This month’s theme: SMALL AND MEDIUM-SIZED ENTERPRISE GROWTH

New evidence shows way forward for SME growth and job creation

Small and medium-sized enterprises (SMEs) play an outsized role in developing economies, where they account for about half of employment and the majority of jobs created. Often, they are not as productive as large firms, so measures that reduce this productivity gap and boost SME growth could translate directly into higher earnings for low-income households. In this Policy Research Talk, Miriam Bruhn, Senior Economist, compared approaches to promote SMEs in three areas where research is providing new insight—regulatory reform, access to finance, and business practices—using evidence from Mexico, Georgia, Bosnia and elsewhere on effective policies for small and medium-sized enterprise (SME) growth.1

SMEs employ around 50 percent of workers in developing countries

While small firms (<20 employees) have the smallest share of aggregate employment, the small and medium enterprise sector’s (<100 employees) contribution is comparable to that of large firms. Small firms have the largest shares of job creation, and highest sales and employment growth, even after controlling for firm age. Large firms, however, have higher productivity growth. Conditional on size, young firms are the fastest growing and large mature firms have the largest employment shares but small young firms have higher job creation rates.2

REGULATION REFORM

Introduction of preferential tax regime in Georgia is a partial success

The introduction of a preferential tax regime for Georgian micro businesses in 2010 increased the number of newly registered firms by 27–41 percent below the eligibility threshold during the first year of the reform, but not in subsequent years. A new tax regime for small businesses did not increase formal firm creation in any year. However, the differentiated tax treatment of micro- and small businesses revealed reduced tax compliance among small taxpayers for multiple years after the reform and among micro-business taxpayers only during the first year of the reform.3

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1 Event | Story | Video | Presentation.


Registration reform in Mexico attracted informal business owners most like formal business owners

One view on why informal business do not register is that regulations are too complex. Another view claims that business owners are making a living while searching for a job. Both views are correct if you consider there may be two types of informal business owners. When separating informal business owners into those with characteristics similar to wage workers and to formal business owners, the impact of a business registration reform in Mexico becomes clearer. Informal business owners from the wage worker species are less likely to register due to the reform, but more likely to become wage workers since the reform created jobs. Informal business owners more like formal business owners are more likely to register, but only in municipalities with high pre-reform constraints to formal entrepreneurship. These results explain why an earlier study finds no effect of the reform for all informal business owners taken together.  

ACCESS TO FINANCE

Local branches of Banco Azteca improved access to finance for low-income individuals

Banco Azteca in Mexico opened over 800 branches almost overnight in 2002, targeting savings and loan services mainly to low-income individuals and informal businesses. The results suggest that Banco Azteca helped informal business owners keep their business running instead of becoming wage earners or becoming unemployed. The fraction of informal business owners increased by 7.6 percent, and overall employment increased by about 1.4 percent as a result of Azteca’s opening. These increases in informal business ownership and employment led in turn to an increase in income of about 7 percent, on average. Finally, real GDP per capita growth rates increased following the opening of Banco Azteca and all 800 branches, which further strengthens the case for the positive impact of access to financial services on economic activity.  

Psychometric screening tool can improve loan repayment behavior

A study of small business owners in Peru compared entrepreneurs offered a loan based on the traditional credit-scoring method versus a psychometric test, designed by the Entrepreneurial Finance Lab (EFL). The psychometric test can lower the risk of the loan portfolio when used as a secondary screening mechanism for banked entrepreneurs—i.e., those with a credit history. The EFL tool can also allow lenders to offer credit to some unbanked entrepreneurs—i.e., those without a credit history—who were rejected based on their traditional credit scores, without increasing the risk of the portfolio.  

BUSINESS PRACTICES

**Consulting services can improve SME performance**

A randomized control trial with 432 small and medium enterprises in Mexico shows positive impact of a one-year management consulting services program on total factor productivity (TFP) and return-on-assets. Owners also showed heightened “entrepreneurial spirit” (an index that measures entrepreneurial confidence and goal setting). Mexican social security data shows a persistent sizeable increase (about 50%) in the number of employees and total wage bill even five years after the program. The specific managerial practices that improved as a result of the consulting were marketing, financial accounting, and long-term business planning.7

**Business literacy program not enough to improve firm performance in Bosnia**

Identifying the determinants of entrepreneurship is an important research and policy goal, especially in emerging market economies where lack of capital and supporting infrastructure often impose stringent constraints on business growth. The impact of a comprehensive business and financial literacy program on firm outcomes of young entrepreneurs in an emerging post-conflict economy, Bosnia and Herzegovina did not influence business survival, but significantly improved business practices, investments and loan terms for surviving businesses. Female-run businesses further exhibited some improvements in business performance and sales.8

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