STUDY SUMMARY

What Generates Growth in Microenterprises? Evidence from Sri Lanka

Few microenterprises grow and employ more than one worker, and policymakers have struggled to identify what keeps these businesses from growing further. To study these limitations, researchers offered microentrepreneurs capital to incentivize them to hire. Results showed that a wage subsidy did not lead to lasting increases in employment sales or profits.

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COUNTRY
Sri Lanka

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PROGRAM AREA
Small and Medium Enterprises

TOPICS
Access to Finance, Human Capital & Skills, Microenterprise, Savings, Training & Mentoring

TIMELINE
2008-2014

Policy Issue

Very small businesses abound in the developing world, but few grow to the point where they employ more than one person. If even a small percentage of these microenterprises scaled up and hired a few employees, a significant number of new jobs could be created. While recent studies suggest that injections of capital for firms could increase profitability and employment, it remains unknown whether this profit increase could eventually sustain additional employees among microenterprises. In addition, while wage subsidy interventions have had effects maintaining higher employment levels during an economy-wide crisis, prior programs have seldom evaluated the effects among new hires. Evidence on the effects (if any) of wage subsidies among microenterprises could inform future programs aimed at increasing employment levels.

Evaluation Context

In Sri Lanka, the vast majority of enterprises are either microenterprises or small enterprises. This study targeted male-owned microenterprises with two or fewer employees, located in urban areas of, Colombo, Kandy, and Galle/Matara in Sri Lanka. Of 1,533 microenterprises in the sample, the majority of entrepreneurs were engaged in retail, followed by manufacturing, and services.

Details of the Intervention

In this randomized evaluation, microentrepreneurs were provided with a wage subsidy to test whether the injection of capital led to sustained new hires. Researchers randomly assigned 536 microentrepreneurs to either receive the wage subsidy, or to a comparison group that did not receive any support at the time of the study. In addition, researchers also offered a subset of firms a matched-savings account, as well as with a business training to test complementarities. The analysis in this summary is of the 536 microenterprises that partook in the wage subsidy or the comparison group only.

The subsidy provided a flat amount of 4,000 LKR per month for a period of six months to businesses that hired an additional employee to work at least 30 hours per week. A flat amount of 2,000 LKR per month was offered for an additional two months following the six months. The initial subsidy of 4,000 LKR represented about half of the earnings of a typical unskilled worker.

Researchers used 12 rounds of surveys to track impacts on profitability, sales, firm survival, number of employees, and other outcomes, over four years.

Results and Policy Lessons

Between 21 and 24 percent of firms offered the subsidy took it up. These firms were more like to be in manufacturing than retail or services. The skills of the owner also mattered, with more highly educated owners, and those employing better business practices at baseline being more likely to have used the subsidy.

Survival

Those that received the subsidy were between 5 and 7 percentage points more likely to still be self-employed in the last follow-up rounds compared to owners in the control group.

Employment

Among participating firms, the subsidy led to an increase in the likelihood of hiring a worker (14 percentage points), and the number of paid employees in the firms (.19 workers) compared to firms in the control groups. However, this effect on employment only last during the six months of the treatment and quickly dissipated thereafter.

Profits and Sales

Subsidy uptake did not result in statistically significant effects on firm profits and sales among treatment firms.

Sources