EVENT SUMMARY

Fostering enterprises in low-income countries

7 September 2017 | Overseas Development Institute

Key points:

- It is important to bring together the different research programmes, so we can compare findings and think about the so-what question of the research that has been funded: how it could influence policymakers and practitioners.
- Many projects discussed at the workshop were implemented at the firm level, using RCTs. There would be value in jointly thinking about how to obtain policy impact from this – which change actors to target.
- There is emerging thinking around the need to support peer learning amongst firms in low-income countries.

Introduction

DFID's research department supports growth research across a number of different programmes:

- DEGRP focuses on issues of economic growth across four areas: finance, innovation, agriculture and China-Africa relationships.
- PEDL addresses issues of private enterprise development in low-income countries.
- GLM projects conduct research on the contribution of labour markets to economic growth.
- EIP-LIC supports research on innovation and productivity growth in low-income countries.

The fostering enterprises event was held to bring together selected projects from these four programmes to: identify areas of common interest between the programmes and potential areas for future collaboration; and to foster connections between researchers. DFID is keen to generate bodies of evidence relevant to policymakers and practitioners. The focus of this event was on two areas of innovation: innovation and management practices at the firm level, and skills training and innovation at the firm level. 13 projects from across the four programmes were represented at the workshop.

DEGRP's Dirk Willem te Velde outlined the policy context for the event. Economic transformation in low-income countries (LICs) could come about in three ways:

- Movement of labour from low- to high-productivity sectors.
- Movement of labour within sectors, from low to high-productivity firms.
- Within-firm movement of labour, enabling them to become more productive and to grow.

For the purposes of this event, we were particularly interested in the policy debate around the need for economic transformation to be at the heart of achieving the global goals (the SDGs). LICs want to industrialise, transform and become more productive in both agriculture and manufacturing sectors, and as researchers it is important to ensure that we connect with this debate by helping improve firms' growth strategies, the national policy environment or the framing of donor support. There is an increased interest in the role of the state in fostering economic transformation, and in the role the private sector can play in fostering development. The challenge is to understand where responsibility for innovation at firm-level lies, how to research this and how to communicate the results.

A second issue arises in the role of skills, and whether skills building should be seen as a precursor to investment or vice versa. Understanding this is important for planning ministries and donors who are seeking to support innovation – whether they should support the supply of skills through working through specific skills building programmes, or stimulate the demand for improved skills by working with particular types of firm.

Project synopses were circulated in advance. This note contains a summary of workshop discussion after short presentations from selected researchers.

Discussion summary

1. Innovation and management practices

Dirk te Velde introduced the discussion on this topic with the observation that innovation is highly context-dependent, which makes a rich environment for research and for policy interventions. He noted two areas for policy attention: (i) improving firm capability through peer support, coaching and other platforms for social learning and (ii) public policy for innovation and the role of wider contextual issues such as the effect of land rights on innovation in the Indian brick industry, or the effect of trade policies and exposure to foreign markets. Chris Woodruff noted the importance of understanding context: without it, for example, it would be possible to mistake the characteristics of the Indian brick industry for a flat sector with perfect competition. But as Dan Keniston's project summary demonstrated, this is not the case at all: land rights and the rental market for land play important roles in shaping brick manufacturing. Institutional constraints such as these are actually impeding innovation by preventing more innovative firms from entering these somewhat stagnant markets. And because the wider context shapes behaviour it is important to consider how it affects the relationship between optimisation of existing resources and innovation.

Along similar lines, Lauren Bergquist's project looked at the competition between intermediaries and the pass-through of a shock to traders' marginal costs. She has found a good deal of collusion between intermediaries, and that entry doesn't do much to improve overall competition. Credit constraints appear to be a real barrier to entry.

Victor Murinde from the Inclusive Finance Project at DEGRP wondered about whether the possibility of innovation had something to do with firm ownership. Is excluding firms from sources of finance a constraint to innovation? In many countries directed finance is thought of as a policy tool for innovation, but does it simply encourage the private sector to own more? How can finance be provided that encourages innovation but does not have a negative effect on firm ownership?

David Lam noted that it was important to look for innovation at different levels: there is a danger of not seeing the forest for the trees. While most work focused on firm- or sector-level analysis, Nina Pavcnik's work showed the necessity of zooming out to look at the macro effects of how trade policies and improving export opportunities affect productivity. Comments were also made about the need to consider income effects which have long-term influences on issues such as education, not simply growth effects. Innovation doesn't just happen where we see high growth in employment; it's much more nuanced than that.

Naufel Vilcassim's Growth Potential Index, if it works, could be used more widely to look at small firms' innovative potential. Simon Quinn noted that it's important not to forget that innovation isn't a single step, but involves multiple steps that relate to issues of perception (of being behind the curve), inspiration (what to do), motivation and finally implementation (the Gibbons/Henderson framework). There's heterogeneity in all four of these dimensions. For example, motivation could be channelled through peer to peer networks such as the one Fernando Vega-Redondo is piloting, but there's a lot more work to be done to understand if they do work, and if so why they work. Julius Rüschenpöhler's project on business practices and growth aspirations of SMEs in Jakarta, Indonesia suggest that any concerns about competition are mitigated if peer networks connect people in different geographical locations or who aren't competing in the same markets. The challenge for funders is to see how to scale peer networks and make them profitable, if they are effective.

Discussion then moved to the issue of risk. The comment was made that for microentrepreneurs concepts of risk are inverted between high-income countries (HICs) and LICs: in HICs being an entrepreneur means taking risks, but in LICs it's seen as a strategy for mitigating the risk of losing your job, or something else happening. In this context there may be less scope for product innovation; innovation mostly comes in the form of service innovation or how they approach their business. Naufel Vilcassim's project shows that coaching doesn't so much change aspects of businesses as get business owners to completely rethink it – though his project works mainly with big-picture people rather than those with specific local knowledge.

Steve Wiggins asked whether there was a difference between agriculture and manufacturing in terms of the returns to size. Because there are high transaction costs on farms of moving outside the family, family farms are generally better off staying small. But there has been an astonishing reduction in unit costs of milk production by small farmers in LICs because of technological innovation: span of control isn't necessarily a constraint on innovation in agriculture.

In terms of future work, the group thought it important to share knowledge around where innovation happens and how to strengthen it:

- Innovation between and within firms (both small and large)
- How to identify firms that have growth potential
- Different types of innovation: supply chain, process, business performance – not just product innovation
- Ways to improve innovation. This could centre around making markets work (e.g. through competition), but most firm-level analysis relates more to thinking around peer review networks, collaboration and issue of trust in the innovation process (the question then becomes, what to do this with this information, which change actors to work with to create impacts and scale up the work)

Annelise van Uden reminded us that entrepreneurs talk a lot about social innovation, which brings a different perspective to innovation and the steps they should take. Innovation isn't just about enhancing productivity.

2. Skills training and innovation at the firm level

David Lam introduced the session by saying that while governments invest enormous amounts in post-school training, when these trainings are evaluated the results are often disappointing. Investment in human capital is rising: the proportion of the population with primary schooling has risen a great deal in most countries (slightly less so for secondary schooling) and the gender gap in schooling has almost been eliminated. Discussions about skills are mainly around employment and job creation: sub-Saharan Africa (SSA) will need about 2 million new jobs per month to keep up with existing employment levels (though China and India have produced jobs at comparable rates in recent decades). The world has absorbed a doubling of the working age population in the past 50 years without a major global unemployment problem. However the dynamics are changing: for example the population of unskilled youth in regions outside SSA has stopped growing, with future population growth concentrated entirely in older ages. In SSA, however, there will be continued growth in the number of young workers, putting pressure on employment.

Chris Woodruff began the discussion by noting that skills search and matching frictions are often thought of as being very extensive, but is that really the case? Are frictions the main cause of unemployment? Simon Quinn noted that the simple problem of costs of matching doesn't seem to be driving large inefficiencies, but labour market exclusion is another issue. With heterogeneity in jobs people might find it easier to find short-term jobs, but what they're looking for is long term jobs with contracts. However active labour market policies can have a large effect on groups that are a priori excluded, often disadvantaged workers.

Chris noted that innovation is about being able to 'flick all the switches at the same time to have an effect'. Switches could range from training to top management buying into new processes, to providing capital investment. Firms may flick a few switches at a time (e.g. training) – and if there is no difference – conclude that training does not have an effect. The question is how to ensure that all the right switches are flicked at the same time. Dirk asked which comes first, capital or skills, and Atonu Rabbani noted that his project found that reasoning and fine motor skills were the most strongly correlated with productivity – but that generally nobody gives training in reasoning or nimble fingers. An additional challenge is that training is expensive, particularly if it takes a vertical slice of the organisation to include top management.

Are there cheap ways to get people started on training and thinking about what the next experiment should be to boost productivity? One suggestion was to run experiments in the same area: Sharon Buteau at the IFMR in India is working to improve the digitisation of merchants and raise awareness of the poor about the possibilities of digital payments. Selecting pilot programmes in the same area may help deliver more than the sum of their parts.

A second question arose about net employment effects and how innovation contributes to employment growth and poverty reduction. It is important to distinguish between creating new jobs and worker reallocation: Imran Rasul's research notes that giving firms working capital without specifying who they should employ has significant effects on additional employment. David Lam pointed out that while much research studies marginal changes there is an incredible absorptive capacity in labour markets that we don't yet understand. This has something to do with market frictions and how that feeds back into the demand for labour – whether research can say anything about how to make firm-level demand curves elastic; how to provide incentives for productivity and innovation. And while there are very few opportunities for natural experiments on labour markets which would bring out some of these more macro issues, more attention needs to be paid to the institutional and legal environments which affect the demand for labour. But as Imran observed, the supply of unemployed workers isn't homogeneous, and where this heterogeneity comes from isn't well understood.

The goal of trying to create entrepreneurs and turn them into firms with 100+ employees is proving very challenging indeed. We need to pay more attention to institutional environments and demand issues such as how market frictions affect the ways labour markets work (and how that feeds back to the demand for labour). We need to be able to say more about what makes firm-level demand curves more elastic – that is what provides the incentives for productivity and innovation.

There are promising avenues for future work and collaboration, particularly around considering the next steps on peer learning and B2B. This requires a bit more thinking about who the change agents are to facilitate learning to ensure the work is scalable; but there are interesting commonalities emerging around skills/management/training/coaching which all relate to how innovation is managed at firm level. Annelise pointed out that it's important to link this to the broader themes and discussions about the role of competition, collaboration, culture and community in our interconnected world. The important point is that context (the global and the local) matters for policymakers.

Wrap up discussion

The final discussion centred on thinking about how this research contributes to change in low-income countries. Chris observed that PEDL asks grantees annually what they think the impact of their research is, and encourages them to think about all the different levers for policy impact, not just changing laws. For example, in Bangladesh the government is, for many policies, not the actor that needs to be influenced – it is important to think creatively about what or who the levers for change really are. Similarly, DEGRP provides guidance and support to its grantees to consider different types of impact (instrumental, conceptual, capacity building and connectivity) and use different knowledge exchange and communication strategies to engage with them effectively. In his closing remarks, DFID's John Piper noted that there seem to be some emerging synergies across a number of areas, and it will be important to take this further – to understand the implications for policy and practice and to pull the research together into a robust body of evidence that can influence policymakers and practitioners.