LATIN AMERICAN ENTREPRENEURS
MANY FIRMS BUT LITTLE INNOVATION

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More than half of Latin American income-earners are employed in small firms, most of which are informal...

Employment by firm size and formality status, circa 2010

- Uruguay
- Chile
- Argentina
- Costa Rica
- Mexico
- Brazil
- LAC
- Dominican Rep.
- Honduras
- Ecuador
- Colombia
- Paraguay
- Peru

- Informal (5 employees or less)
- Informal (> 5 employees)
- Formal (5 employees or less)
- Formal (> 5 employees)
This has understandably led to a policy focus on supporting small firms’ growth and formalization.
Yet, contrary to popular belief, small firms are also common in the formal sector…

Size Distribution of Formal Firms, 2011

- India
- LAC5
- Other LAC
- Caribbean
- China
- High Income
- EAP4
- ECA

- 0 employees
- 1 to 5 employees
- 6 to 50 employees
- 50+ employees
...and the increase in formal jobs is associated with the expansion of large firms (not the formalization of small ones)

Shift focus from small/low-growth to high-end/high-growth entrepreneurs that generate good jobs

Uruguay
Chile
Argentina
Costa Rica
Mexico
Brazil
LAC
Dominican Rep.
Honduras
Ecuador
Colombia
Paraguay
Peru
What we mean by “high-end entrepreneurs”

We follow Schumpeter (1911):

• The introduction of a new good or a new quality good,
• the introduction of a new method of production,
• the opening of a new market,
• the conquest of a new source of supply of raw materials or half-manufactured goods,
• the carrying out of the new organization of any industry.
What we mean by “high-end entrepreneurs”

Edge of Medium and Larger over Small Firms in LAC, 2010

- Labor productivity
- Exporter
- Exports share
- Invested R&D
- Patent abroad
- Patent, trademark, or copyright
- New or significantly improved process
- Patent in country
- New products introduced
- Tech. from a foreign-owned company
- Cooperates on innovation

Marginal effect (%)

0 10 20 30 40 50

- Medium firms
- Large firms
- 95% confidence interval

In LAC, large firms pay, on average, 60 percent higher wages than small firms
Message 1. Numerous small firms reflect a deeper problem: large firms do not generate enough good jobs.
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After 40 years:
- LAC: 110
- East Asian MICs: 170
- Eastern Europe: 220
- High Income: 255
The problem is not in the number of enterprises – LAC is indeed a region of employers ...

Non Agricultural Employer vs. GDP per capita (ppp), 2010
The problem is not in the number of enterprises – LAC is indeed a region of employers …

Share of Employers

<table>
<thead>
<tr>
<th>Country</th>
<th>Share</th>
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<tbody>
<tr>
<td>LAC-4</td>
<td>3.5</td>
</tr>
<tr>
<td>Hungary</td>
<td>4</td>
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<tr>
<td>Poland</td>
<td>1</td>
</tr>
<tr>
<td>Portugal</td>
<td>4</td>
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...but they do not generate enough good jobs

Non Agricultural Wage and Salaried vs. GDP per capita (PPP), 2010
...but they do not generate enough good jobs

Non Agricultural Wage and Salaried vs. GDP per capita (ppp), 2010

<table>
<thead>
<tr>
<th>Share of Employees</th>
<th></th>
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<tbody>
<tr>
<td>LAC-4</td>
<td>55</td>
</tr>
<tr>
<td>Hungary</td>
<td>84</td>
</tr>
<tr>
<td>Poland</td>
<td>73</td>
</tr>
<tr>
<td>Portugal</td>
<td>81</td>
</tr>
</tbody>
</table>
Message 2. Age matters much more than size... for job creation by firms

Employment growth in Colombia, 1993-2008

Continuers (abstracting from entry/exit)

...hence, a need to rebalance SME programs towards younger firms with potential...
Message 3. Formal firms have an innovation deficit: Low product innovation...

Percentage of Firms that Developed or Introduced a New Product, 2010
...low R&D investment (mostly public)...

R&D by Region, 2008-2010

- Business Enterprise
- Government
- Private Non-Profit
- Abroad
- Higher Education

Percentage of GDP

Other LAC
Eastern Europe
LAC-5
China
High Income
... subpar management practices...

Management Scores Across Countries, circa 2010
(manufacturing firms with 100-5000 employees)

Four Management Categories:
- Operation Management
- Performance Monitoring
- Target Management
- Talent Management
...and uninspiring patent production

Number of Patents per 1 Million People
(Average number of patents granted between 2006-2010)
Message 4. Even our superstars innovate little: Low entry into export markets...

Conditional relative entry rates to export markets, 2005-2009

Not due to specialization in extractive industries: the result compares entry rates in similar sectors
“Multilatinas” perform better than other local firms but are much less innovative than MNCs from other EMs...

- Multilatinas have worse management practices than Multinationals from other middle income regions
- Multilatinas are less integrated to global value chains than those in comparable countries
...and although foreign MNCs bring benefits to LAC, they are less innovative than those in East Asia.
Summing up: Some encouraging trends and policy developments in LAC…

Trends
- LAC’s a region of entrepreneurs
- The emergence of Multilatinas
- Dynamic trade integration

Policies
- Effective export and investment promotion agencies
- The emergence of empowered competition agencies
- Awareness and policy experimentation (Star-up Chile, policy evaluation through randomized experiments)
..but there are challenges: the innovation gap goes beyond individuals, must be the “enabling environment”

- It cannot just be individual entrepreneurs: even foreign MNCs that are innovative elsewhere are less so in LAC
- While the reasons for the innovation deficit vary from country to country, three fundamental areas stand out for LAC as a whole
  1. Low competition, especially in non-tradable sectors
  2. Insufficient innovation-friendly human capital – low educational achievement, low number of engineers, etc.
  3. Innovation-unfriendly features of the contractual environment – especially as regards intellectual property rights
- This is aggravated by LAC’s deficit in terms of infrastructure and logistics
Some specific bright spots in LAC (not discussed in the report)

- Mexico: Autopart global value chain
- Costa Rica: Export promotion
- Colombia: Fashion industry
- Brazil: High-tech agriculture
- Uruguay: Dairy and meat industry
- Argentina: Science and technology
- Chile: Upscale wine production
Thank you

The full report is available at:

http://go.worldbank.org/Z1D3AJFNP0