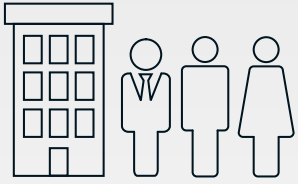
EVIDENCE-INSIGHTS-POLICY



It is very difficult to predict which firms will have high-growth, but starting size persists.

Most firms in developing countries have no paid workers, and hardly any reach the size of 10 workers or more. For example, Hsieh and Olken (2014, p.93) report that in India and Indonesia "the fraction of firms with less than 10 workers is almost visually indistinguishable from 100 percent", and in Nigeria, survey data indicate that 99.6 percent of firms have fewer than 10 workers. Are there constrained entrepreneurs in developing countries with the ability to grow a firm beyond this 10-worker threshold? If so, this raises the questions of whether such individuals can be identified in advance, and of whether public policy can help them overcome these constraints to firm growth?

FINDINGS

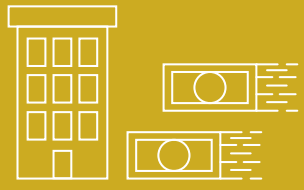
1 Predicting high-growth entrepreneurship is difficult.

McKenzie and Sansone (2017) use data from participants in a business plan competition in Nigeria, and test the relative effectiveness of judges, models from economists, and machine learning models in predicting the growth of firms over the subsequent three years. They find all three methods struggle to predict which firms will grow fastest. The business plan competition appears to act as a good screen for identifying firms with some potential for growth, but conditional on getting to the stage of submitting a business plan, firms with plans scored poorly by judges grow just as well as those with high-scoring plans.

2 What Determines Entrepreneurial Outcomes in Emerging Markets? The Role of Initial Conditions.

Ayyagari et al. (2017) use Indian census data to track the trajectory of formal firms over their early years. They find that the rate of firm entry and the size at which firms enter are sensitive to institutional differences across states in India such as the level of credit provided and the quality of business regulations. When institutions are poorly developed, fewer firms enter, and those that do tend to be larger. However, after entry, small and large firms grow at the same rate across different industries and different institutions, so that initial size persists. A final point to note here is that firm owners themselves also find it very hard to know how much they would grow if given assistance: Can business owners form accurate counterfactuals?

3 Can Business Owners Form Accurate Counterfactuals? Probably not.



McKenzie (2017) shows that even after having received substantial financing (of USD 50,000), Nigerian business owners of a business plan competition experiment are not able to accurately assess how much it has helped them; nor can those who did not receive financing accurately predict how much they would have grown had they received this finance. The control group dramatically overestimates how much winning would help them grow the size of their firm. The treatment group overestimates how much winning helps their chance of their business surviving, and overestimates how much winning helps them grow their firms. In addition, these counterfactual expectations appear unable to generate accurate relative rankings of which groups of participants benefit most from treatment.

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