Small and Medium Enterprise Program

Five Years in Review: 2011-2016

ipa
INNOVATIONS FOR POVERTY ACTION

Letter from the Leadership Team

Dear Friends,

Over the past five years, the SME Program at IPA has grown from an ambitious idea to a thriving, prolific, and influential initiative. It is with great enthusiasm that we share this report highlighting some of our accomplishments—which would not have been possible without the collaboration and support of so many of you.

Our work began at the end of 2010, when we sat down with leading practitioners and academics working on entrepreneurship and SME growth in developing countries, and assessed the most pressing knowledge gaps in the sector. At the time, only a handful of impact evaluations had been conducted on SME support programs in developing countries, and there was an urgent need for evidence to help guide decision-making.

Following that initial event, IPA launched the SME Program (formerly known as the "SME Initiative"), with the goal of addressing the existing knowledge gaps and generating evidence on the most effective solutions to the constraints SMEs face in developing countries. Since then, our network of researchers and practitioners has continuously expanded, and has regularly come together at our conferences, working group meetings, roundtables, and workshops. New partnerships have emerged from these gatherings and from the SME Program's support in identifying and promoting new research opportunities.

Over the past five years, IPA's research portfolio in the SME sector has grown to include more than 85 studies in 32 countries, leading to valuable lessons learned that can inform the design of more effective policies and programs. Our hope is to see this research used to help SMEs succeed and generate sustainable livelihoods.

In this report, we present some highlights from the SME research portfolio, lessons learned in each of our program's focus areas, details about the events we have hosted, and information about what we do to support, create, and promote evidence in the SME sector.

The relationships we have built and the evidence we have helped generate over the past five years have already started to make a difference in the SME sector. These achievements would not have been possible without the commitment, passion, expertise, generosity, and hard work of our research affiliates, partners, donors, and IPA staff across the world. To all of them, we are deeply grateful.

Many important questions remain unanswered and there is still much to be done to bridge the gap between the worlds of research and practice. We are eagerly embarking on the next phase of bringing a culture of evidence-based decision-making to the SME sector.

We look forward to continuing this work together with you.

Sincerely,

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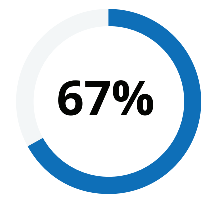
SME Growth and Development

Small and medium enterprises (SMEs) are the backbone of most economies and have a key role in the path towards socially inclusive economic growth.

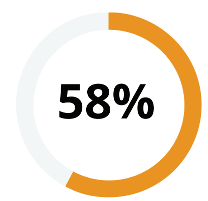
They are crucial to the development of strong, dynamic economies, and a significant source of job creation and social mobility. SMEs generate opportunities across sectors and geographic areas, and employ broad and diverse segments of the labor force. Moreover, they have a huge multiplier effect: as they grow, they benefit employees, suppliers, and customers, as well as local governments and the overall community. However, **SMEs in developing countries face important barriers that limit their ability to grow and create jobs, such as limited access to finance, poor managerial skills, and lack of access to markets**.

In an effort to unlock the SME sector's potential, governments, nonprofits, and development institutions spend billions of dollars every year on programs aimed at reducing the barriers to growth for SMEs. However, rigorous research on what works to promote SME development is very limited, leaving decision-makers without clear guidance on which programs and policies to support. There is a pressing need to identify effective solutions in order to steer investments to the areas where they will have the greatest impact.

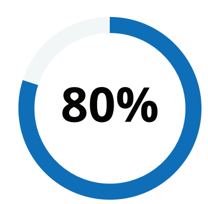
Contributions of SMEs to Developing Economies



estimated contribution of formal and informal SMEs to GDP[1]



new job creation in low-income countries due to growth in small businesses[2]



estimated proportion of workers employed in formal and informal Micro, Small, and Medium Enterprises (MSMEs)[3]

1 Teima, Ghada, Alexander Berthaud, Miriam Bruhn, Olympia De Castro, Mukta Joshi, Melina Mirmulstein, and Andrea Onate. "Scaling-up SME access to financial services in the developing world." World Bank Group, 2010. Accessed August 15, 2016. http://documents.worldbank.org/curated/en/669161468140035907/Scaling-up-SME-access-to-financial-services-in-the-developing-world

2 Ayyagari, Meghana, Asli Demirguc-Kunt, and Vojislav Maksimovic. "Who creates jobs in developing countries?." *Small Business Economics* 43, no. 1 (2014).

What We Do

The SME Program at Innovations for Poverty Action (IPA) brings together a global network of leading researchers and decision-makers to identify, test, and scale-up effective solutions to the constraints that affect SME growth and entrepreneurship in developing countries.

Identify key knowledge gaps

- Review evidence in the SME and entrepreneurship sector
- Identify policy-relevant research opportunities

Support the development of new evidence

- Develop and support a network of researchers with an interest in SMEs and entrepreneurship in developing countries
- Identify innovative programs and products to be tested
- Match new project opportunities with affiliated researchers
- Support the development of new research partnerships

Fund program evaluations

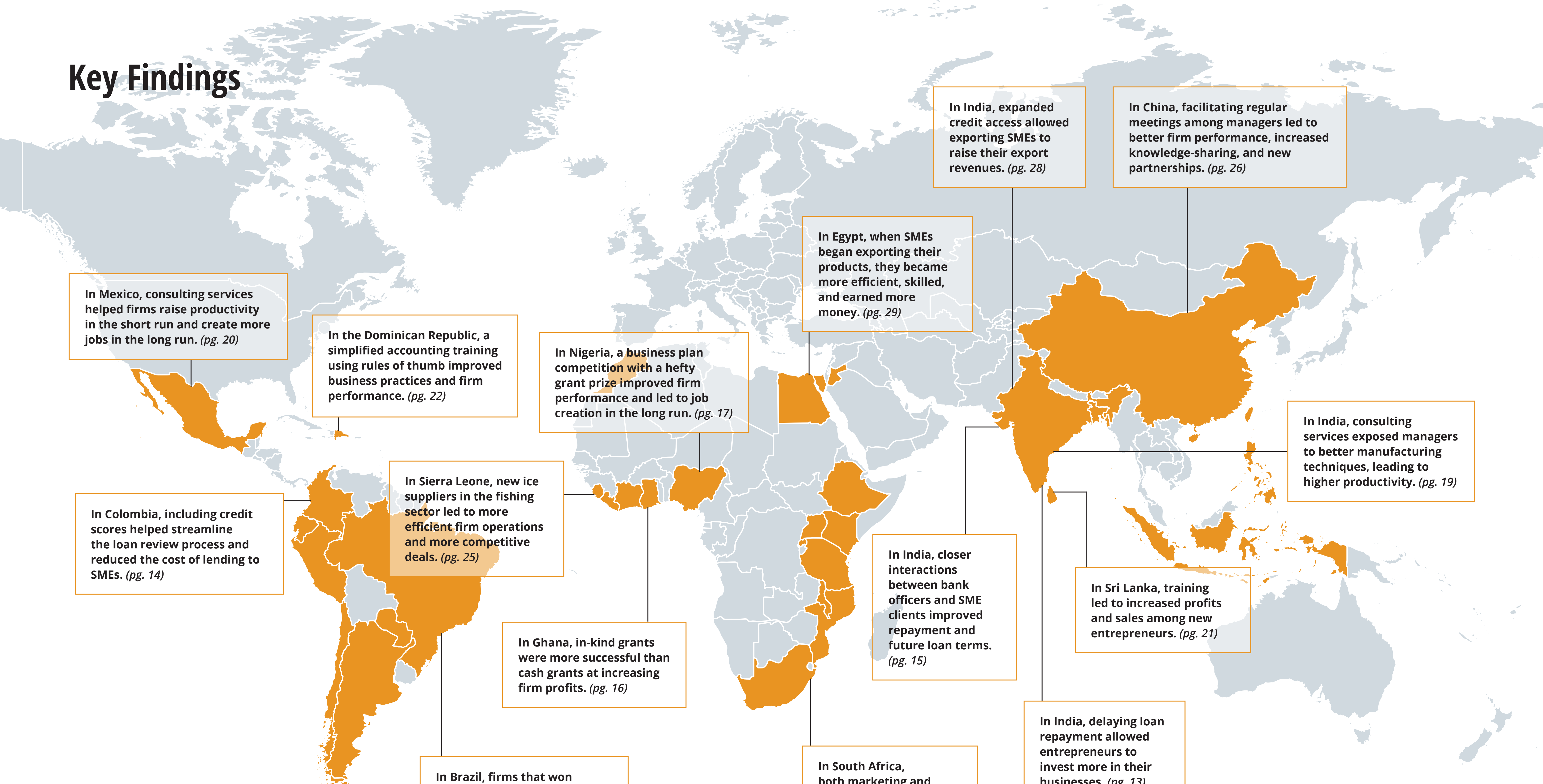
- Run the Competitive Research Fund for SME Growth and Entrepreneurship
- Support other fundraising efforts for SME projects

Disseminate results and influence policy

- Host networking and dissemination events
- Present research results at external events
- Produce policy briefs and other dissemination materials

3 Formal MSMEs employ about 33 percent of the labor force, while informal MSMEs employ about 47 percent. Figures from Teima et al. and Kushnir et al. "Micro, Small, and Medium Enterprises Around the World: How Many Are There, and What Affects the Count?." World Bank/International Finance Corporation, 2010. Accessed April 12, 2017. https://www.smefinanceforum.org/post/micro-small-and-medium-enterprises-around-the-world-how-many-are-there-and-what-affects-the

Key Findings



In Mexico, consulting services helped firms raise productivity in the short run and create more jobs in the long run. *(pg. 20)*

In the Dominican Republic, a simplified accounting training using rules of thumb improved business practices and firm performance. *(pg. 22)*

In Nigeria, a business plan competition with a hefty grant prize improved firm performance and led to job creation in the long run. *(pg. 17)*

In Egypt, when SMEs began exporting their products, they became more efficient, skilled, and earned more money. *(pg. 29)*

In India, expanded credit access allowed exporting SMEs to raise their export revenues. *(pg. 28)*

In China, facilitating regular meetings among managers led to better firm performance, increased knowledge-sharing, and new partnerships. *(pg. 26)*

In Colombia, including credit scores helped streamline the loan review process and reduced the cost of lending to SMEs. *(pg. 14)*

In Sierra Leone, new ice suppliers in the fishing sector led to more efficient firm operations and more competitive deals. *(pg. 25)*

In India, consulting services exposed managers to better manufacturing techniques, leading to higher productivity. *(pg. 19)*

In Ghana, in-kind grants were more successful than cash grants at increasing firm profits. *(pg. 16)*

In India, closer interactions between bank officers and SME clients improved repayment and future loan terms. *(pg. 15)*

In Sri Lanka, training led to increased profits and sales among new entrepreneurs. *(pg. 21)*

In Brazil, firms that won government contract bids experienced more growth and hired more workers. *(pg. 27)*

In South Africa, both marketing and accounting training programs improved firm performance, but trainees used different pathways to increase profits. *(pg. 23)*

In India, delaying loan repayment allowed entrepreneurs to invest more in their businesses. *(pg. 13)*

86 *SME research projects*

32 *countries*

Research Areas

SMEs in developing countries face constraints that are disproportionately large compared to those faced by larger firms and by SMEs in developed countries. Limited access to finance, low levels of human capital, and difficulty accessing markets stand out as some of the most challenging barriers to business growth. The SME Program's research agenda focuses on these constraints and identifies effective interventions that can help businesses overcome them.

Finance

The global credit gap for SMEs is estimated at over US$2 trillion. Insufficient funding severely limits a firm's capacity to grow, create jobs and add value. Financial institutions often restrict lending to SMEs due to their opaque credit histories, as well as to the higher risk and transaction costs associated with these loans. Studies have shown high returns on capital provided to SMEs, but fostering market-based solutions to the credit constraints SMEs face remains a challenge.

How can financial institutions design better screening mechanisms to identify good SME borrowers? Are there effective and innovative strategies to reduce the default rates of SME clients? Can alternative forms of collateral become an important tool to improve access to finance for SMEs?

Human Capital

Firm management is critical for productivity and growth, but, compared to their peers in developed markets, **SMEs in the developing world score poorly on management practices**. Managers at these firms are seldom chosen competitively, they often have less education than their peers, and firm size prevents them from specializing in specific areas.

What are the most effective ways to build and develop managerial capital in SMEs? What types of knowledge and skills are missing, and what kind of content delivery mechanism maximizes adoption? What types of entrepreneurs benefit the most from capacity development, and how can programs identify and reach them?

Markets

Entering domestic and international markets is a formidable challenge for SMEs. They struggle to access information about market opportunities, and potential clients do not know how to reach the SMEs that are best-suited to meet their needs. Moreover, many market opportunities are out of reach for SMEs due to their legal, financial, and quality standards.

How can entrepreneurs access the markets that are critical for their growth? When access opens up, does exporting actually help SMEs grow? How can SMEs win larger contracts and negotiate better terms?

Lessons Learned

The SME Program at IPA has provided various forms of assistance to more than 80 studies in the SME sector. Many questions remain, however, and we continue to partner with leading researchers and practitioners around the world to build the body of evidence on what facilitates SME growth. The studies showcased in this report, together with others in our portfolio, suggest the following takeaways:

Finance

» Addressing the market failures that constrain access to finance for SMEs can help improve their profits and growth prospects.

» Focusing on innovations in financial institutions can help SMEs access credit: better screening mechanisms, closer relationships between lenders and borrowers, and more flexible credit products have all improved access to credit for SMEs.

» Grants can have a large impact on entrepreneurship and business growth, but selection of high-potential entrepreneurs can be challenging.

» The form in which SMEs receive capital can affect the impact of grants on their business growth. Especially for women entrepreneurs, in-kind grants appear to work better than cash.

Human Capital

» High-quality, intensive consulting services can improve managerial capacity and firm performance.

» Training programs, however, appear not to work as well: some programs are effective, but most evaluations show limited to no impact of training on business outcomes. These mixed results indicate a need to better understand what kinds of training work and for whom. Differences in the quality, content, and intensity of training, as well as the characteristics of the recipient enterprises, can all affect the impact of business training.

» The skills that businesses lack and the problems they face are diverse. Interventions must be customized, not one-size-fits-all.

Markets

» Demand-side interventions can have positive and persistent effects on business performance.

» Government procurement can increase SME growth and employment, even beyond the contract period.

» Facilitating access to international markets can lead to lasting gains in product quality and profits.

» Increased access to finance can help SMEs take advantage of exporting opportunities.

» Appropriate interventions are context-specific. While increased competition can improve business performance, facilitating cooperation can also lead to positive effects, depending on the context.

Featured Studies

The studies on the following pages detail the rigorous, IPA-supported research that has furthered our understanding of how to address the barriers to growth that SMEs face. We invite you to discover more about our research agenda and projects at www.poverty-action.org/sme-studies.

Finance

Over the past few decades, financial institutions, governments, and donors have invested considerable resources in developing new products and programs to provide SMEs with the financing they need to grow. These solutions, which have aimed to address different challenges along the SME lending cycle, have included: innovative ways of screening potential clients to handle the problem of their limited and opaque credit history; non-traditional collateral to compensate for lack of real estate; more flexible financial products; and novel incentive schemes to encourage SME borrowers to repay loans on time. In addition, matching grants programs, business plan competitions, and financial technology innovations have flourished around the world as alternative funding options for SMEs. Our researchers have evaluated the impact that these and other solutions have on access to finance for SMEs. In this section, we present five studies that provide insights on this topic.

Credit

- Flexible Credit and Business Growth in India
- Credit Scoring in Colombia
- Relationship Banking for SMEs in India

Grants

- In-Kind vs. Cash Grants for Microenterprises in Ghana
- Identifying and Spurring High-Growth Entrepreneurship in Nigeria

Flexible Credit and Business Growth in India

Delaying loan repayment allowed entrepreneurs to invest more in their businesses

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Institute for Financial Management and Research

STUDY TYPE

Randomized Evaluation

41%

higher weekly profits for businesses who received loans with grace periods

Most loans issued by microfinance institutions (MFIs) have a weekly repayment schedule beginning shortly after loan disbursement. These immediate repayment obligations may reduce the long-term growth potential of businesses because borrowers have less money to make investments that are capital-intensive in the short-term but can significantly grow their businesses in the long-term. In partnership with Village Financial Services, an MFI operating in Kolkata, India, researchers evaluated the impacts of offering clients a two-month grace period before their first payment.

Clients who received loans with the two-month grace period invested approximately 6 percent more in their businesses, were more than twice as likely to start a new business, and had 41 percent higher weekly profits after nearly three years. However, clients who received the grace period were also more than three times as likely to default on their loans, possibly because it encouraged entrepreneurs to make riskier business decisions. This suggests the traditional MFI contract model may reduce risk of default but also inhibit the growth of microenterprises.

Credit Scoring in Colombia

Including credit scores helped streamline the loan review process and reduced the cost of lending to SMEs

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Bancamía
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STUDY TYPE

Randomized Evaluation

2.3

percentage point reduction in loan applications referred to regional managers

1.7

percentage point reduction in need for additional information

Assessing the creditworthiness of prospective borrowers in developing countries can be cumbersome in the absence of reliable information about their financial history. The high costs associated with assessing the riskiness of loan applicants can outweigh the financial returns of lending, making banks reluctant or unable to make loans to SMEs. In Colombia, IPA partnered with Bancamía, a bank focused on MSME lending, to evaluate whether a computer-generated credit scoring system reduced the cost and improved the quality of the bank's loan review process. The research examined whether the bank's credit committees—who approve, reject, or refer loan applications—made better decisions when the clients' credit scores were available.

The study found that when the credit score was included in the loan review, the committees were able to better allocate loans, extending larger loans to less risky borrowers and smaller loans to riskier borrowers. Additionally, the existence of a credit score—whether committees received it before or after the initial loan review—encouraged members to put more effort into difficult-to-evaluate applications. The committees' improved decision-making process lowered the number of loan applications referred to regional managers by 2.3 percentage points (on a base of 4.8 percent) and the number of requests for an additional round of information by 1.7 percentage points (on a base of 6.3 percent), which in turn reduced the overall cost of the decision-making process.

Committees even changed their behavior when they were simply informed in advance that a credit score would become available after their review. This suggests that prior to the intervention committees may have had the necessary information to make decisions on difficult applications, but lacked the incentives to use this information efficiently.

Relationship Banking for SMEs in India

Closer interactions between bank officers and SME clients improved repayment and future loan terms

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ICICI Bank
Institute for Financial Management Research

STUDY TYPE

Randomized Evaluation

24.5

percentage points less likely to have repeated late payments for clients who received regular calls from the bank

Banks have difficulty assessing the credit risk of small firms because financial information on these potential borrowers is often unverifiable or hard to obtain. This is particularly problematic in developing countries, where credit bureaus rarely exist and other verification methods are onerous. Moreover, loan contracts are often difficult to enforce if the client decides to default, which makes it even riskier to lend to SMEs.

In partnership with ICICI Bank, researchers evaluated whether closer ties between the bank and the client can affect their loyalty and repayment behavior. The study found that building a relationship between bank officers and clients via biweekly calls reduced late loan payments and, in particular, reduced the likelihood of repeated late payments. Borrowers who received calls from relationship managers had on average about 0.1 fewer late payments than those who followed the usual bank protocol of receiving only SMS reminders before payment due dates (on a base of 0.22 late payments). Among borrowers who had at least one late payment, those who received calls from relationship managers were between 21.7 and 24.5 percentage points less likely to have a second late payment than those who only received SMS reminders (on average, 31.2 percent of clients who had ever been late were late more than once). The reduction in late payments outweighed the additional cost of the phone calls and bank staff time, making the program cost effective for the bank. Better repayment among borrowers also helped small business owners secure more favorable terms with the bank for subsequent loans.

In-Kind vs. Cash Grants for Microenterprises in Ghana

Compared to cash grants, in-kind grants were more successful at increasing firm profits

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STUDY TYPE

Randomized Evaluation

15%

average increase in monthly profits from in-kind grants

Financial constraints are among the most important barriers to growth for MSMEs, but it is unclear whether the form in which entrepreneurs receive capital matters for how it is used. Researchers worked with IPA to investigate the impact of in-kind and cash grants on microenterprises, to determine whether grants can help businesses grow and, if so, what types of grants are more effective. They also looked for any differences in impact between men- and women-owned businesses.

The study found large average returns to capital, increasing monthly profits by around 15 percent per month. For women, however, only the in-kind grants grew business profits, and only for businesses with higher profits at the start of the study; cash grants had no effect. The difference in effects between in-kind and cash results is partly indicative of self-control issues, with inventories and equipment (in-kind grant options) serving as a commitment device against impulse purchases.

Female entrepreneurs with low profits at the start of the study, however, did not see any effect from either grant type. Based on further analysis, researchers suggest that women who owned very small businesses found it impossible to grow their firms, and determined that they would be better off using their grants in their households. Women-owned businesses that were larger had more scope to grow, and so these female business owners kept the grants—especially in-kind grants—invested in their firms.

Identifying and Spurring High-Growth Entrepreneurship in Nigeria

A business plan competition with a hefty grant prize improved firm performance and led to job creation in the long run

RESEARCHER

David McKenzie
World Bank

PARTNERS

Ministry of Communication Technology, Nigeria

Ministry of Youth Development, Nigeria

World Bank

STUDY TYPE

Randomized Evaluation

37%

increase in likelihood of firm survival for business plan competition participants

23%

increase in profits for firms receiving the grant

7,000+

new jobs created directly as a result of the competition

Nigeria, like many countries across sub-Saharan Africa, has large numbers of unemployed youth. Also like elsewhere, many businesses remain small—99.6 percent employ fewer than 10 people. Governments struggle to design policies that spur business growth and hiring because it can be impossible to predict in advance which firms will grow if provided with capital. Researchers used a nationwide business plan competition in Nigeria to test if the contest could identify the entrepreneurs with the most potential, and if a large cash grant could spur growth.

Almost 24,000 people submitted business plans in competition for 1,200 prizes of $50,000. In addition to the top proposals selected by an independent panel, researchers also awarded funding to a randomly chosen group of applicants who did not win.

Results showed that the cash investment resulted in large increases in profitability and number of employees, as well as an increased likelihood of being in business three years later. But researchers also found there was no difference between results for the randomly selected winners with higher scores to those with lower scores. A $50,000 cash grant was very successful at spurring entrepreneurship and hiring, but this success was conditional on getting to the semi-finalist stage. These findings suggest that while the money was effective, even outside experts were not effective at predicting which entrepreneurs would be the most successful.

Human Capital

Countless SME development programs aim to help businesses improve the quality of their management. Some of them focus on training managers in various aspects of running a business, including financial planning, accounting, and marketing. Others offer consultants to work with SMEs to identify areas that need improvement and implement any required changes. In some cases, more successful or experienced entrepreneurs mentor SME managers. In this section, we present five studies that provide insights on the mechanisms and limitations of these programs for SME development.

Consulting

» The Impact of Management Consulting on Manufacturing Firm Productivity in India

» The Impact of Consulting Services on Firm Productivity and Employment in Mexico

Training

» Training and Grants for Female Entrepreneurs in Sri Lanka

» Financial Literacy Training in the Dominican Republic

» Accounting or Marketing Training for Entrepreneurs in South Africa

The Impact of Management Consulting on Manufacturing Firm Productivity in India

Consulting services exposed managers to better manufacturing techniques, leading to higher productivity

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STUDY TYPE

Randomized Evaluation

17%

increased plant productivity in the first year after consulting

Manufacturing firms create jobs as they grow, due to their labor-intensive nature. In developing countries, however, poor management practices and low productivity can undercut this growth potential. To study whether consulting services could help firms improve their management and productivity, researchers offered a randomly selected group of textile manufacturing firms in Mumbai the chance to receive five months of management consulting services. The intervention covered management practices for factory operations, inventory control, quality control, human resources, planning, and sales and order management.

Consulting services led to significant improvements in quality, inventory, and output. Treatment plants saw a 9.4 percent increase in output, which was driven by a number of changes. There was a roughly 50 percent reduction in quality defects, a reduction in machine downtime due to more routine maintenance, and greater worker efficiency and attendance due to the introduction of incentive schemes. Within the first year, productivity in treatment plants increased by 17 percent. Based on these changes, researchers estimated a total increase in profits of over US$300,000 per treatment plant per year. Better management also allowed treatment firms to open more production plants in the three years following the start of the experiment than comparison firms.

The Impact of Consulting Services on Firm Productivity and Employment in Mexico

Consulting services helped firms raise productivity in the short run and create more jobs in the long run

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Instituto Poblano para la Productividad Competitiva

STUDY TYPE

Randomized Evaluation

57%

increase in firm employment in the long run for firms that received consulting services

While management practices and skills vary widely across firms, there is little evidence around whether consulting services can help improve management of SMEs, and whether these improvements can affect firm performance. Also, management consulting services are generally costly, and organizations working in private sector development struggle to scale these programs in a cost-effective way. In Mexico, researchers tested the impact of alleviating managerial capital constraints on the performance and growth of small enterprises. They partnered with Instituto Poblano para la Productividad Competitiva, a training institute set up by the Ministry of Labor of the Mexican State of Puebla, to provide subsidized consulting and mentoring services to a randomly selected set of firms. Enterprises were matched with one of nine local consulting firms based on the specialized services they needed. Enterprises met with their consultants for four hours per week over a one-year period. The enterprise owner and consulting firm decided jointly on the focus and scope of the consulting services based on a daylong diagnostic consultation between the enterprise and the consulting firm.

The study found that, after one year, access to management consulting had positive effects on total factor productivity and returns-on-assets. Owners also had a significant increase in "entrepreneurial spirit" (an index that measures entrepreneurial confidence and goal setting). In the long run—up to five years later—researchers found a 57 percent increase in the number of employees (the average number of employees in the comparison group across the five years was slightly above 10), as well as a 72 percent increase in total wage bill (the average daily wage bill in the comparison group across the five years was $172).

Given the large increases in productivity and eventual growth in employees, it is puzzling that firms do not use consulting services more. A cost-effectiveness calculation suggests that the returns to hiring a consultant may be well worth the cost. The findings from this study indicate that management consulting services can have high returns for MSMEs, but funding constraints and uncertainty about the benefits are the most likely explanations for the lack of market transactions in consulting services.

Training and Grants for Female Entrepreneurs in Sri Lanka

Among new entrepreneurs, training led to increased profits and sales

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STUDY TYPE

Randomized Evaluation

43%

increase in profits among market entrants after training

40%

increase in sales among market entrants after training

Entrepreneurship accounts for a large share of female employment in most developing countries, and it is considered an important avenue for women's economic empowerment. However, the majority of female-owned enterprises are small in scale with low earning levels. Moreover, in much of South Asia and the Middle East, the majority of women remain out of the labor force. In Sri Lanka, researchers tested whether business training, by itself or combined with a grant, can raise the income of women entrepreneurs. In partnership with the International Labor Organization, they evaluated the impact of the most common training course in developing countries, the Start and Improve Your Business (SIYB) program, in two distinct groups: women operating subsistence enterprises and women who were out of the labor force but interested in starting a business.

Among current entrepreneurs, the training improved business practices but did not have an impact on performance. The addition of the grant led to short-run increases in revenues and profits, although most of these improvements dissipated two years after the intervention. These results highlight the challenge in getting subsistence-level female-owned microenterprises to grow, and suggest that the binding constraints may lie outside the realm of capital and skills.

Among aspiring entrepreneurs, the training and grant combination helped speed up market entry but had no lasting effect on firm survival. Among those that opened a new business, the training program led to an increase of 43 percent in profits and a 40 percent increase in sales.

Taken together, these results suggest that providing grants and training to women outside the labor force may lead to new businesses, but facilitating growth among existing businesses continues to be a more enduring challenge.

Financial Literacy Training in the Dominican Republic

A simplified accounting training using rules of thumb improved business practices and firm performance

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ideas42

STUDY TYPE

Randomized Evaluation

While there is a strong association between higher financial literacy and better firm performance, there is little evidence on the best ways to teach financial practices to business owners. Researchers partnered with ADOPEM, a microfinance institution, to evaluate two methods of financial literacy training: one based on traditional accounting principles, and another one focused on simple "rules-of-thumb" for financial decision-making.

Among rules-of-thumb trainees, the likelihood that clients separated business and personal cash and accounts, kept accounting records, and calculated revenues formally increased by 6 to 12 percentage points relative to the comparison group (prior to the intervention, between 54 and 81 percent of those surveyed had followed these business practices). Rules-of-thumb trainees also reported higher sales during "bad weeks," suggesting that the simplified training content equipped them to better cope with slower periods. The standard accounting program had no effect on firm performance or business practices.

The rules-of-thumb training produced more pronounced improvements for clients with the lowest human capital, limited ex-ante interest in accounting or financial training, and with baseline business practices in the lowest quartile.

11

percentage point increase in likelihood of rules-of-thumb trainees to keep accounting records

Accounting or Marketing Training for Entrepreneurs in South Africa

Both marketing and accounting training programs improved firm performance, but trainees used different pathways to increase profits

RESEARCHERS

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PARTNER

Business Bridge

STUDY TYPE

Randomized Evaluation

Financial and marketing skills can affect firm performance through different channels. Previous studies, however, have not evaluated how trainings in either skill could lead to different pathways to growth for SMEs. Researchers partnered with Business Bridge to compare the impact of marketing versus finance trainings by randomly assigning firms to receive either one. The business training programs were 10 weeks long, with approximately eight hours per week of face-to-face classroom time.

Twelve months after the program ended, both trained groups saw an increase in profits relative to the businesses that did not receive training. The finance group's profits increased 41 percent, and the marketing group's profits increased by 61 percent—although the differences in these effects were not statistically significant. However, the pathways to these higher profits differed between the two groups. Entrepreneurs who received marketing training achieved gains by increasing sales and hiring more staff (i.e., they focused on growth). Finance trainees, on the other hand, enhanced profits by trimming costs (i.e., they focused on efficiency).

Less seasoned entrepreneurs tended to do better when they received the marketing program, as it encouraged them to look beyond their existing business context and develop new perspectives on products, customers, distributors and suppliers. More established firms, on the other hand, benefited more from finance and accounting skills to reduce costs and increase efficiencies in the business.

41%

increase in profits 12 months after attending finance training

61%

increase in profits 12 months after attending marketing training

Markets

Reaching new markets often provides the opportunities that SMEs need to scale up: being able to purchase quality inputs at good prices, selling their products to a reliable buyer, and acquiring new technologies and knowledge to improve production or move up in the value chain are all significant ways in which SMEs can benefit from market access. A variety of programs and policies exist to help SMEs take advantage of these opportunities. Some programs attempt to solve the problem of coordination by developing linkages across firms. Local content policies require large companies or government departments to buy from local SMEs. Export promotion programs support SMEs to become internationally competitive. In this section, we present five studies that test these and other solutions to understand what works in improving access to markets for SMEs.

Domestic

» Market Entry and Firm Competition in Sierra Leone
» Inter-Firm Relationships and Business Performance in China
» Government Procurement with Local SMEs in Brazil

International

» Increasing Credit Access for SME Exporters in India
» The Impact of Exporting for Rug Producers in Egypt

Market Entry and Firm Competition in Sierra Leone

New ice suppliers in the fishing sector led to more efficient firm operations and more competitive deals

RESEARCHERS

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University of Chicago, Urban Labs

STUDY TYPE

Observational

75

percentage point increase in number of fishermen who switched retailers at least once after new manufacturer entry

29

percentage point increase in weekly ice orders that were provided on trade credit

In low-income countries, business relationships are essential to offset high levels of uncertainty and instability, weak contract enforcement, and thin supplier markets. In the Sierra Leone fishing market, small fishing enterprises invest in relationships with ice retailers to minimize late ice deliveries and rationing. Ice retailers reward loyal customers with prioritized deliveries and provide trade credit—where customers purchase goods on account and promise to pay at a later date—to those they know and trust. But while existing relationships help facilitate the flow of trade, they can also reduce responsiveness to changes in prices and restrict competition for buyers. To study the impact of increased competition on contracts, prices, deliveries, and credit access, researchers gathered transaction-level data from firms in the fishing industry in Freetown during the entry of four new ice manufacturers, which introduced competition in a previously monopolistic market. Additionally, the research team conducted interviews with all of the major manufacturers and retailers, providing a qualitative history to complement the quantitative analysis.

The study found that market entry by new ice producers improved the contractual terms that fishing firms received through lower prices, more timely deliveries, and increased trade credit access. Researchers estimate that each ice manufacturer entry lowered prices by 5-6 percent, while the overall frequency of late deliveries fell to 1 percent (from 26 percent) during the first six months. Competing retailers expanded trade credit provision to encourage loyalty from new clients, which led to new stable buyer relationships. The number of fishermen who switched retailers at least once after manufacturer entry rose by 75 percentage points. Meanwhile, the share of weekly orders provided on trade credit increased 29 percentage points. The findings suggest that thin supplier and retail markets support collusion and restrict competition for buyers, and new manufacturers' entry can improve contractual outcomes for small enterprises.

Inter-Firm Relationships and Business Performance in China

Facilitating regular meetings among managers led to better firm performance, increased knowledge-sharing, and new partnerships

RESEARCHERS

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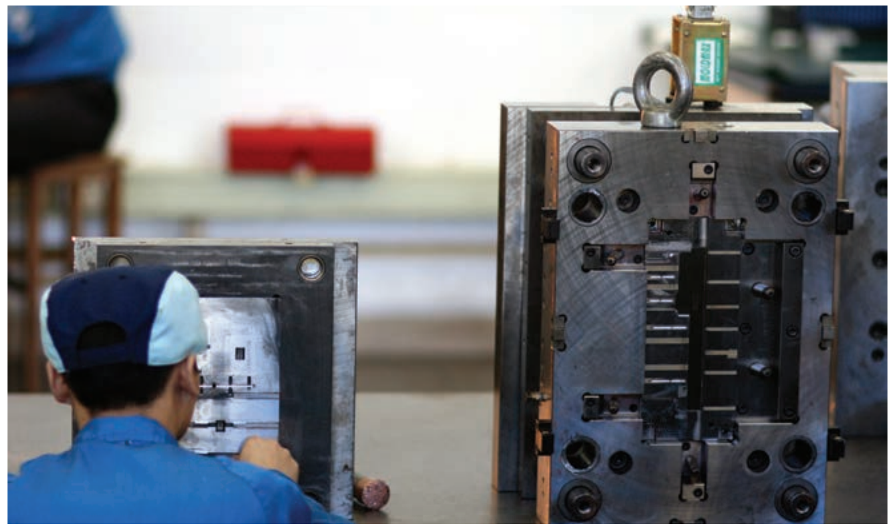
Central European University

PARTNER

Commission of Industry and Information Technology of Nanchang, China

STUDY TYPE

Randomized Evaluation



7.8

percent increase in sales for firms whose managers participated in monthly networking events

Business networks play an important role in firm growth by supplying information, knowledge, referrals, intermediate inputs, and other services. In China, researchers examined the effects of business networks on firm performance by inviting managers from newly-formed SMEs to participate in monthly meetings with peers from other local firms. To study concrete mechanisms, researchers also randomly distributed business-relevant information to some managers, and organized one-time cross-group meetings.

The study found that the monthly meetings increased firm sales by 7.8 percent, and significantly raised profits, employment, and a management score. The meetings also increased the number of suppliers and buyers, as well as formal and informal borrowing. Moreover, these effects persisted one year after the conclusion of the meetings. Firms in groups with larger peers exhibited higher growth, showing that group composition affects performance. Researchers also documented evidence of two concrete mechanisms. Managers who received information about financial products shared it with their peers, showing that the meetings facilitate learning. Managers also forged more partnerships with their monthly peers, rather than with the ones they met at one-time cross-group meetings, showing evidence that the meetings improved firm-to-firm matching.

The study concluded that because organizing the meetings is low-cost, business associations may be an effective policy tool to foster private sector development in similar settings.

Government Procurement with Local SMEs in Brazil

Firms that won government contract bids experienced more growth and hired more workers

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STUDY TYPE

Quasi-Experimental

2.2

percentage point increase in growth in the quarter of a successful contract

93%

of new hires came from unemployment or the informal sector

Governments in developing countries can use public procurement as an important tool to help local SMEs grow, as they usually spend close to 50 percent of their budgets purchasing goods and services. In Brazil, researchers exploited the unique features of public auctions to study the impact of government procurement and demand-side approaches on SME employment and growth. Researchers used data on public procurement auctions and comprehensive employer-employee records to map the growth and performance of firms that won government contracts.

The study found that winning at least one contract in a given quarter increased firm growth by 2.2 percentage points over that quarter (from a baseline growth rate of 2.4 percent), with 93 percent of new hires coming from unemployment or the informal sector. These effects persisted at least two years beyond the length of the contracts, partly as a result of firms participating and winning more contracts as well as penetrating new markets. The findings also showed that winning a close auction affected the markets that firms entered and the products they supplied: winners were more likely to participate in auctions in different municipalities and increase the number of products for which they competed in auctions.

These results suggest that winning government contracts through auctions increases firm growth—not only because firms are more likely to get contracts in the future, but also because they enter more valuable auctions, penetrate more markets, and increase the variety of products they sell. The effects are more pronounced for retail firms, smaller firms, and younger firms.

Increasing Credit Access for SME Exporters in India

Expanded credit access allowed exporting SMEs to raise their export revenues

RESEARCHERS

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Indian Statistical Institute

Priya Ranjan
University of California, Irvine

Jibonayan Raychaudhuri
University of East Anglia

STUDY TYPE

Quasi-Experimental

22%

increase in export revenues among SMEs that accessed subsidized credit

18%

increase in short-term credit among firms affected by the policy change

20%

increase in total borrowing

Exporting allows SMEs to scale up production, improve quality, acquire new technologies, and mitigate risk. However, limited financing may be a barrier to exporting and firm growth in general. In India, researchers exploited a unique policy change to evaluate the effects of expanded credit access on exporting firms. Between 1998 and 2000, the Indian government raised the investment cutoff for subsidized credit available to small firms, making larger ones eligible.

Among firms affected by the policy change, the rate of short-term credit increased by 18 percent and total bank borrowing increased by 20 percent. More credit also led to a 22 percent increase in export revenues among these businesses. The policy reversal in 2000 had almost no effect on bank borrowing or export revenues for eligible firms. Given the positive performance of these firms, banks had no reason to reduce their credit limit and firms continued to borrow at the market interest rate. The 1998 policy change also decreased borrowing among small firms that were already eligible for subsidized credit and larger firms that never qualified.

The Impact of Exporting for Rug Producers in Egypt

When SMEs began exporting their products, they became more efficient, skilled, and earned more money

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PARTNERS

Aid to Artisans

Hamis Carpets

STUDY TYPE

Randomized Evaluation

16-26%

increase in profits among participating firms

Helping SMEs in developing countries gain access to international markets is considered an effective tool to spur development. In recent decades, aid-for-trade and market access initiatives in developing countries have attracted large resources. It is unclear, however, whether and how these initiatives can impact firm performance, in particular productivity, product quality, and profits.

Researchers partnered with the international NGO Aid to Artisans and a local intermediary, Hamis Carpets, to evaluate the impact of exporting on the productivity and profits of handmade rug producers in Fowa, Egypt. The partners worked to develop relationships with buyers in high-income countries. Researchers then randomly assigned initial export orders to rug producers in the study. To mimic typical buyer-seller relationships, producers received subsequent orders as long as they remained reliable.

Rug producers who were offered the opportunity to export earned 16 to 26 percent higher profits (depending on the measure) and exhibited large improvements in quality compared to those who were not (even though their productivity, as measured by rug production per worker hour, was lower). Even when producing identical rugs for the domestic market—where quality is valued less—the producers who had been offered the opportunity to export produced rugs of much higher quality, yet took no longer to do so.

These findings are suggestive of quality upgrading where buyers in high-income countries demand high-quality rugs that take longer to manufacture. They also suggest that exporting can lead to better technical skills and efficiency for SMEs (a process called "learning-by-exporting"), contributing to higher earnings and the growth of their businesses.

Research Affiliates

The SME Program works closely with a strong network of researchers to shape the Program's agenda and develop a portfolio of innovative projects.

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University of Michigan

Bilal Zia
World Bank

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DBP
giz Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH
brac
edge GROWTH
Hamis Carpets
Building Markets
EDRI Ethiopian Development Research Institute
ICICI Bank

IDB Inter-American Development Bank
METROPOL reach new heights
tigo
IFC International Finance Corporation World Bank Group
MICROENSURE Helping the poor weather life's storms
USAID From the American People
ILO
Perú Ministerio de la Producción
Village Enterprise
INADEM Instituto Nacional del Emprendedor
NSB National Savings Bank
Village Financial Services Private Limited An ISO Certified Microfinance Institution
Instituto Poblano para la Productividad Competitiva
rootcapital
The World Bank
Kopo Kopo
TechnoServe Business Solutions to Poverty
ybi Youth Business International

Events: Working Group Meetings, Policy Conferences, and Workshops

The SME Program regularly hosts working group meetings, with the purpose of convening its network of researchers and practitioners for a full day of discussions on early-stage results, innovative research designs, and new papers focused on SME growth and entrepreneurship in developing countries. Policy conferences and workshops organized by the SME Program bring together academics and high-level decision-makers to disseminate findings and lessons learned, identify policy-relevant knowledge gaps, and foster new research partnerships. Below are some highlighted events from the past five years:

1st Working Group Meeting

CAMBRIDGE, MA | SEP. 16, 2011

Hosted at the MIT Sloan School of Management

First Annual Conference on Entrepreneurship and SME Development

WASHINGTON, DC | NOV. 30, 2011

Co-hosted with the Inter-American Development Bank's Multilateral Investment Fund

One hundred and thirty researchers and decision-makers gathered to present and discuss evidence from Ghana, India, Mexico, Peru, and Sri Lanka.

Impact and Policy Conference: Evidence in Governance, Financial Inclusion, and Entrepreneurship

BANGKOK, THAILAND | AUG. 30 - SEP. 1, 2012

Co-hosted with the Asian Development Bank and Abdul Latif Jameel Poverty Action Lab (J-PAL)

This event convened 230 researchers and decision-makers to share findings in financial inclusion, governance and post-conflict recovery, and small and medium enterprise development. The event's matchmaking portion culminated in eleven researcher-practitioner partnerships funded by the Asian Development Bank.

2nd Working Group Meeting

CAMBRIDGE, MA | NOV. 16, 2012

Hosted at the MIT Sloan School of Management

3rd Working Group Meeting

NEW YORK, NY | MAY 11, 2013

Hosted at Columbia University

4th Working Group Meeting

LONDON, UK | DEC. 13, 2013

Co-hosted with Private Enterprise Development in Low-Income Countries (PEDL)

Course and Workshop on Experimental Impact Evaluation with the Ministry of Production

LIMA, PERU | AUG. 25, 2014

Held in collaboration with J-PAL's office for Latin America and the Caribbean, and Peru's Ministry of Production

Participants included decision-makers from the Vice-Ministry of Small and Medium Enterprises (SME) and Industry. Later in the year, participants convened a series of high-level meetings to continue discussing future evaluations and ongoing research.

5th Working Group Meeting

CAMBRIDGE, MA | SEP. 19, 2014

Hosted at the MIT Sloan School of Management

Evaluating SME Development Policies

MEXICO CITY, MEXICO | NOV. 1, 2014

The SME Program Director presented the latest evidence on SME development policies for high-level officials from Mexico's Ministry of Economy, the National Institute of Entrepreneurship, and the Unit of Economic Productivity. They also explored opportunities for collaboration to evaluate Mexico's portfolio of SME policies, such as the National Entrepreneurship Fund.

High-Level Dialogue on SME Financing in Africa

PARIS, FRANCE | JAN. 12, 2015

Co-hosted with the African Development Bank (AfDB)

IPA's SME Program and the African Development Bank (AfDB) convened executives from the AfDB as well as from leading banks across Africa to discuss the challenges that banks face in lending to SMEs, identify potential solutions to those problems, and develop an action plan for testing these innovative ideas to help expand access to finance for SMEs across Africa. This event also included a matchmaking component, in which SME research affiliates met with bank executives to discuss opportunities for collaboration.

SME Financing in India

MUMBAI, INDIA | MAR. 16, 2015

Co-hosted with IFMR and the Reserve Bank of India

IPA and the Reserve Bank of India collaborated to bring together researchers in the SME space with top executives from India's banking sectors. Researchers shared the latest findings from their studies, and bank executives took part in panel discussions on best practices in SME financing. A brief matchmaking session closed the event with the goal of fostering new collaborations.

Evidence for the Development of SMEs

LIMA, PERU | NOV. 3, 2015

Hosted in collaboration with J-PAL, Peru's Ministry of Production, and the National Society of Industries of Peru

The event convened representatives of the public and private sector, civil society and researchers, with the aim of spreading existing rigorous evidence on effective interventions for promoting SME growth and identifying opportunities for collaboration to generate new research in this area. International researchers presented evidence from rigorous impact evaluations on the effectiveness of programs and services targeting SMEs around the world. Researchers and practitioners also participated in a matchmaking session, aimed at generating new evaluations.

6th Working Group Meeting

CAMBRIDGE, MA | NOV. 20, 2015

Hosted at the MIT Sloan School of Management

7th Working Group Meeting

NEW HAVEN, CT | OCT. 21, 2016

Hosted at the Yale School of Management

Funding for Research

The SME Competitive Research Fund supports innovative research on entrepreneurship and SMEs. Between 2011 and 2016, the SME Program completed ten cycles, and awarded a total of 39 research grants in three funding categories:

- **Core Research Grants** — Up to US$100,000: for research projects at a mature stage of development.
- **Project Development Grants** — Up to US$25,000: for studies that require early-stage support and piloting.
- **Young Scholars Grants** — Up to US$20,000: supports research by advanced graduate students and non-tenured professors.

10
Rounds

39
Research Grants

$1.1M
Total Awarded

Donors

US$1,000,000+

Anonymous
Center for Economic Policy Research
London Business School
World Bank

US$500,000-$999,999

Inter-American Development Bank/ Multilateral Investment Fund
International Growth Centre
Economic and Social Research Council

US$100,000-$499,999

Anonymous
Asian Development Bank
Fund for Shared Insight
Kauffman Foundation
International Labour Organization
Massachusetts Institute of Technology
Stanford University
Templeton Foundation
Village Enterprise

US$25,000-$99,999

Central European University
International Initiative for Impact Evaluation
Law and Development Partnership
London School of Economics and Political Science
Ministry of Production, Peru
New York University

US$5,000-$24,999

Brown University
Columbia University
University of Chicago

Publications and Resources

Academic Papers

- 31 academic papers completed
- 10 published in academic journals, including *American Economic Journal*, *American Economic Review*, *Journal of Development Economics*, and *Quarterly Journal of Economics*, among others

Project Summaries

- Available on the IPA website

Policy Briefs

- SME Program two-pager, available in English and Spanish
- Access to Finance policy briefcase, available in English and Spanish
- Human Capital policy briefcase, forthcoming in English and Spanish

American Economic Review

SME Page on IPA's Website

SME Two-Page Brief

SME Access to Finance Brief

SME Program in the Media

Results have been featured by general interest and specialized publications

INTERVIEW | APRIL 2013

SME Finance Forum

Interview with Lucia Sanchez, Director of the SME Program at IPA

BLOG | JULY 2014

next billion

Scoring for Access: Emerging Evidence on the Impact of Credit Scoring on SME Lending

PODCAST | MAY 2016

npr

***Planet Money* Episode 702: Nigeria, You Win!**

NEWS COVERAGE | APRIL 2013

London Business School Business Strategy Review

Transforming the Missing Middle

NEWS COVERAGE | OCT. 2014

The Broker

Managers through Classroom Training?

NEWS COVERAGE | AUG. 2016

IT

Mejor que los Políticos: Ciencia Aplicada a Políticas Públicas

NEWS COVERAGE | SEPT. 2013

The World Bank

Placing your Bets: Subsistence or Transformational Entrepreneurship

NEWS COVERAGE | MAY 2015

Harvard Business Review

From "Economic Man" to Behavioral Economics

NEWS COVERAGE | SEPT. 2016

Vox

Is globalization bad for the global poor? This study ran an experiment to find out.

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Featured Studies

Accounting or Marketing Training for Entrepreneurs in South Africa
Anderson-Macdonald, Stephen, Rajesh Chandy, and Bilal Zia. "The Impact of Marketing (versus Finance) Skills on Firm Performance: Evidence from a Randomized Controlled Trial in South Africa." Working Paper.

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