

Cluster Brief: Targeting Firms with High Growth Potential in Developing Countries¹

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The Competitiveness Policy Evaluation Lab, or ComPEL, supports the rigorous impact evaluations of interventions that aim at targeting firms with high growth potential. Policies that target and promote firms with high growth potential have shown to have considerable impact on increasing employment, incomes and economic growth (McKenzie, 2017; De Mel, Woodruff, & McKenzie, 2012). High growth firms in the context of developed countries are defined as firms that grow over 20% annually, have more than 10 employees and some tend to be older than 5 years in the context of OECD countries (OECD, 2010). When applied in the context of developing countries, however, a remarkably small number of firms meet the criteria (Hsieh & Klenow, 2014). This leaves us with the possibility of addressing a broader range of issues that are centered around firm growth and employment growth in the context of developing countries.

This suggests that the more relevant policy questions in the context of developing countries are:

- i) How do we identify firms with high growth potential?
- ii) What kind of policy would assist them in achieving growth?
- iii) What does prevent a high growth potential firm from growing on its own?

Targeting Mechanisms

The rather recent body of literature on how to identify firms with high growth potential is centered around the following types of mechanisms:

1) Marketing and Screening. Marketing and screening is one of the mechanism of identifying firms with high growth potential that involves reaching out to the public for funding applications and then screening or targeting a selection of them. In the cases of the YouWin! Programme in Nigeria and the Western Balkans Investment Readiness project for instance, a public advertisement calling for applications and business plans was carried out to which many firms had to fill out an online application with their information and a business details (McKenzie, 2017). In the case of the YouWin! Programme, providing a grant to a random selection of these applicants was successful in creating more jobs and profits for firms, suggesting that the application process caused some form of self-selection.

2) Judge's Scores. The screening of the applications can often be done using different mechanisms. Using experts in the field to judge the applications and assign scores, is one popular method. Business proposals from different firms are put before either venture capitalists or experts in the field who judge and at times assign scores to each participant. These scores are then seen as a measure of investment readiness; where specific number of firms with the highest scores or those who meet certain criteria are selected for investment are identified as firms with high growth potential. The study by Fafchamps and Woodruff (2016) in Ghana find that the ones ranked higher by a panel of experts grow faster.

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3) Psychometrics, Mechanism Design and Machine Learning. There are other studies in the literature that used psychometrics and machine learning algorithms to identify characteristics or traits that correlate between successful entrepreneurs and use this as a basis to predict the performance of a given firm (McKenzie, 2017; Fafchamps & Woodruff, 2016). Hussam et al (2017) leverage community knowledge using Mechanism Design to successfully identify firms with high growth potential. This study was done in India where they wanted to see if the peers in the community have better information on who will successfully manage a business and who will not. They find this information can be obtained from the community, given the incentives for providing such information is correctly aligned.

4) Incentivize self-selection. It is possible to design interventions that are provided conditional on the participants achieving set targets. For instance, if there are firms that are going to receive a training program, the training could be a tiered one, where firms can only progress to the next stage of the training conditional on the firm's performance in the previous stage. This would incentivize firms to perform well on the training and simultaneously screen out firms that do not meet the requirements. The ComPEL's study with Georgian Government looking at training SME firms on e-commerce marketing, is designed to evaluate precisely such an intervention.

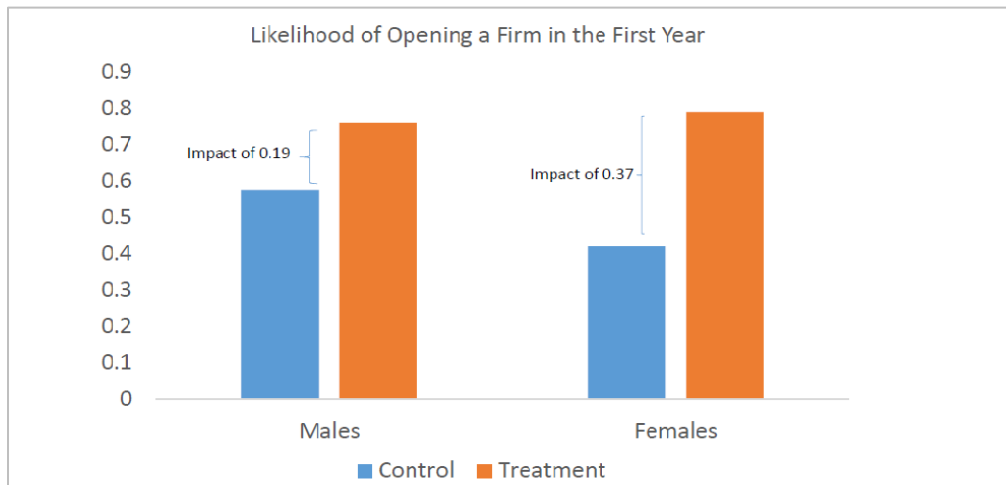
Firm Support Interventions

Once firms with high growth potential have been identified, the relevant question is what kind of support would assist them better in achieving that level growth. Currently the literature on firm support policies that do not involve any identification or targeting of firms is often found to be less impactful. For example, several business training programs have found to be expensive and have either modest or no impact (McKenzie, 2017). Wage subsidies provided by governments to encourage firms to hire workers were taken up with the intention of overcoming labor market frictions. While the intervention did not always significantly increase employment, when it did increase employment, it did not last once the subsidies were withdrawn (Groh, Krishnan, McKenzie, & Vishwanath, 2016). The evidence still leaves the possibility, however, of some improvements in the way such programs are delivered.

There are interventions that have shown to be impactful too. Bertrand and Crepon (2016) show that teaching firms about labor laws and providing them legal assistance spurs employment in South Africa. One key hypothesis that ComPEL is interested in testing is whether these conventional firm support interventions can be more impactful when combined with identification of firms with high growth potential.

The most successful interventions that have improved firm growth as well as employment has been providing grants to firms after screening. YouWin! programme in Nigeria has shown that once targeting of firms is done successfully then providing grants can boost employment and firm growth (McKenzie, 2017). For new firms, winning the competition results in a 23 percentage point increase in the likelihood the firm has 10 or more workers along with a 23% increase in profits. For existing firms, winning results in a 21 percentage point increase in the likelihood the firm has 10 or more workers and a 25 percent increase in profits. It was also found that providing grants to randomly selected firms from a business competition led to a larger increase in the probability of women in the treatment group starting a business against the women in the control group, when compared with the probability of men in the treatment group starting

a business when compared with the men in the control group (McKenzie, 2016; seen in the above graph). This suggests providing a grant had differential impact across gender.



Source: McKenzie, 2017

While there are a few isolated cases of successful interventions such as, a certain type of training, building accelerators and incubators and matching grants, more evidence is required from different contexts (McKenzie, 2017). Future projects in this area would allow us to identify not only which of these policies are impactful, but the relative impact of each of these policies compared to each other.

Cluster of Impact Evaluations on Targeting Firms with High Growth Potential

ComPEL works closely with government representatives and World Bank project teams to provide technical and financial support to incorporate impact evaluations into programs that target businesses with high growth potential. Our aim is to build a body of evidence that can better inform which interventions have proven to be impactful and which have not in this policy space. Sample interventions currently supported by ComPEL include: different types of selection panels to identify businesses with high growth potential and award grants, and using performance benchmarks to allocate firm support. More information about this cluster and its related impact evaluations is available in:

<http://www.worldbank.org/en/programs/competitiveness-policy-impact-evaluation-lab#2>

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