

Can entrepreneurship be fostered?

Self-employment is prevalent in developing countries, and micro- and small enterprises are a major source of livelihood for low-skilled workers. Even if only a small fraction of these tiny economic units succeeded in building a viable business, with the potential to hire others, the aggregate effect on living standards would be substantial. Their success would also matter for productivity reasons. Quite a few currently large enterprises in industrial countries started out as micro- and small family businesses. By contrast, in developing countries many large enterprises are born large, often the result of government support or privileged access to finance and information. Breaking privileges is one more reason why the success of microenterprises is so important.

Views differ on whether there is scope to help the self-employed succeed. At one time almost every self-employed person or owner of a microenterprise was seen as a potential entrepreneur, held back only by regulatory zeal and corruption. Substantial rates of return on capital for micro- and small enterprises were viewed as evidence of a potential to thrive.⁵⁸ But the pendulum has swung, and the conventional wisdom is now rather pessimistic. The large numbers of unregistered self-employed in developing countries are viewed as subsistence entrepreneurs who are trying to make ends meet, not thriving.⁵⁹ Evidence on the growth of micro- and small enterprises in several countries in Latin America and West Africa shows that most microenterprises with at least two years of operations remain at their start-up employment levels.⁶⁰ Embedded in the pessimism of the conventional wisdom is the idea that entrepreneurial ability and skills cannot be easily transferred, especially not to adults with limited formal education. In this view, entrepreneurs are born, not made. If this view is correct, attempts to convert survivorship into entrepreneurship are bound to fail. The wide dispersion of productivity across firms, including across microenterprises, suggests, however, that reality is somewhere in between the optimistic and the pessimistic view: survivor-

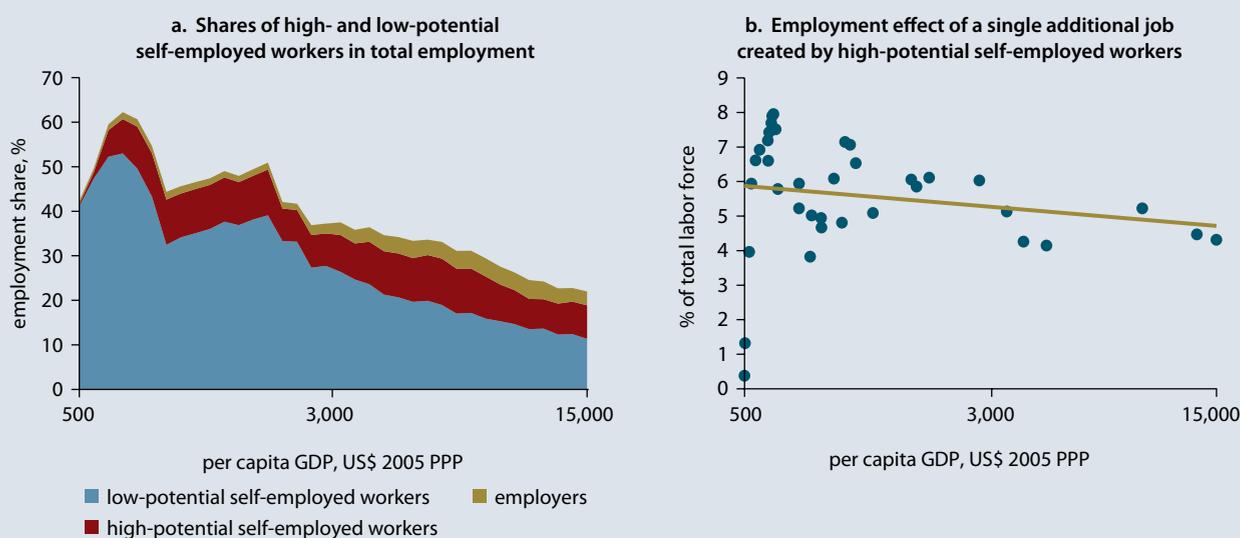
ship may be dominant, but entrepreneurship is unlikely to be missing altogether.

Who is an entrepreneur?

Entrepreneurship combines innovative capacity to put new ideas into effect with managerial capacity to increase a firm's efficiency within the limits of known technology. Specific psychological traits are associated with entrepreneurship, such as a personal need for achievement, a belief in the effect of personal effort on outcomes, self-confidence, and a positive attitude toward risk. These traits are difficult to observe or measure. But surveys comparing entrepreneurs with other workers in places as diverse as China and the Russian Federation show that observable individual characteristics such as education, experience, gender, location, and age are good predictors of entrepreneurship.⁶¹ Among microenterprises, rates of return on capital tend to be higher when their owners are more educated and experienced.

Observable characteristics of the self-employed can thus be used to identify individuals who have potential to become successful entrepreneurs.⁶² To illustrate the point, a successful entrepreneur is defined as someone who employs others and is not living in poverty. The share of this group in total employment is small and relatively stable across countries at different levels of development.⁶³ The share of self-employed workers without paid employees, on the other hand, initially increases and then declines with GDP per capita (figure 3.14a). At its peak, which corresponds to low-income countries, the share of self-employed workers without paid employees reaches almost three-fifths of total employment. Among this group, a majority are individuals with relatively low potential to succeed. Their characteristics are closer to those of wage workers than of employers.⁶⁴

However, if each of the self-employed workers with high potential were to create a single additional job, total employment would increase substantially, somewhat more so in low-income countries (figure 3.14b). As a share of the work-

FIGURE 3.14 *Some among the self-employed have the potential to become successful entrepreneurs*

Sources: Gindling and Newhouse 2012 for the World Development Report 2013; World Development Report 2013 team estimates based on data from 36 countries. Note: GDP = gross domestic product. PPP = purchasing power parity. In panel b, each dot represents a country.

ing age population, such additional job creation would amount to 8 percent in Kenya, 5 percent in the Arab Republic of Egypt and 4 percent in Costa Rica.

While this calculation is hypothetical, several studies report that observable characteristics of micro- and small informal enterprise owners, such as education and gender, are important determinants of innovation and employment growth.⁶⁵ In Mexico, after a business registration reform, informal enterprise owners with observable traits similar to those found among formal enterprise owners were more likely to register their business than those similar to wage workers.⁶⁶

What constrains entrepreneurship?

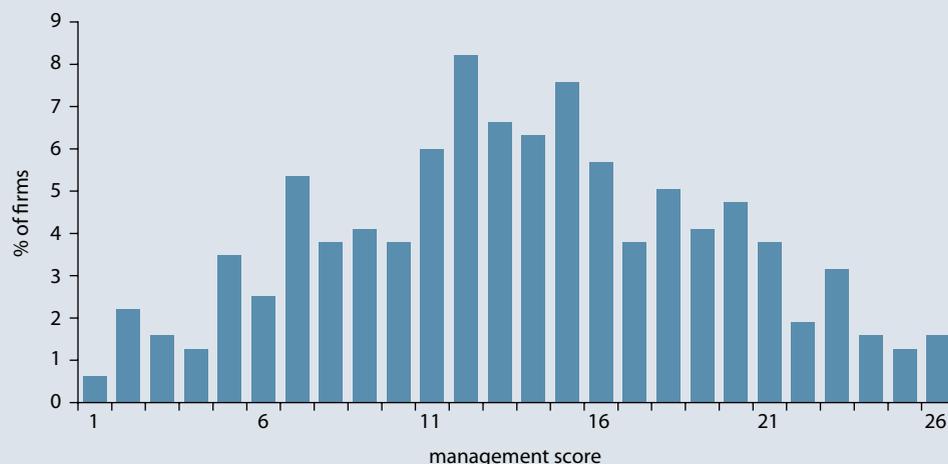
Even potentially skilled entrepreneurs would have difficulty succeeding without access to basic infrastructure and financial resources. In their absence, managerial capacity alone may not be enough to realize productivity gains and employment expansion. The investment climate matters for business performance as well.

Removing obstacles to firm growth is thus a prerequisite to foster entrepreneurship.

Obstacles notwithstanding, entrepreneurial capacity varies substantially across microenterprises and small firms. A distinction is often made between innovative or transformative entrepreneurs and replicative or subsistence entrepreneurs.⁶⁷ The former correspond to Schumpeterian type of entrepreneurs, while the latter, who generally manage micro- and small enterprises, are followers. Such a distinction, however, does not capture the broader gradation of managerial performance that lies between the transformative and subsistence extremes. A study of the number of management practices adopted by the owners of micro- and small enterprises in Sub-Saharan Africa reveals a large variation of management scores (figure 3.15). These scores are closely associated with business performance.⁶⁸ A broad dispersion of management scores is also found among relatively larger firms in India.⁶⁹

An emerging literature confirms the importance of management practices in explaining firm productivity. Although much of the focus is on large firms, recent studies have turned their

FIGURE 3.15 *Management scores vary widely across small enterprises in Sub-Saharan Africa*



Source: Fafchamps and Woodruff 2012.

Note: The management score measures the degree to which firm owners use and master core management and business techniques. Scores are based on an evaluation of 26 techniques (26 is the highest possible score).

attention to how innovation in small and medium firms takes place. The most telling studies involve management training provided for free to randomly selected firms whose performance is then compared to that of a control group of firms. Evaluations of these programs find that the training improves the financial literacy and basic management skills of business owners. The estimated impact is also positive, but less robust, when it comes to improved business outcomes and job creation. Better outcomes are associated with business owners who already had an initial understanding of the concepts and relatively better access to financial resources.

On the other hand, similarly designed interventions to provide financial resources to microenterprises, or to process their registration with authorities, or to pay the salary of an additional employee, show mixed impacts on business performance.⁷⁰ In Mexico and Sri Lanka, grants given to microenterprises increase the income of their owners—and then only if they are male—but do not result in employment creation. In Ghana, similar grants given to female business owners do not result in significant growth of their microenterprises. In Sri Lanka, only 22 percent of eligible microenterprises took

up an offer of a wage subsidy covering 50 percent of the cost of hiring a worker for six months and 25 percent of the cost for another two months. Overall, these results suggest that lack of access to finance is not the only constraint.

Entrepreneurial skills, measured by the education of business owners and their participation in training, explain a large share of the differences in productivity across firms and regions in developing countries.⁷¹ Yet markets fail to nurture entrepreneurship, because knowledge spillovers imply that some of the returns to acquiring or developing new managerial ideas are appropriated by others. More important perhaps, entrepreneurs themselves do not recognize the relevance of management expertise.⁷² Only 3 percent of Brazil's owners of micro- and small enterprises, for instance, see management as a binding business constraint.⁷³ This may be an area where information and knowledge failures matter, leading to a vicious circle of low productivity, low living standards, and insufficient job creation.

The capacity to acquire skills and to apply them to business seems to be one of the most important characteristics of successful entrepreneurs. Success also depends on having core skills

such as numeracy and literacy, as well as social skills. A vast literature highlights the importance of entrepreneurs' schooling as a determinant of firm growth, employment, and efficiency.⁷⁴ Russian and Chinese business owners have more entrepreneurs in their families and among childhood friends than otherwise similar individuals, suggesting that social environment also matters.⁷⁵

Learning can also happen through jobs. Nearly half of entrepreneurs managing the 50 largest manufacturing firms in Ethiopia began their careers in trading companies, thereby learning about the market and what it takes to meet demand.⁷⁶ A large number of founders and leading entrepreneurs in the light manufacturing industries in Asia and Sub-Saharan Africa were initially traders or employees in the marketing division of large enterprises.⁷⁷

Integration in supply chains with larger, often foreign, firms, is receiving much attention as a potential source of knowledge transfers.⁷⁸ Indian entrepreneurs returning from Silicon Valley made Bangalore a hub of the information technology industry. Perhaps the most dramatic evidence attesting to the importance of learning

from abroad can be found in the case of the garment industry in Bangladesh (box 3.4).

The case for targeted management training

Managerial practices are linked to differences in productivity, profitability, firm growth, and survival.⁷⁹ The development experience of the garment industry in Bangladesh suggests that entrepreneurship can be fostered by exposure to advanced management practices and technologies. But whether managerial capacity can be improved through management training is more debatable. Creativity, foresight, and risk taking are key elements of any innovative process, but the question is whether they can be diffused and nurtured.

A substantial number of experiments have been conducted in recent years, providing evidence of both successes and failures of management training interventions. Some patterns emerge from a systematic review of the available evidence. To be successful, management training must be kept simple, appropriate teaching materials must be available, and the training must

BOX 3.4 *What explains the boom in the garment industry in Bangladesh?*

The garment industry in Bangladesh illustrates how important it is to learn advanced management practices, marketing, and technologies from abroad. When Daewoo Corporation of Korea teamed up with Bangladesh's Dosh Ltd. to produce garments for export in Bangladesh in 1979, the South Asian country had no modern industry. Little more than 20 years later, the industry was generating more than US\$12.5 billion in export revenue. Women accounted for 80 percent of its 3.6 million workers

Arguably, a wide set of factors, from financial innovation to policy support, contributed to this development success. But it began in 1979, when Dosh sent 130 newly recruited, educated employees to Daewoo's garment factory in Korea, where they participated in an eight-month intensive training course covering topics from sewing skills to factory management, quality control, and international procurement and marketing—skills that they then applied in the Dosh factories in Bangladesh. Within a few years, almost all the trainees had left Dosh to start their own garment businesses. Some of the ex-Dosh workers joined new garment factories established by affluent businessmen, while others founded trading houses, which then

contributed to the proliferation of garment manufacturers by providing a variety of valuable services including international procurement and marketing, sample making, and design reengineering.

Observing Dosh's good start in exporting, and subsequently the success of ex-Dosh workers, highly educated people started their own garment businesses, and wealthy families actively invested in the industry. As a result, the size of garment firms has been quite large since the beginning; their average size was 300 workers in 1983–84 and 700 in 2010–11. As of 2005, owners of garment firms had 15 years of schooling on average, and about 60 percent of them had completed college or university education.

Learning from abroad continued. Some entrepreneurs participated in training programs in Singapore, Japan, and Europe. Beyond garment enterprises in Korea, other newly industrial countries in East Asia followed Daewoo into operation in Bangladesh and invested in training Bangladeshi workers and managers. Thus, many Bangladeshi traders and manufacturers had work experience in garment trading and production, including the experience of working at joint ventures, before starting their current businesses.

last for a certain minimum length of time. Complementing classroom teaching with instructors' visits to trainees on the job can yield significant positive effects.⁸⁰ In Mexico, for example, such on-site visits improved sales, profits, and productivity.⁸¹ But in Ghana, on-site visits and support for microenterprises were not successful.⁸² It is also possible that key entrepreneurial skills are gained more effectively through work experience in large productive firms than through training programs.⁸³

Entrepreneurship training for women has had mixed results. Nurturing female entrepreneurship has the potential to create wider social benefits associated with female employment, such as changes in the household allocation of resources that improve family well-being, especially of children. Female entrepreneurship often provides employment opportunities to women that allow them to balance work and family roles. Yet providing classroom training to female microentrepreneurs in Peru had no effect on key business outcomes such as sales and profits, even when some business practices improved.⁸⁴ Classroom training complemented with on-site visits, though, yielded positive results.⁸⁵ In Pakistan and Tanzania, management training improved management practices and business outcomes for male but not female entrepreneurs.⁸⁶ These mixed results can also reflect wider constraints facing women in societies, including access to effective learning in schools.

A common finding of training evaluations is that the potential to absorb management practices differs greatly among beneficiaries. Readily observable individual characteristics can help

identify those business owners with the highest potential to benefit from management training. Expert panels may be used to identify and rank micro- and small enterprises on their potential to grow, but such methods are expensive and difficult to apply on a large scale. An effective alternative is a survey questionnaire designed to capture abilities, attitudes, and management scores of potential trainees.⁸⁷ Management training itself can be used as a screening device. Trainees with high potential often undertake new investments and expand employment as a result of their training. Financial institutions could view such activity as an indication of potentially high investment returns. Programs that combine management training with financial support yield better firm performance in developing countries.⁸⁸

Training programs can be implemented by private providers and financed by private investors with a significant interest in the success of the entrepreneurs in whom they have invested. But as long as there are knowledge spillovers and the importance of management expertise is undervalued, governments have a role to play. Given the differing capabilities among business owners, proper targeting is crucial to ensure positive returns to publicly funded programs. Randomized experiments in Ghana, Tanzania, and Vietnam indicate that the benefit of such programs generally outweighs the cost, even though the costs of implementing training programs vary greatly.⁸⁹ If the overall investment climate is not conducive to private sector growth, however, targeted training programs for better business skills will most likely return meager results.