Self-Employment and Entrepreneurship: Evidence and Implications for the Youth

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The challenge

- MENA is a “young” region: over 50% of population under 25 → huge opportunities and challenges
- Rapid job creation is a pressing need
- If not achieved: growth will be slow, high skilled youth will emigrate, and there will be high youth unemployment and social unrest.
- Private sector is not expanding fast enough
- Key to accelerating job creation in the region: promoting entrepreneurship and private sector development.
Entrepreneurship

Start-ups not only employ their owners, they also
• create jobs,
• increase innovation,
• raise competition,
• increase efficiency and productivity, and
• provide role models to other young people

Once they mature into small and medium-sized enterprises (SMEs), they become significant contributors to employment and GDP.
MENA’s entrepreneurial activity today

At first glance, it seems high...

**Early stage entrepreneurship, % of adult population (2009)**

Entrepreneurial activity in Arab countries is deceptively high, as it is mostly driven by necessity.

Note: The percentage of the population performing early-stage entrepreneurial activity are those people who are involved in setting up a business or owners-managers of new businesses (less than 42 months).

Source: Global Entrepreneurship Monitor, 2009; Booz & Company
… but looks might be deceiving

• High level of entrepreneurship mainly driven by necessity (not choice)
• More than 80% of entrepreneurs in the MENA region have very small-scale operations (firm values <US$15,000).
• Vulnerable to external shocks
• Most microenterprises do not survive the journey towards sustainable small businesses.
• Why?
Constraints to firm growth

- Access to Capital/Finance
- Managerial Human Capital and Skilled Labor
- Access to Markets
- Regulatory Constraints

Even more pervasive in youth entrepreneurship
What we know, what we don’t know…

• Small but growing body of evidence
  → Especially on access to finance and human capital

• A lot of mixed results
• A lot of heterogeneous effects
• Very little focused on youth

Much more research is needed!
• SME Initiative (IPA)
• Youth Employment Initiative (J-PAL)
Human Capital and Skills
Human Capital and Skills

• Managerial capital improves productivity and financial management (thus boosting the impact of access to finance)

• Management education and practices are usually worse in developing countries than in developed countries (Bloom and Van Reenen, 2010)

• Business owners may be missing key skills and leaving profits on the table.

• However, evidence on potential remedies is limited and mixed
Human Capital and Skills

- **Consulting**
  - India (Bloom et al, 2012): management consulting for SMEs increases quality, productivity, output and employment.
  - Mexico (Bruhn, Karlan and Schoar, 2012): consulting services increase sales, profits and productivity but not employment

- **Business training**
  Most studies find small but positive impacts of business skills trainings on knowledge and attitudes, but no impact on profits and sales (McKenzie Woodruff, 2012)
  - Peru (Karlan and Valdivia, 2010)
  - Ghana (Karlan, Knight and Udry, 2012).

- **Financial Literacy**
  - Dominican Republic (Drexler, Fischer and Schoar, 2010): no impact on standard, fundamentals-based accounting training; but a simplified, rules-of-thumb based training improves business practices and outcomes. *Content matters!*

When do training programs work?
Evidence Focused on Youth

Tunisia (Premand et al, 2012):
• Entrepreneurship track in final year of university provides business training and personalized coaching
• Increases self-employment rates one year later (6% for males and 3% for females).
• Channel: fostered business skills, expanded networks, and shaped behavioral skills. (hear more this afternoon!)

Bosnia and Herzegovina (Bruhn and Zia, 2012):
• Financial training increases knowledge for those with low financial literacy
• Improves business performance and sales for those with high initial financial literacy.
• Some improvements in business practices, but no increases in business profits or in business survival rates.
Access to Finance
Challenges in access to finance for entrepreneurs affect young people disproportionately:

- Screening small firms with poor financial infrastructure is hard
  - Even harder for youth, given their lack of assets, credit history, and information about their productivity
  - e.g. Credit scoring (Schoar and Paravisini, 2013); personal traits (de Mel et al 2009)

- Small firms are most sensitive to economic downturns, hurting expected repayment
  - Youth are even more sensitive due to lack of assets and experience
  - e.g. Delaying repayment (Field et al, 2011)

- Moral hazard: enforcing contracts or seizing assets is difficult
  - More reluctance to lend to youth, often seen as irresponsible and have no collateral
  - e.g. Relationship lending (Schoar, 2012)
Impact: Cash Grants

Evidence shows **high returns** but **heterogeneous** effects:

- Sri Lanka (de Mel et al 2008)
  - Cash or in-kind grants yield **high returns** (>5%/month)
  - Impacts higher in **male-owned enterprises**
    - Half of female enterprises show **negative** returns
  - Returns are **highest for higher-ability** entrepreneurs and those with fewer other workers in the household

- Ghana: Fafchamps et al (2011)
  - **Huge returns** (15%/month)
  - **Heterogeneous effects** depending on type of grant (cash/in kind) and gender

*how high are the returns to capital for young entrepreneurs?*
Impact: Microcredit

Randomized evaluations usually find **modest effects** that **vary across groups**:

- **Hyderabad, India (Banerjee et al 2010)**
  - Households behave differently
    - Entrepreneurs invest in durable assets
    - Non-entrepreneurs spend more on nondurable goods
  - 2nd wave (2013): business profits increase only for businesses above the 85th percentile

- **Morocco (Crepon et al 2011)**
  - Similar to previous study, decrease in consumption to expand activities only in HHs with a pre-existing business

- **Philippines (Karlan and Zinman 2010)**
  - Profits increase, but only for men
  - Effects stronger for higher-income entrepreneurs

*Not so good at creating entrepreneurs but rather supporting existing businesses (moderately).*
Savings

Access to **formal savings, time inconsistencies** (present bias), and **pressure to share** income with peers and family make it hard to save.

- Access to formal **savings accounts** can lead to increased business investment and reduce vulnerability to shocks (Dupas and Robinson 2011 – Kenya Study)
- **(Self-)commitment devices** can increase savings substantially (Ashraf et al. 2005), and can also increase agriculture input use, value of agriculture output and household expenditure (Brune et al. 2011 – Malawi Study)
- **SMS reminders** address limited attention issues (Karlan et al. 2010).

Youth have particularly high rates of future discounting, greater self-control problems, and may be more susceptible to pressure from friends and family to share their money.
A research agenda on youth entrepreneurship

• The important **role of entrepreneurship** for growth and employment creation is largely acknowledged, but we need much more research to figure out **what works to promote it.**

• Existing evidence shows **highly heterogeneous effects:** we need to consider different groups and different contexts. No silver bullet.

• **Very little research focused on youth:**
  – Young entrepreneurs have limited resources, life and work experience, and face **greater barriers** than older entrepreneurs

• Within the youth, different **sub-groups** may have different needs and potential (i.e. gender).

• Human capital: We need to look inside the **black box** of training and get at mechanisms.
Thank you

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