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ROUND TABLE

Organising the unorganised: Role of platform intermediaries in the Indian real estate market

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Abstract A large component of the Indian economy is still in the unorganised (or informal) sector. The emergence of new intermediaries leveraging the Internet has contributed significantly to organising the hitherto unorganised sector. We discuss the case of the Indian real estate industry and elucidate how Internet-based intermediaries have mitigated the problems associated with the unorganised nature of the industry. The three primary problems associated with the unorganised nature of the industry are adverse selection, moral hazard, and weak contract enforcement. Leaders representing four leading real estate platforms discuss how organising the real estate business as a platform business model helps mitigate these risks.

Academic perspective note

Introduction

A unique feature of the Indian economy has been the prevalence of the unincorporated/non-corporate sector. The unincorporated, according to the legal definition, includes those organisations that are not registered (or incorporated) as independent legal entities, and may include all kinds of firms including agricultural households, self-employed persons, and partnership/proprietorship firms. However, the unorganised sector or the informal sector may be a subset of the non-corporate sector (Vaidyanathan, 2004), and includes non-agricultural production units that "form part of the household sector as household enterprises, or equivalently, unincorporated enterprises owned by households" (NSC, 2012, 9–10). A critical characteristic of the unorganised sector[1] is that the enterprises are not separate legal entities independent of the households/owners; the capital assets used for the business may also be used for other purposes by the owners, and the working capital flows including income and expenditure of the enterprise are inseparable from the cash in hand of the enterprise. In such conditions, it has been a significant challenge

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[1] In this note, we use the terms informal sector and unorganised sector interchangeably.

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to separate out the financial and operational performance of these firms.

The World Bank estimated that the informal economy contributed close to 40% of the Gross National Product (GNP) of low-income countries and 17% for high-income countries (Schneider, 2002). The significance of these unorganised enterprises in the context of the Indian economy is highly accentuated. A 2008 National Commission for Enterprises in the Unorganised Sector (NCEUS) task force sub-committee on evaluating the contribution of the unorganised sector to the GDP estimated that the unorganised sector contribution was over 50% of the Net Domestic Product (NDP) and 91.2% of employment, including over 40% of non-agricultural employment (Mazumdar, 2008; NCEUS, 2008). The National Statistical Commission (NSC) affirmed that the high growth rates of the Indian economy had been accompanied by increasing informalisation (NSC, 2012).

In this note and the accompanying panel discussion, we explore how emerging platform-based business models mitigate the problems of the informal (unorganised) sector and contribute to formalising (organising) the sector. We take the case of the Indian real-estate intermediation market to support our case. The NCEUS (2008) report defined real-estate as a sub-sector that included buying, selling, renting and operating of self-owned or leased real-estate such as apartment buildings and dwellings, non-residential buildings, developing and subdividing real estate into plots, as well as activities with own or leased property on a fee or a contract basis, and estimated the contribution of the unorganised real-estate services (excluding income from ownership) as Rs. 1277 Crores (Rs. 12.27 billion), or about 1% of the GDP (NCEUS, 2008, 24–26).

Issues with the unorganised sector

Farrell (2004) identifies three factors that contribute to the prevalence and growth of the unorganised sector—slack enforcement of regulations, bureaucratic costs of formal operations, and social norms that encourage non-adherence to laws as a tool used by small enterprises to compete with large modern players. Farrel highlights the consequences of operating informally as (i) low productivity levels due to lack of access to capital for investments from the formal financial system; and (ii) the lack of comparable choice for the consumers, with the unorganised sector providing them with cheap, unregulated products and services (Farrell, 2004). Attempts at formalising the informal sector in the past have not had consistent results (Garcia-Bolivar, 2006). Gibson and Kelley (1994) characterised the informal sector as a reserve army for employing those who are not employed/employable by the formal sector. Given the low productivity levels, and the high information asymmetry between the contracting parties, the unorganised sector is likely to be plagued with a variety of contractual issues. Economists studying the unorganised sector highlight three problems with informality—adverse selection, moral hazard, and imperfect contract enforcement (for instance, see Batini, Kim, Levine, & Lotti, 2009; Bell, 1990).

In India, the real estate market had been dominated by unorganised intermediaries, known as brokers. These intermediaries typically operate in local neighbourhoods, use primitive contracting terms (mostly oral contracts), and are one-person operations. A typical customer looking to buy/lease/rent a property would approach these brokers, who would have an inventory of properties in the area that were available. Some of these inventories could be non-exclusively available with multiple brokers as well. Once a broker understands the customer's requirements, he would typically show a short-list of properties to help make a choice, till such time the customer finds what she was looking for. It is only after that, that the customer (buyer) would be put in touch with the property owner (seller) by the broker, and the broker is paid a commission for the discovery/intermediation. Most often, the broker is thickly involved in the price negotiations, as his commission would be a proportion of the transaction value.

It is in this discovery phase that the problem of adverse selection manifests itself. The seller (and in some cases, the broker as well) may be aware of the problems with the property, which the buyer cannot discover; and hence cannot separate "good" properties from the "bad". The most common issues include unpaid municipal taxes, lacunae in statutory approvals, quality of construction, or even risks of flooding in monsoon rains. The moral hazard problem manifests in the contracting when the broker has an interest in raising the value of the transaction, as his commission is a proportion of the transaction value, rather than acting in the interest of both the buyer and the seller. And finally, when the buyer discovers the real information (that was not present with her when she got into the contract), she has no recourse to make the seller/broker liable, due to poor contract enforcement.

Intermediation platform business models

There are three kinds of intermediation platforms—matching platforms, transaction platforms, and info-mediation platforms. *Matching platforms* are those where customers/users look for one-to-one matches. Typically these are matrimonial websites such as Bharatmatrimony.com. Generally, in order to create an account, users are asked to fill out a questionnaire (Srinivasan & Rao, 2015a). Based on the information given by an individual, the platform provides them with a list of users on the other side with similar interests and sensibilities. The kind of transactions that happen here are one–one and the intent of both sides is for it to be the only transaction they make on this platform, since they hope to find someone and remain married to them for life. Once the transaction is done, the two parties would not engage with the platform any more. A matching platform does not want recurring customers as that would mean that they have not been matched properly the first time. If a customer is unable to find a match and remains on the platform for too long, he/she is considered a bad quality customer by Bharatmatrimony.com, as he/she would be responsible for diluting the quality of the entire platform. It is extremely important for a matching platform to conduct thorough verification on the information provided by the users.

A *transaction platform* facilitates transactions between two sides of the platform, e.g., the buyers and the sellers. It connects the provider of a product/service to the consumer of said product/service. A good example of a transaction platform is Practo.com, where patients can find doctors relevant to all kinds of health disorders and book appointments

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