

Chapter 14

Global Competitiveness of Informal Economy Organizations

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Abstract This chapter presents a framework for informal economies in developing nations. It will explain linkages with the formal economies of both developing and developed nations as a function of national competitiveness. We develop propositions which explain how the dynamics and growth of the informal economy in developing nations are linked to the growth of the formal economy of developing/developed nations. The chapter illustrates the framework with the case of Jaipur Rugs and concludes with suggestions for future research in an under researched area of the informal economy.

Keywords Competitive advantage · Developing nations · Informal economy · Inter linkages

14.1 Introduction

Extant literature has described the informal economy as the: third economy, unorganized sector, parallel economy, shadow economy and the unregistered economy. Furthermore, the informal economy has become an integral part of developing nations. Informal employment in the non-agricultural sector comprised almost 50–75 % in developing countries with 65 % in Asia, 48 % in North Africa, 51 % in Latin America and 72 % in Africa in 2006 (Chen 2006). Of the total of informal employment in these countries, 30–40 % comprised waged employment. As per the ILO (2011) report, a large share of overall economic activity in developing nations comprises informally organized economic activities.

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As evident from above, the ‘informal economy’ is a driving force in today’s world market for its tremendous economic impact. However, conceptual confusion concerning on the informal economy, nation’s growth and its linkages with the formal economy still prevails within extant research (Portes and Schauffler 1993; Bangasser 2000; Guha-Khasnobis and Kanbur 2006). Existing views on the informal economy can be credited to three major research groups (schools of thought)—economists (dual economy school), sociologists (structuralist school) and policy scholars (legalist school).

The dualist economy school (Lewis 1954; Ray 1998) posed that the informal sector provides income for the poor and safety in times of crisis because the sector comprised marginal activities—distinct from and not related to the formal sector (Hart 1973; Sethuraman 1976; Tokman 1978; Santiago and Thorbecke 1988). According to this school, the informal activities exist because not enough job opportunities have been created to employ surplus labour, mainly because of the slow rate in economic growth and faster population growth rates (Marcouiller and Young 1995). The assumptions of this school were challenged by sociologists and policy scholars for three key reasons (Godfrey 2011). First, informal activity did not exist because of distortions in the formal economy; rather the informal economy predated the formal economy (Geertz 1963; Booth 1993; Turner 2004). Second, not every trade outside the formal economy was illegal and a number of trades were legitimate (Godfrey 2011). Third, money was the dominant mode of trade rather than the barter system in the informal economy. The *structuralist* school (Moser 1978; Castells and Portes 1989; Fortuna and Prates 1989; Maloney 2003) views the informal sector largely as subordinated economic workers that increase the competitiveness of large capitalist firms by reducing the input and labour costs (Polanyi 1957; Geertz 1963; Coleman 1988; Momaya 2013).

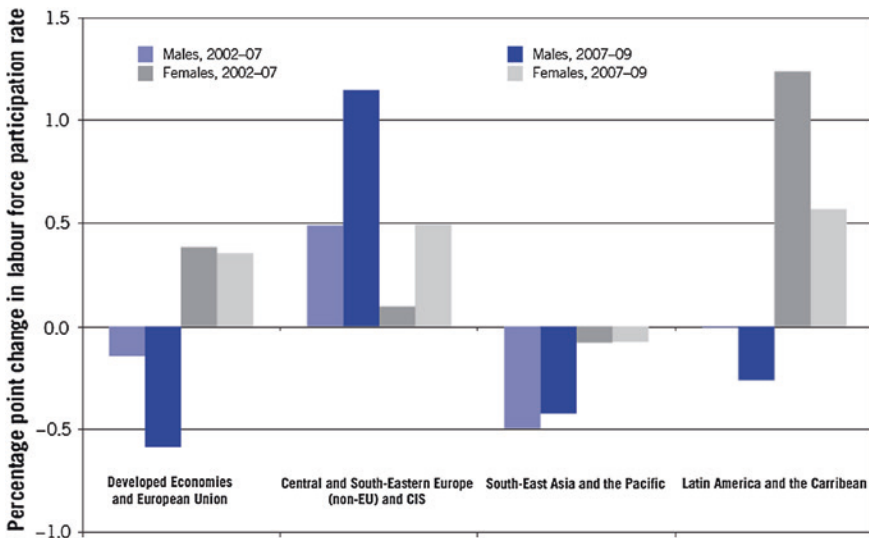
In marked contrast to the dualist model, the structuralist model opines that different modes and forms of production not only to coexist but are also interconnected and interdependent (Banfield 1958; Portes and Haller 2005). The *legalist* school (de Soto 1989; Becker 2004), views the informal sectors comprising micro-entrepreneurs who avoid costs, time and formal registration by choosing to operate informally. Furthermore, micro-entrepreneurs, owing to cumbersome and costly government procedures, will continue to produce informally (de Soto 1989).

According to Momaya (2012, p. 2), “India has a rich history of contributing to the world for centuries through responsible internationalization. A millennium perspective estimated percent share of India to the world GDP at 32.9 as compared to 26.3 for China and 10.8 for total Western Europe. India seems to have sustained such high contribution for centuries. India was contributing about a quarter of world manufacturing output in 1750 and with much less damage to environment, as compared to the leading contributor of the last century. Less able to adapt to international forces, India’s contribution to the world GDP dipped to about 4.2 % in 1950 as per a classic study by Maddison. The upward trend had been slow in the first half century of post-independence journey and can get a massive boost, if leadership in India can evolve right direction for industries, institutions and the largest youth population.”

The comparative understanding of the evolution of the informal economy, in developed and developing nation’s contexts, thus becomes imperative, from a strategic management perspective, especially when the effect, magnitude and trend of the ‘informal economy’ are believed to be relatively different in both contexts (Mittal et al. 2013). Therefore, identifying the national factors affecting informal employment, linkages between the formal and informal economy and its effect on the economy of nations is the main objective of this chapter. Traditional management theories are used as a base to build a conceptual framework of formal–informal economy interactions in developed and developing nations. The role of government policies and context specific factors fostering the growth of informal economy in developing nations is also discussed. Furthermore, we conclude with some suggestions for future research.

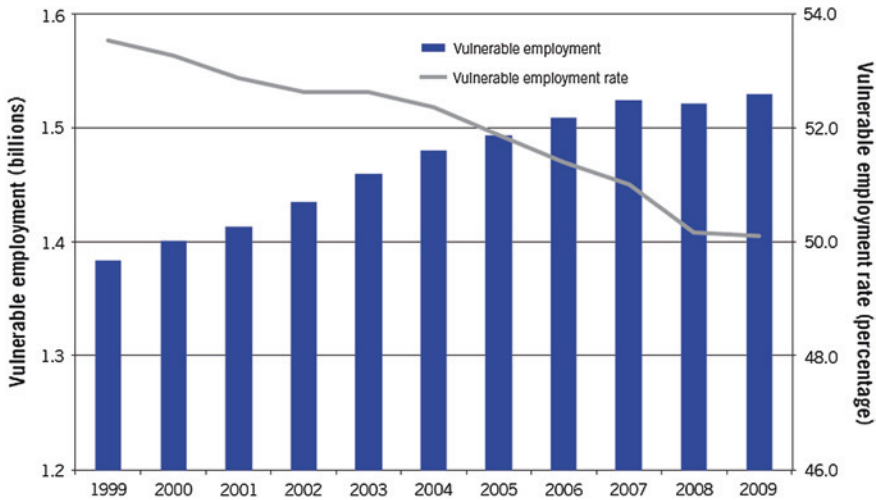
14.2 Informal Economy Scenario

The ILO’s *Global Employment Trends (2011)* report shows three marked characteristics of the informal economy for the developed and developing nation context. First, while the ‘labour force participation rate’, for both females and males decreased in developed nations after the economic recession of 2007–2009, it was held constant in developing nations during the same period (Fig. 14.1).



Note: 2002–07 values are average two-year trends.
 Source: Calculations based on ILO, *Trends econometric models*, October 2010.

Fig. 14.1 Percentage point change in labour force participation rate in developed and developing nations



* 2009 is a preliminary estimate.

Source: ILO, *Trends econometric models*, October 2010 (see Annex 4).

Fig. 14.2 Informal (vulnerable) employment (Nos. and %) of the world

This illustrates the effect of the lack of a social safety net in numerous developing nations, whereby workers affected by the recession, rather than being unemployed or economically inactive, were forced to seek other forms of employment in the informal economy, (Spicer et al. 2000). During recession, the large informal sector in developing nations helped to reduce the impact of the economic crisis. The informal economy continued to function in recession and absorbed people who were not employed in the formal sector (London and Hart 2004). As illustrated in Fig. 14.1 in countries with a budding informal sector, unemployment increased more than in countries that had an established informal sector.

Second, in 2009, the estimated number of workers in the informal economy (referred to as 'vulnerable employment in the ILO, 2011 report) was 1.53 billion. This has increased by 146 million since 1999 (see Fig. 14.2). In South Asia, the number of workers in informal employment increased by 8.5 million. In Sub-Saharan Africa the increase was 7.4 million in 2009. In Latin America and the Caribbean it increased by 1.5 million in 2009, with marginal increases in the Pacific and Southeast Asia, the Middle East and North Africa. South Asia has the highest share of informal employment (78.5 % of total employment in 2009), Sub-Saharan Africa (75.8 %) and Southeast Asia and the Pacific (61.8 %).

Last, the output/worker figures (Fig. 14.3) for developing nations has been significantly lower than that of developed world in 2009. Despite restructuring in the transitional phase in last decade, the initiative has failed to create the jobs that economic growth rates promise in developing nations. The informal economy absorbed the bulk of the workforce that was not able to do more productive work.

Region	Output per worker 2009	Annual growth (%)				2010*		
		2001-06	2007	2008	2009	CI lower bound	Preliminary Estimate	CI upper bound
		World	21 180	2.2	3.3	1.3	-1.4	2.7
Developed Economies and European Union	70 946	1.5	1.1	-0.1	-1.2	2.7	3.1	3.4
Central and South-Eastern Europe (non-EU) and CIS	23 514	6.0	5.2	3.0	-5.5	3.6	4.1	4.7
East Asia	12 383	8.3	11.8	8.2	7.0	8.2	8.5	8.7
South-East Asia and the Pacific	9 263	4.1	3.9	2.2	-0.4	4.7	5.0	5.4
South Asia	6 714	4.7	6.6	2.3	4.8	5.5	5.9	6.2
Latin America and the Caribbean	22 352	0.8	3.4	1.7	-2.4	2.4	3.0	3.5
Middle East	35 822	1.6	3.0	2.8	-1.3	-0.4	0.3	1.0
North Africa	16 235	1.3	2.9	2.1	1.6	1.6	2.4	3.1
Sub-Saharan Africa	5 141	2.3	3.5	2.4	-1.2	1.4	1.8	2.2

* 2010 are preliminary estimates; CI = confidence interval.
 Note: Output calculated on the basis of constant 2005 PPP-adjusted international dollars.
 Source: ILO, *Trends econometric models*, October 2010; see also source of table A2.

Fig. 14.3 Output/worker of world, developing nations and developed nations

In addition, the shortage of employment opportunities in the developing nations resulted in many seeking employment abroad.

14.3 Dynamics of Informal Economy in Developing Nations

By the early 1970s the perception had become widespread that policy measures had failed to trigger a growth process where the ‘informal sector’ expanded at the expense of the ‘formal sector’, despite decades of massive policy efforts in developing nations, (Lewis 1954; Polanyi 1957; Geertz 1963; Hart 1973). From the traditional dualistic economic view this is puzzling because, on the one hand, there was a high productive formal sector, eager to expand, whereas on the other hand, there was a low productive informal sector, where labour was abundant and the people poor (Meagher 1990). Dyer and Singh (1998) try to explain this by the ‘relational view’ between formal and informal sectors, posing that formal sectors encouraged and transacted with informal sectors, which was not governed by contractual specification, to gain competitive rents.

The informal economy has already played a powerful role in transition from command to the capitalist economy in developed nations (Spicer et al. 2000). Many formal firms in developed countries subcontract and outsource production to workers in developing countries, owing to the rising cost of labour, hyper-rationality of compliance in developed markets, the availability of extremely cheap labour/input market in developing nations and as a means to capture those at the Bottom of the Pyramid (Pralhad and Hart 2002; Prahalad 2004; Godfrey 2011). Perkins and Vassolo (2003)

highlight that, for formal sectors in developed nations, labour and inputs from the informal economy of developing nations is an attractive factor condition due to the availability of scarce low cost labour and input factors being abundant and also because of the flexibility experienced during environmental turbulence. This reduces the market uncertainty for developed nation firms and reduces the sum of production and transaction costs associated with hierarchy (Williamson 1975; Gulati 1995). Moreover; there is no real threat of rising wages due to legislation or unionization in developing markets (Boisot and Child 1996; Hudson and Wehrell 2005). Rugman and D'Cruz (1993) established the same through the double diamond framework for interactions between two nations and their competitiveness. In sum, many formal firms of developed nations prefer the informal economy of developing nations, in the interest of flexible specialized production, global competition, or reduced labour costs (Rugman and D'Cruz 1993; Thomas and Mueller 2000; Prahalad 2004; Godfrey 2011). Thus we propose (see Fig. 14.4):

Proposition 1 *The growth of 'informal economy' in developing nations will depend on the extent of sub-contracting and outsourcing strategy of firms from developed nations.*

In developing nations, the lack of robust government policies, prevalent institutional voids, unemployment, poverty and the lack of security nets favour the coexistence of the informal economy and formal economy (Arimah 2001; Xaba et al. 2002; Grimm and Gunther 2006). Liberalization of the developing economy fosters informal sectors because of MNCs entry into the markets, heightened competition for formal sectors and the exploration of means to capture the bottom of the pyramid (Prahalad and Hart 2002; Prahalad 2004). Firms in developing nations also aim to maximize their profits and payoffs by engaging in transactions with the informal economy because of greater bargaining power over the informal factor input conditions and related industries (Porter 1990, 1998). Thus, the formal economy firms (see Fig. 14.4) gain short term advantages in the oligopoly competition and on the other hand, this linkage with the informal economy provides further opportunities for employment and income to informal workers in the developing economy (Chen 2006).

Proposition 2a *The growth of the 'informal economy' in developing nations will depend on the legal environment of the nation, institutional voids and lack of security nets.*

Proposition 2b *The growth of 'informal economy' in developing nations will depend on the extent of liberalization in various sectors of the nation.*

The informal sector of developing nations allows the formal sectors of developed and developing economies to maintain competitive advantage by (a) reducing direct and indirect costs of production, (b) differentiating production and (c) gaining access to valuable resource of flexible labour pool (Godfrey 2011). This poses pressure on other firms to adopt the informal norm by enhancing their transactions with informal sectors to access valuable human resources and gain advantage from the linkages of informal related and supporting industries (Pfeffer

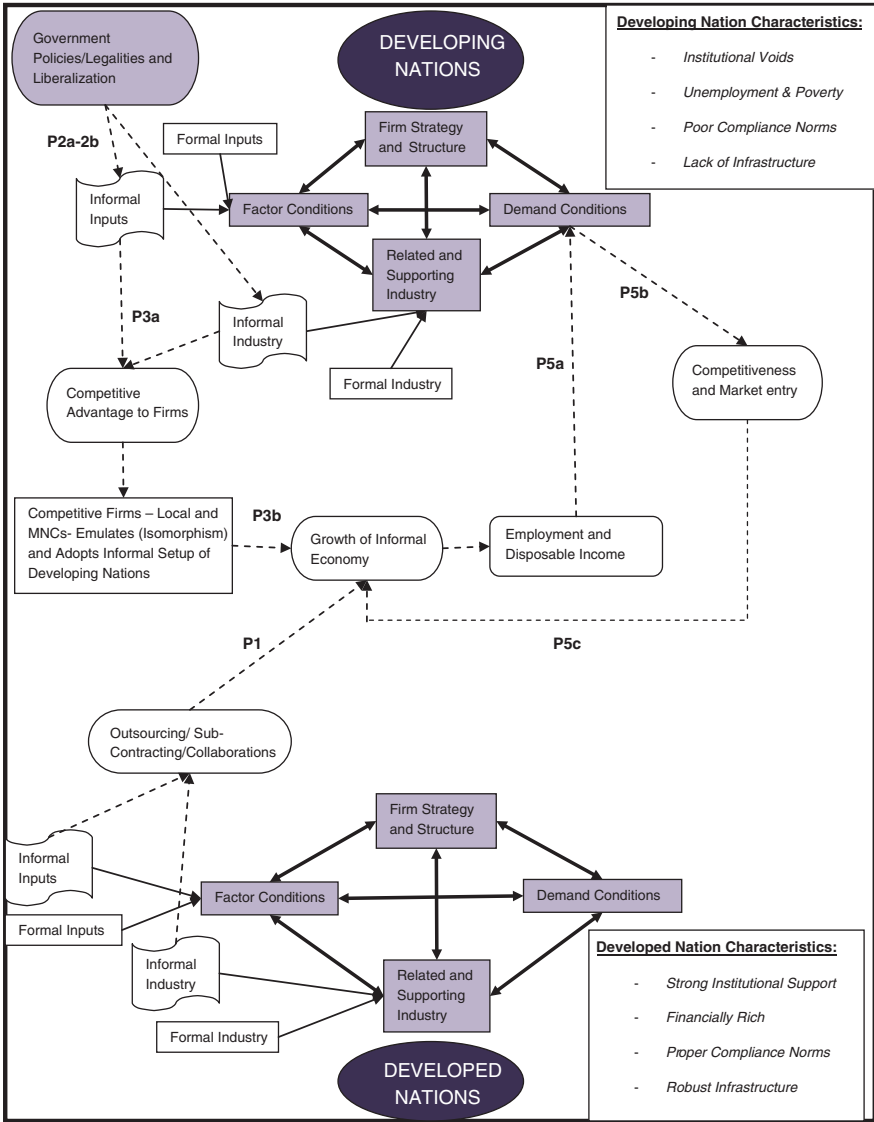


Fig. 14.4 Interlinking informal economy of developing nations to formal economy of developed and developing nations (adapted from Porter 1990)

and Salancik 1978; Wernerfelt 1984; Porter 1990). This institutional isomorphism of firms result from the need to engage in exchange with informal firms which possess scarce labour resources thus improving the competitiveness of firms (Powell and DiMaggio 1991, Ajitabh and Momaya 2004). As a result, the informal sector is integrally linked with the formal sectors of developing economies

(see Fig. 14.4). The informal–formal sector relationship is thus procyclical or in other words, complementary, i.e. expansion or contraction in one necessarily implies an expansion or contraction in the other (Sassen 1989; Godfrey 2011).

Proposition 3a *In the formal economy firms gain competitive advantage by linking to the informal economy in related industries and using factor inputs from them.*

Proposition 3b *The growth of the ‘informal economy’ in developing nations will depend on the institutional isomorphism resulting from the adoption of informal inputs/labour by formal economy firms.*

The informal inputs, operations and processes in formal enterprises/MNCs have limited technological sophistication and competition and is based on price-cutting rather than innovation (Becker 2004; Chen 2006). They are also more exploitative in nature, with formal firms taking advantage of the lower overhead costs in the informal sector (Hemmer and Mannel 1989). The negotiation/bargaining power and capacity of the informal economy is relatively limited, since they are commonly not organized in institutionalized forms of cooperation such as networks or associations (de Soto 2000; Yadav and Momaya 2009). On the other hand, the positive economic effect of this inter-linkage of the formal and informal economy is the expansion of the informal economy which provides huge potential for employment and income for people in developing nations (Thomas and Mueller 2000; Nwabuzor 2005; Chen 2006). The wages of this vulnerable population of developing nations increase (see Fig. 14.4) and so does the disposable income of the population (ILO 2011). Moreover, the sectors of microfinance, informal private equity, micro-entrepreneurship and self-employment become an integral contributing phenomenon to the GDPs of the developing economy (Chakraborty 1997; Spicer et al. 2000; Hudson and Wehrell 2005; Webb et al. 2009).

Proposition 4 *The ‘informal economy’ in developing nations will influence the employment and wages/workers of the economy.*

This increases the standard of living and reduces poverty in the population which in turn increases the demand of products/services in developing nations (Li et al. 2009; ILO 2011). This constitutes the market for the Bottom of the Pyramid of developing nations and, with the enhancement of their disposable income and purchasing power (see Fig. 14.4), more firms enter the market to fulfil this huge unmet demand (Prahalad and Hart 2002; Prahalad 2004; Godfrey 2011; Dhir and Mital 2012). With weak entry barriers for the lesser developed world, especially for accessing informal labour, inputs and related industries and the liberalization of economy, more formal firms and MNCs compete for market power, increase their market share by establishing linkages (see Fig. 14.4) with the informal economy and further contribute to the growth of the informal economy, thus, confirming to complementary relationship of formal–informal linkages (Portes and Sensenbrenner 1993; Chen 2006; Centeno and Portes 2006; Li et al. 2009; Godfrey 2011).

Proposition 5a *The growth of the ‘informal economy’ in developing nations will influence the demand conditions of the nation.*

Proposition 5b *The demand conditions of developing nations will influence the competitiveness and market entry of foreign firms in the industry.*

Proposition 5c *The growth of the ‘informal economy’ in developing nations will depend on competitiveness and market entry of firms in developing nations.*

14.4 Jaipur Rugs—A Case Study

Since its initiation in 1999 by Mr. Nand Kishore Chaudhary, Founder-Chairman and Managing Director, Jaipur Rugs has become a category leader in the carpet industry with its elusively unparalleled hand knotted carpets utilizing informal economy in India. What started with just two looms and nine artisans in 1978 has now become a success equation with the hard work of the toiling artisans, unique market strategy and quality attainment today.

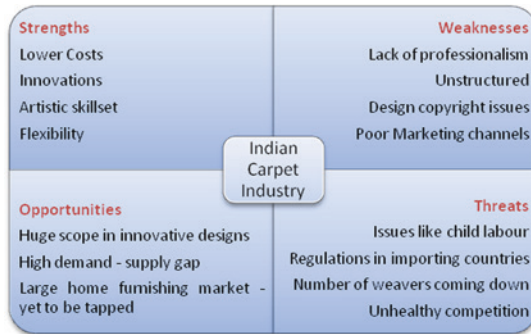
Jaipur Rugs maximizes the unorganized textile industry in India and is one of the well-known market players which manufactures and exports superior quality wool, wool–silk, pure silk and contemporary rugs and carpets. Over the years, the company has continued in an informal setup and perfected the techniques to showcase the rich heritage of Indian designs in the businesses for more than 30 countries globally. Headquartered in Jaipur (India), the company has over 20 branches in ten states of India along with a bonding of more than 40,000 village artisans.

Presently Jaipur Rugs operates in 10 states (Assam, Bihar, Gujarat, Jharkhand, Nagaland, Orissa, Rajasthan, Sikkim, Uttar Pradesh and West Bengal). It has 40 carpet weaving clusters covering 800 villages. Total artisans working for Jaipur Rugs are more than 40,000 covering 9000 families.

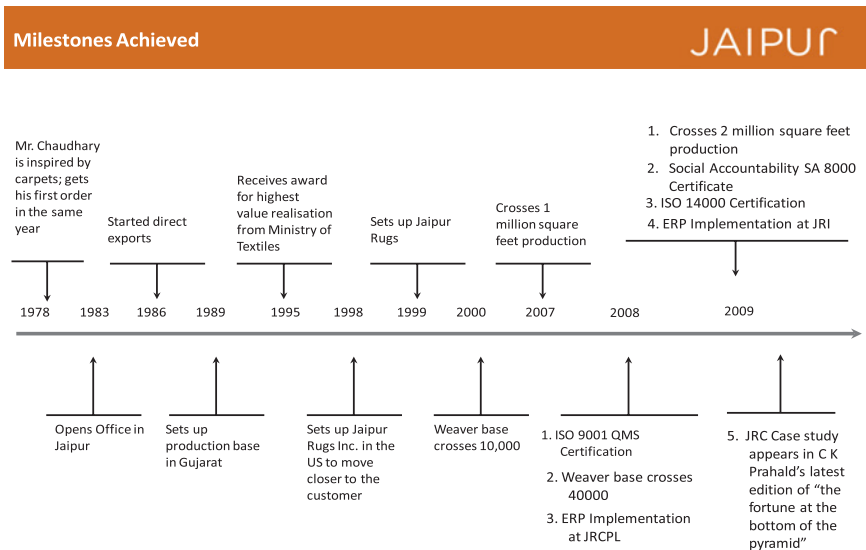
14.4.1 Indian Carpet Industry—An Overview

The carpet industry in India is highly fragmented with nearly 70 % accounted for by the unorganized sector. The relative size of the players can be gauged from the fact the largest player in the market accounts for a share of the little over 5 % of the total market. Another unique feature of the carpet industry in India is that there are traditional clusters which have emerged as major carpet weaving centres like Badohi and Agra (in UP), Panipat (Haryana), Jaipur (Rajasthan) and Kashmir. USA and Germany are the two major export markets for Indian carpets, which account for nearly 80 % of the total exports out of India. In 2007, the total value of exports stood at \$809 million, with the largest share of the market being for hand-made woollen carpets at 60 %.

The Indian carpet industry is a special industry in Indian informal setup. It lacks proper channels and is highly unorganized. Despite the fact, it contributes impressively to the % of GDP in India.



Source: Authors



Source: Jaipur Rugs Website

14.4.2 Unique Model of Jaipur Rugs: Focus on Informal Linkages

Jaipur Rugs leads the industry in design and innovation by acting as supplier to foreign branded firms. Furthermore, Jaipur Rugs creates a unique model of sub-contracting in the rug industry being involved as ODM (original design manufacturer) suppliers for its foreign partner. The firm promotes the rich heritage and tradition of art among the master weavers. Jaipur Rugs impacts the informal Indian economy setup by leveraging the legal environment and lack of security

nets. Jaipur Rugs firm has built and created a well-connected supply chain globally on a massive scale—with a focus on harnessing untapped Indian manpower skills and potential at the informal level, thereby providing handsome salary in the remotest parts of India to the workers and connecting them with markets of the formal economy, like the U.S.A (United States of America).

Jaipur Rugs has its informal linkages to the ground level network of the Indian informal sector and connects the same to the end product users. Jaipur Rugs has utilized the free labour pool of India and built a direct connection with the informal workers little involvement of the middleman. This has enabled them to reward the worker, for his hard work and traditional artistic creation, the return in this unorganized sector. The worker is directly involved with the company and can be creative in design. Jaipur Rugs gains the competitive advantage by procuring the material through standard specifications. Moreover, as per the production requirements plans, Jaipur Rugs links the related industries for the manufacturing of the goods. Utilizing the factor inputs of the Indian informal economy, Jaipur Rugs sells its product through its aggressive marketing techniques to the different developed countries of the world.

Salutatory coordination and efficiency is the unique factor in the ecosystem of Jaipur Rugs because of its interlinkages and isomorphism, resulting from adoption of the informal products by formal economy firms. Jaipur Rugs maintains efficient synergy in the process from the raw material procurement till the dispatch of finished goods. Jaipur Rugs is able to create a demand for its products because of its adherence to build deep rooted relationships with informal inputs and formal demand. Jaipur Rugs has decentralized its manufacturing as well as logistical support. The firm adheres to the unrelenting faith of fundamental social values such as equality of wages as well as equal opportunities. Jaipur Rugs is able to maintain the quality in its products as it demonstrates strong social values in the informal economy and is able to build enduring healthy relationships with both the workers and suppliers it interacts with.

Jaipur Rugs combines several interlinked processes such as: infrastructure for information technology, human interfaces, employee training and loyalty rewards. The Enterprise Resource Planning system of Jaipur Rugs allows for institutionalizing quality control, continuity of work and achieving enormous scale in an informal setup, thus resulting in an optimized and geographically diverse supply chain.

The production process of Jaipur Rugs is vertically integrated from the procurement of raw materials till the finished product is shipped. At each stage, after quality inspections, each product of Jaipur Rugs undergoes multiple tasks. Adherence to exceptional quality standards by experienced and skilled investigators has enabled the firm to attain the ISO 9001: 2008 and SA 8000 Certification. Therefore, Jaipur Rugs exceeds their customer's expectations within the specified time frame due to the above stated international standards which duly prescribe set quality management systems and quality controls.

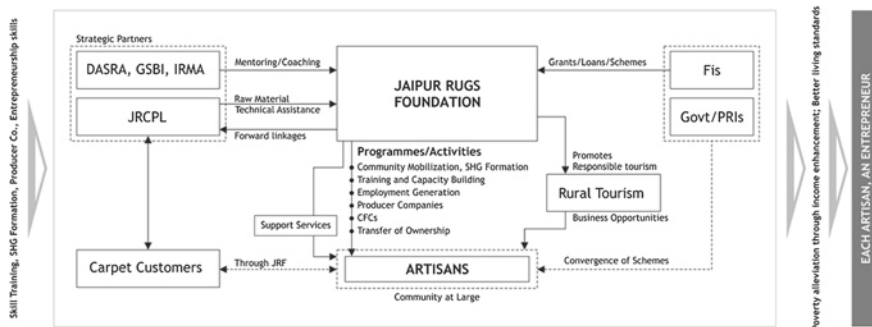
14.4.3 Challenge for Jaipur Rugs

In its dream run towards being the most successful carpet exporter of India, Jaipur Rugs started facing a new challenge a few years back—the challenge of reducing the number of weavers in India owing to different issues faced by the informal industry. There came a period where the formal world demand could not be met by the informal world supply and the weavers had to be pushed hard to increase the production in order to meet the demand. This challenge was threatening and had to be addressed immediately as this forced the clients to look for alternate markets to buy carpets.

N.K. Chaudhary, a veteran for the carpet industry, understood that all these were symptoms of a larger problem of informal economy and he has set up the Jaipur Rugs Foundation to address the problem and aimed to provide a permanent solution which would help not only the company and unorganized industry but also the informal economy workers’ community in the long run.

Through continuous research and interactions, it was discovered that the majority of the informal world artisans face one of the most devastating consequences of unrelenting poverty. Many informal communities do not know of or avail their rights to education, health and sanitation. Informal world weavers are paid below the industry standards by the middlemen and are not exposed directly to the markets their work is created for. The standard of living of the artisans of the unorganized sector is generally low and has not improved even after conventional development interventions. The artisans of the informal economy are unaware of their rights and various beneficiary schemes by the Indian government that can aid them with financial assistance.

Jaipur Rugs Foundation Working Model



Source: www.jaipurrugs.org

14.4.4 Looking Ahead

Apart from its successes, there were a few challenges which the company faced at this point of time in 2014. Attracting the right talent with the right culture fit was a paramount challenge to Jaipur Rugs. “We don’t need just people with high

credentials, we need people who are enthusiastic and empathetic and are willing to go the extra mile”, said N.K. Chaudhary in an interview with authors in 2013. The HR head also believes that employee recruitment and selection will be a huge challenge when the company would grow in the next few years. The company is also taking steps to keep its artisans involved in the art of making handmade carpets. With growing opportunities being available, many of the artisans are moving onto new activities—hence the future of handmade carpets is under eminent threat of getting lost. Also, the company has future plans of entering Indian markets yet the current orders have already been booked for the next 2 years. In order to attain their vision of entering new markets, Jaipur Rugs has to look at ways to enhance their production process and schedules to meet the new orders. Yet Mr. Chaudhary believed that this was just the beginning of a new journey for Jaipur Rugs and he was confident that Jaipur Rugs would continue to produce quality carpets as well as improvise the lives of the rural artisans in the days to come.

14.5 Conclusion

Informal economies have not only proliferated over the years, especially in past three decades in developing nations but also have also been established as a dominant form of exchange for firms across the globe. We posit that firms in the formal economy gain competitive advantage over competitors through linkages with informal factor inputs and related industries as per Fig. 14.4. The informal economy provides a means for firms in the formal economy to capture the BOP market encouraging entrepreneurship for early-stage enterprises. We have argued that national economic factors, government policies and context specific factors also serve an important role in the growth of the informal economy. From socio-economic perspectives, the informal economy is an important avenue from which to tackle unemployment and poverty as the formal economy in developing nations cannot absorb the abundant labour in the market. This informal setup has provided a source of income to the poor and raised the disposable income of the population. The informal economy significantly contributes to the GDP of developing nations and due to the inter-linkages with the formal economy has become procyclic with the formal economy. The informal economy has also been observed to act as a cushion to absorb global economic shocks and thus reduce uncertainty.

Future work in the informal economy can explore its impact on BOP concepts such as scalability and local embeddedness. Apart from the positive effect of creativeness and opportunity richness of the informal economy, the negative impact of coerciveness and poverty can be contrasted in further studies.

Another area of future work might be to establish the scope of organizations that constitute the informal economy. The informal–formal distinction could be further subdivided by including the degree of formality and informality along a continuum. This would further clarify the formal and informal economy linkages in different contexts helping to provide policy makers with a more robust picture

of the situation. Empirical testing for the degree of informality in both developed and developing nation contexts would also provide a better understanding of this widespread phenomenon across the world.

Finally, the symbiotic relationship of the informal and formal economy can be another avenue of research to explore the synergies and relationships which exist. How do the joint purposes and goals meet for the informal and formal economy? Does the informal economy precede the formal economy? Do the two economies complement or are they substitutes of each other? These questions along with the moral, values and ethics of linking the informal economy with the formal economy could also help to enrich future research perspectives on the informal economy.

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