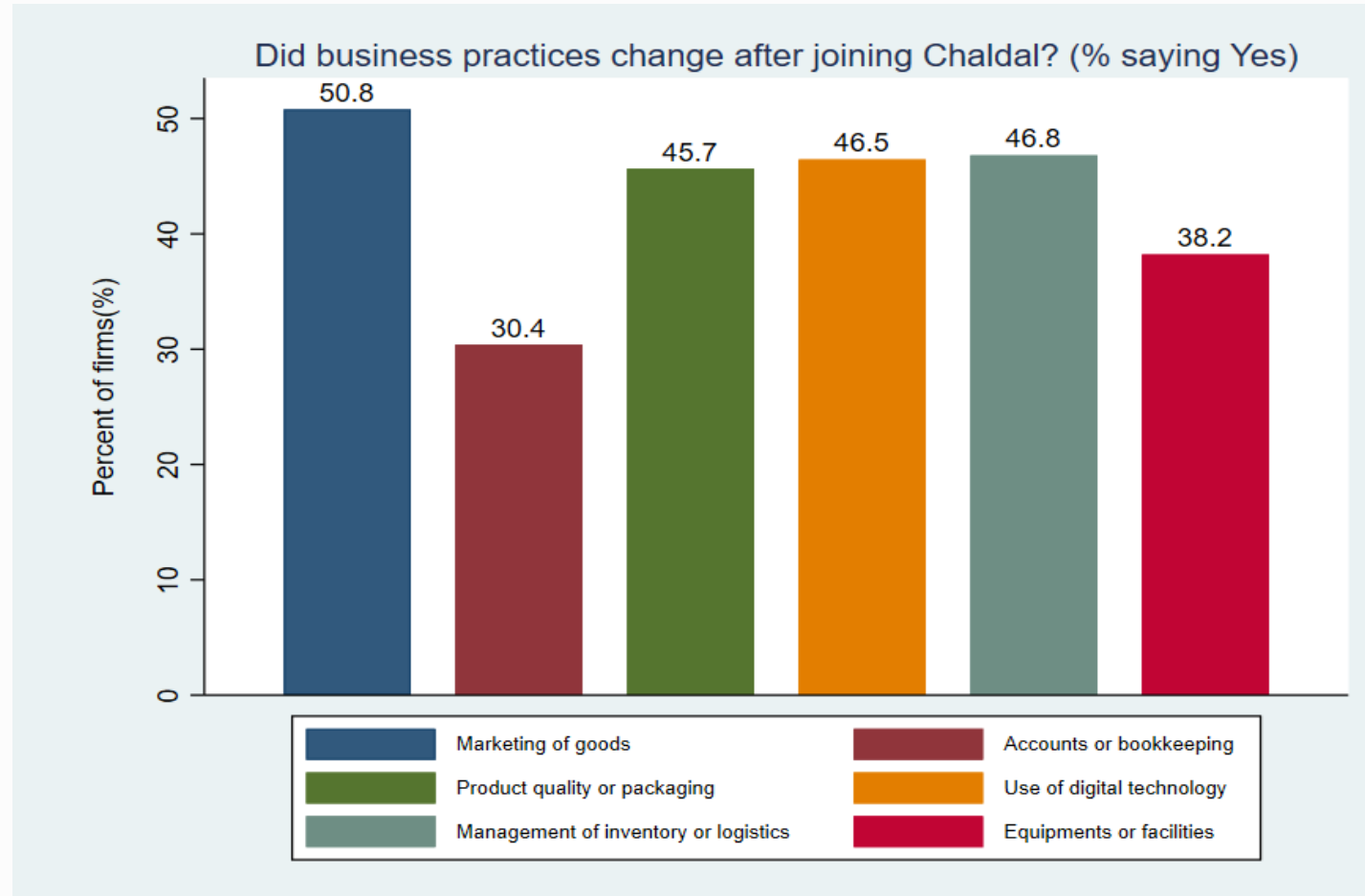
Firms in Bangladesh joined Chaldal e-commerce platform specifically to reach more customers, and their sales grew after joining



Source: World Bank-Chaldal Survey of Chaldal Supplier Firms, 2021

CHALDAL: ENTREPRENEURSHIP AND INNOVATION

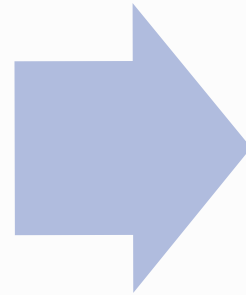
Firms that sell on the platform have adopted new business practices



Source: World Bank-Chaldal Survey of Chaldal Supplier Firms, 2021

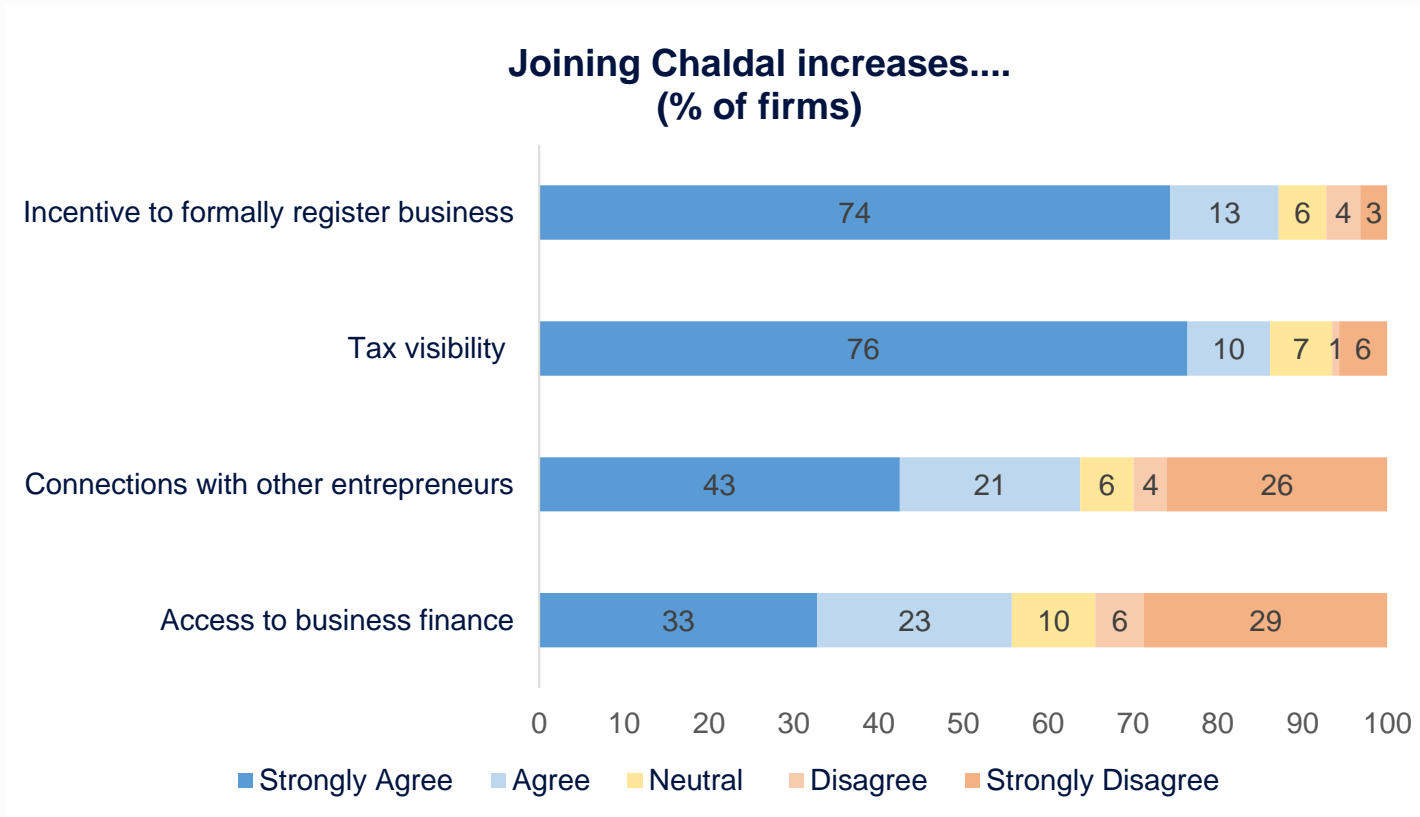
DIGITAL PLATFORMS MAY ALSO ENCOURAGE CLOSER RELATIONSHIPS WITH THE STATE AND THE FORMAL FINANCIAL SECTOR

- Greater visibility of the firm
- Greater ease of verification
(of financial information)



- Increased incentives to formalize
- Better access to formal credit

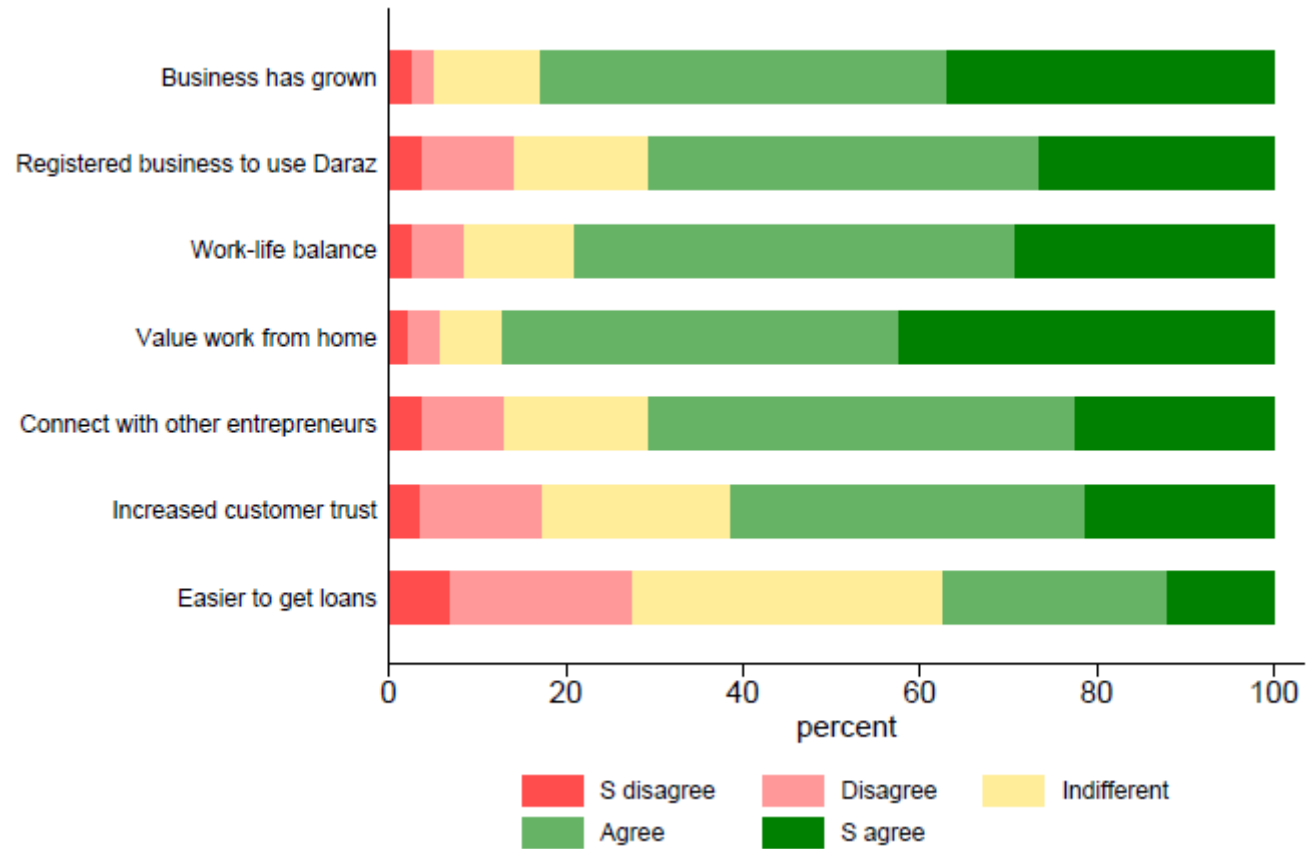
CHALDAL: FORMALIZATION



- 18% of platform sellers report having changed their legal structure or registration status after joining
- 18% report having increased their use of bank loans
 - Not trivial in a context where access to credit is the top-rated constraint among businesses

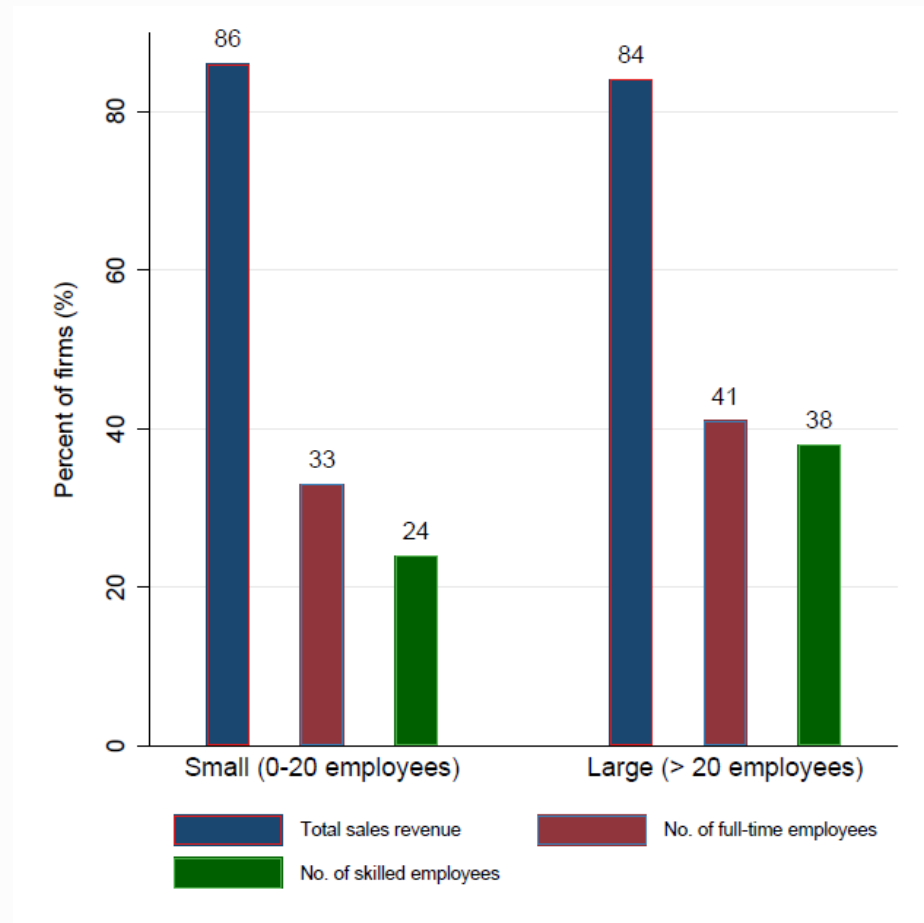
Source: World Bank-Chaldal Survey of Chaldal Supplier Firms, 2021

DARAZ - IMPACTS



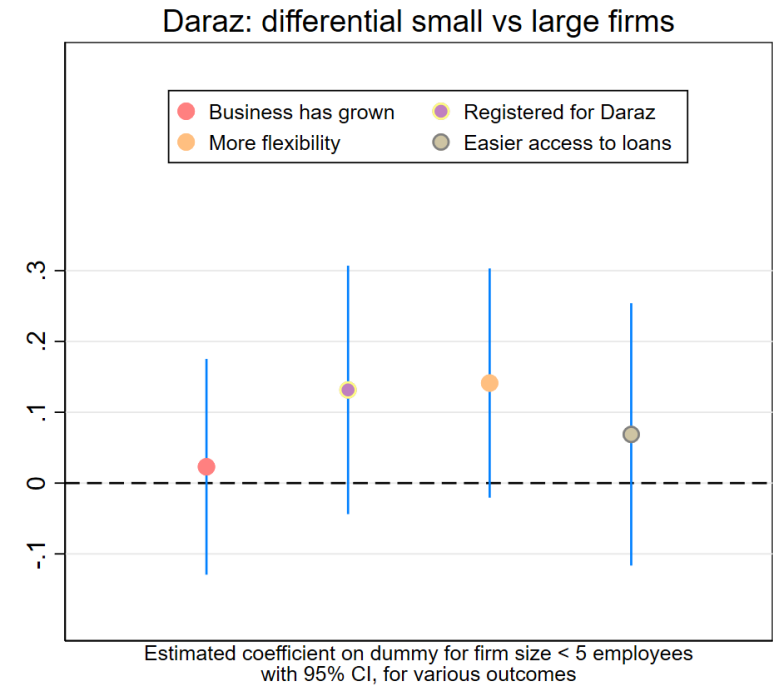
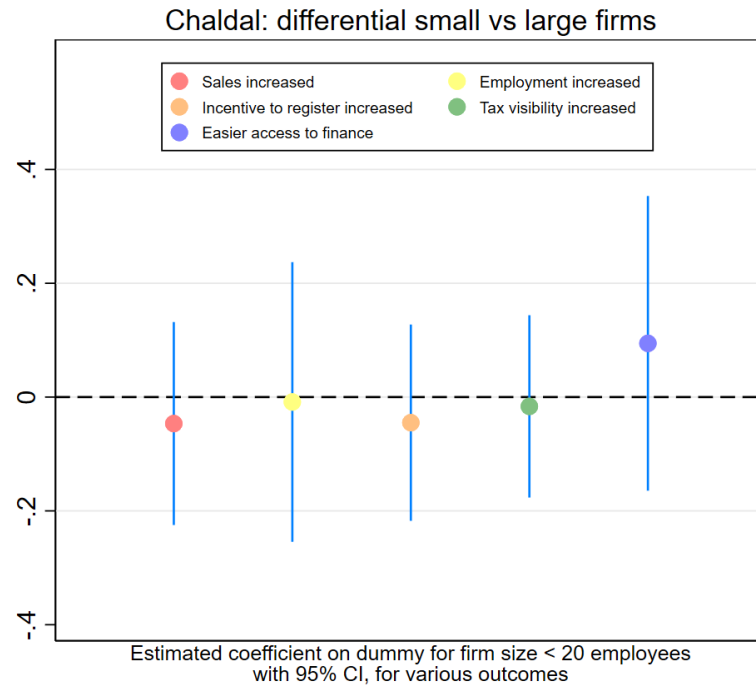
HETEROGENEITY

“Small” Chaldal sellers are just as likely to benefit from increased market access as larger sellers. Small firms are less likely to report an increase in employment than large firms



HETEROGENEITY

Regression analysis indicates that differences are statistically not significant



03.

SELECTIVITY



E-COMMERCE SELLERS ARE A SELECTED GROUP OF FIRMS

Firms selling on Chaldal and Daraz vary substantially in terms of size and other key characteristics, but they are a selective group of firms. Specifically, their owners or main managers have above average levels of education and are also comparatively young.

Chaldal:

- Of manufacturing firms in Bangladesh, 54% of managers have a graduate (B.A.) or higher degree, and > 90 % are managed by the owner or their family;
- In the case of Chaldal, 79% of managers have graduate (B.A.) or higher degree and only 82% are family run businesses.

Daraz:

- Among family business with at least one hired worker (in India CMIE survey), only 25% of owners have tertiary (above senior secondary) education and their average age is 45;
- In Daraz, the majority of sellers have tertiary education and average age of 30 years.

SUMMING UP

The quantitative case studies presented in this paper have contributed to the scant evidence base on the ways in which selling on e-commerce platforms impacts small firms in developing countries

Main channel of impact is the greater product market access due to reduction in transactions costs.

- This finding is significant given important demand-side constraints to firm growth (Atkin and Osman 2017 and Foster and Syverson 2016).

Additionally:

- Increases e-commerce sellers' incentives to formalize and undertake complementary changes to business practises and technologies;
- No differences between large and small firms;
- Selectivity

Complementary public policy interventions are useful and range from improving access to digital infrastructure, efficient postal and parcel service and access to finance, to information and support campaigns to make online economic transactions more familiar and trustworthy to the informal sector.