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Evidence Brief

What Works in Addressing Global Poverty – Marketing and Entrepreneurship in Low-Income Countries

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Key Points

1. Most businesses in low- and middle-income countries are informal, small and locked in a no-growth cycle of low sales and low profits. Research is uncovering ways to help entrepreneurs break out by improving their access to managerial capital through practical business training, consulting and coaching programs, as well as their access to financial capital via appropriate loan products.

2. One promising approach is to complement traditional business skills programs, which tend to focus on financial records and operational efficiency, by offering firm owners personal initiative training or one-on-one remote coaching to provide business support services in which entrepreneurs also focus on growing sales (e.g., by innovating or changing their product offering, understanding and attracting new customers, or expanding into new markets).

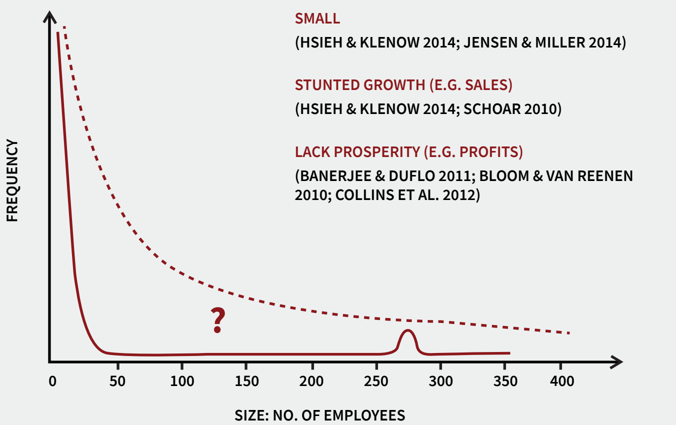
3. In the developing world, the positive returns to borrowing are often high for small businesses and yet many entrepreneurs may be afraid to take on debt given the pressures they face to divert funds to non-business purposes. Innovative loans products may help overcome these pressures and the reluctance to borrow.

The Problem

A large literature suggests that entrepreneurship can drive economic development, job creation, and prosperity in both advanced and developing economies. Indeed, in developing or emerging economies, expanding the small business sector is an essential component of economic growth and, in turn, poverty alleviation. Throughout the developing world, it's estimated that some 400 million businesses are operating in this sector. Together, they account for about 60% of total employment (including 80% of new employment) and roughly 40% of gross domestic product. Moreover, management surveys find that multinationals are looking to these emerging economies for future expansion opportunities, and the small enterprises that dominate the local landscape offer partnership opportunities when they enter these markets.

Although small businesses represent a key engine of growth in emerging economies, these enterprises face a daunting challenge. It is hard for them to expand. The large majority tend to get stuck in a cycle of low sales, low profits, and stunted growth—starting small, staying small, and never prospering. A substantial and robust sector of small and medium enterprises (SMEs) is often lacking in many emerging economies, as are larger enterprises and corporations. Instead, there may be hundreds of thousands or even millions of micro-sized businesses with five or fewer employees that operate informally and on a subsistence level. By contrast, the distribution of businesses in an advanced economy typically includes firms of all sizes. And in a country like the United States, the formal SMEs 'in the middle' represent a major part of the employment and tax base. Thus, a critical development question is how to get more micro enterprises to grow sales and scale their operations in emerging economies.

Challenges: faced by emerging market firms



Illustrative Figure

What We've Learned

Researchers have investigated a wide range of strategies for stimulating small business growth in the developing world. Two areas that have received increased attention in recent years are the cultivation of managerial capital and financial capital.

Managerial capital. Sound business practices, such as detailed accounting records, informed pricing decisions, and proper maintenance of capital equipment, are critical to the success and growth of small enterprises in emerging economies. Improvement and professionalization of the ways that small businesses are managed and operated tends to be correlated with increased sales.

Several studies have examined the impact of consulting services on business performance in emerging economies (Anderson, Kaul, & McKenzie, 2019; Bloom, et al., 2013; Bruhn, Karlan, & Schoar, 2018). An external consultant is brought in to evaluate operations and advise on new business practices, such as keeping track of inventory or maintaining equipment – and, sometimes, expansion into new markets. Research has found that consulting services can lead to persistent improvements in business practices and profitability. But this kind of intervention is practical primarily for medium-size and larger enterprises, and is less applicable to small businesses. Hiring a professional consultant is expensive and not easily scalable when targeting micro and small sized firms in emerging economies.

Training represents an alternative model for building managerial capital and one that is often times more suitable for even the smallest micro businesses. It focuses on the business owner rather than the organization and is more scalable in that it can be carried out in a classroom setting with a large number of participants. However, the evidence regarding the effectiveness of business skills training has been mixed. Some of the more successful approaches tend to consist of training that targets growth-oriented entrepreneurs, implements an intense program, builds practical skills, and focuses on real-world application to one's own business.

For example, a recent field trial compared a traditional business skills training program against a curriculum designed to foster personal initiative, innovation, and self-starting behavior (Campos, et al., 2017). A total of 1,500 micro business owners in Togo were invited to take part, with 500 randomly selected for the traditional program, 500 for the personal initiative program, and 500 assigned to a control group. The two training programs included 36 hours of classroom time over four weeks, plus a series of on-site trainer visits to each business. The personal initiative training notably outperformed the traditional program. Participants increased monthly sales 17% and profits 30% relative to the control group, while the business skills program did not have a significant impact.

And in Uganda, researchers recently examined the impact of Skype-aided remote business coaching on the strategies and sales of small-scale entrepreneurs (Anderson, Chintagunta, & Vilcassim, 2019). Entrepreneurs were randomly assigned to receive remote coaching that connects overseas management professionals and the local entrepreneurs with the aim of improving business performance. The remote coaching had significant effect on firm sales – entrepreneurs who received the coaching increased monthly sales by 27% on average. In addition, entrepreneurs who received remote coaching were 63% more likely to have "pivoted" or shifted their marketing strategy in a new direction. And consistent with this mechanism of inducing strategic business changes, the entrepreneurs who initially lacked strategic focus tended to be the ones who improved outcomes more when they received remote coaching.

Financial capital. One of the biggest challenges small businesses face in the developing world is accumulating the capital they need to grow. Several studies have demonstrated the benefits of acquiring funds to invest in a business, including field trials that gave small cash grants to business owners. Returns to capital have been found to range from 60% to as much as 360% a year (Fafchamps, et al., 2011; de Mel, McKenzie, & Woodruff, 2008; McKenzie & Woodruff, 2008).

These findings raise an important question: Since these returns far exceed prevailing interest rates on microfinance loans, why are so many entrepreneurs reluctant to borrow? Poor loan adoption is a significant factor in the underinvestment endemic among micro and small firms in emerging economies. A number of explanations have been offered, including the time, expense, and hassle of taking out a loan, as well as aversion to the risk of taking on a financial obligation. But another reason why business owners may not want a loan is they fear the money could get diverted to nonbusiness purposes, a mindset or attitude that might be called “frailty c onsciousness.” In fact, given the difficult day-to-day challenges of surviving and operating a small business in emerging economies, many entrepreneurs likely face external or internal pressures to use loan proceeds for living expenses or buying something frivolous. The result could be under (or zero) investment in the productive assets needed for growing one’s businesses – not to mention a spiral of debt. In a recent study in Ghana, adoption of a “locked loan” that could only be used for a specific business asset was 10 – 14% higher even though the loan had restrictions. Entrepreneurs with high “frailty consciousness” were less likely to take an unlocked loan, but instead adopted locked loans at a much higher rate (Anderson, Chandy, & Narasimhan, 2019).

Implications

A combination of interventions to improve both management skill and access to financial capital in small and medium enterprises (SMEs) can help to overcome a cycle of low sales and low profits:

1. Improving managerial capital. Providing applied and more intense business training, ranging from applied financial strategies to marketing and operational topics, yields organizational improvements. Also, providing local coaching and mentoring strengthens take-up of improved management practices.

2. Promising interventions to financial capital. Direct cash transfers and in-kind grants to SMEs show promise for boosting profits and continue to be the best way to quickly boost capital. Locked-in loans (i.e. loans that restrict funds to be invested in productive business assets) also have a high adoption rate across SMEs and can counter pressures to divert funds to non-business uses.

Additional research is needed to help identify the most effective combinations of support for promoting small businesses in a cost-effective manner that can be effectively tailored to local contexts.

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Stephen J. Anderson is an associate professor of marketing at the Stanford Graduate School of Business and a King Center faculty affiliate. His research focuses on marketing and entrepreneurship in emerging economies, and he has conducted randomized controlled field experiments to determine what business solutions best stimulate small business growth. He has completed field studies in South Africa and Ghana, and also carried out research in Kenya, Mexico, Nigeria, Rwanda, and Uganda.

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