Firm Dynamics in Developing Countries.
A LAC Perspective

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*The views and interpretations in this presentation are those of the author and should not be attributed to the Inter-American Development Bank.
Paper overview

• Lack of contract enforcement prevents owners to obtain manager effort.
  – This reduces incentives to innovate.
  – Lack of innovation translates into insufficient productivity, which is at the source of firms growth.
  – Small firms are not wiped out from the market due to insufficient competition.

• Key mechanism: (Internal) contractual failure prevents firm growth and selection
Assessment

• Very nice paper!

• Offers an interesting and plausible mechanism to explain insufficient creative destruction in developing countries.

• Calibration suggests that contract failures can go a long way in explaining differential firm dynamics between India and the US.
This Discussion. Outline

1. How relevant the problem in LAC?

2. How relevant this mechanism for LAC?
   - Rule of law and contractual enforcement.
   - Firms’ growth dynamics and market selection.
   - Labor market turnover.

3. How relevant are productivity differentials for firm selection?
   - The missing role of demand.

4. Concluding thoughts.
1. HOW RELEVANT IS THIS PROBLEM FOR LAC
Fact 1. LAC firms are very small

Share of firms with no employees in selected countries, 2011

Distribution of firm size in selected countries, 2011

Fact 2. Too many self-employed, and too few employees

Nonagriculture, wage and salaried

Nonagriculture, own account

Fact 3 (i). Little Innovation

R&D Investments

Fact 3 (ii). Little Innovation

Fact 3 (iii). Little Innovation

Percentage of Firms that Develop or Introduce a New Product

2. HOW RELEVANT IS THE MECHANISM IN LAC?

RULE OF LAW AND CONTRACTUAL ENFORCEMENT
The rule of law in LAC

Rule of Law captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence. Estimate gives the country's score on the aggregate indicator, in units of a standard normal distribution, i.e. ranging from approximately -2.5 to 2.5.

Source: WDI. The World Bank. Worldwide Governance Indicators.
Contractual uncertainty in LAC

Enforcing Contracts in 2013:

2. HOW RELEVANT IS THE MECHANISM IN LAC?

FIRMS’ GROWTH AND MARKET SELECTION
Firm Dynamics in LAC. Growth

Average size of firm relative to its initial size

Average initial size of firm

Selection in LAC. Entry

Selection in LAC. Exit (in Colombia)

Source: Eslava and Haltiwanger (2014).
2. HOW RELEVANT IS THE MECHANISM IN LAC?

LABOR MARKET TURNOVER
Fact 1. High Job Creation and Destruction

Job Creation and Job Destruction Rates

-30 -20 -10 0 10 20 30

Percentage of employment

[Salidas] [Entradas] [Destructión bruta de empleo] [Creación bruta de empleo]

Source: Adapted from Empleos Para Crecer (2015). IAD.

Fact 2. High worker flows, but exits mostly due to layoffs and quits (not firm closures)

Fact 3. Low Duration of Jobs (i)

Wage employees’ average spell in their firms by age of the worker. LAC vs. OECD

Fact 3. Low Duration of Formal Jobs (ii)

Tenure in Brazil by firms’ size

Tenure in Brazil. 5 year averages

Source: Dix-Carneiro, Messina and Ulyssea.(2015). The Dynamics of Formal Employment: Evidence from Brazil. IDB. Mimeo
Fact 4. High flows in and out of unemployment

Probability of moving from employment to unemployment

Probability of moving from unemployment to employment

3. HOW RELEVANT ARE PRODUCTIVITY DIFFERENTIALS FOR FIRM SELECTION?
The forces behind firm selection

- In most of the literature, firm selection works through “productivity” differences.
- Productivity here is a proxy for the value of a firm, its competitive edge.
- Firms may grow and gain market share because of technological advances, but also because of demand shifts.
- Up to recently, literature was silent about the relative importance of these two forces.
The forces behind firm selection: demand at the forefront

• Recent papers suggest a fundamental role of demand factors for:

• This may be important for the mechanisms outlined in the paper: internal vs. external contractual imperfections.

• Contractual imperfections may hinder specialization across firms
4. CONCLUDING THOUGHTS
Concluding thoughts (i)

• Contractual imperfections may limit incentives to grow or hinder specialization across firms

• Low productivity-low innovation-low firm growth equilibrium

• Mechanism is sensible, and broad-brush data does not reject its potential importance in LAC

• Other forces may be important (Lederman et al. 2013):
  – Quality and type of human capital
  – Lack of competition in service sectors
Concluding thoughts (ii)

• However, LAC labor markets present tremendous turnover (prima facie, this seems inconsistent with a sclerotic labor market)
  – Probably a lot of these worker flows are inefficient (workers not moving from low to high value firms)
  – Damaging effects – Low investments in HK

• We need more research and more and better data, in particular on the firms’ side
THANK YOU!