



What do firms tell us?

Evidence for firm-level surveys in Latin America and the Caribbean

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Inter-American Development Bank

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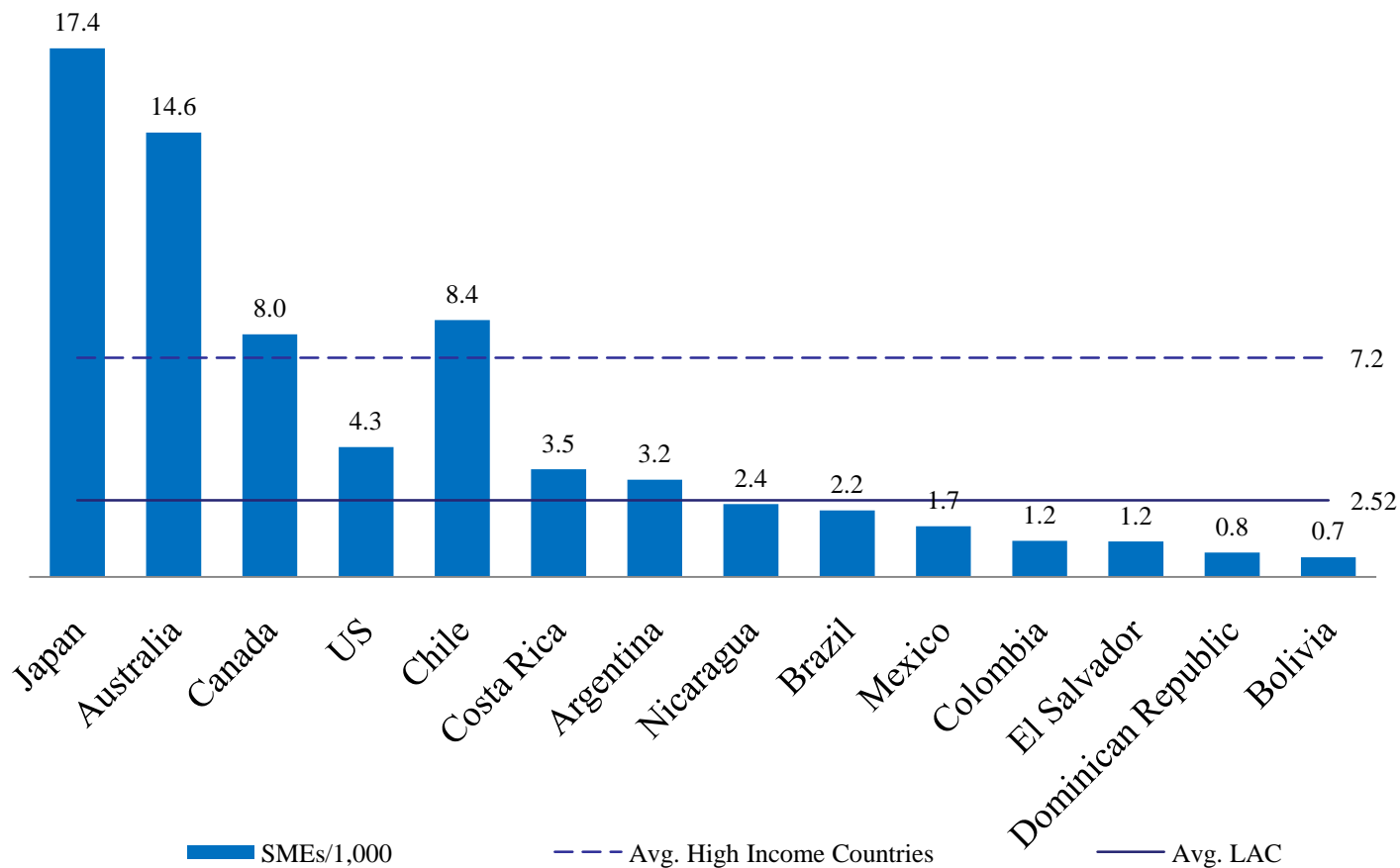
Outline

1. Where are the SMEs?
2. What do the firms tell us? Costs, incentives and structural factors
3. What should policymakers do?

1. Economic and Institutional Landscape of LAC

- ❖ A wide productivity gap exists between LAC and developed economies
- ❖ ... growth based on factor accumulation, not innovation and productivity enhancements
- ❖ and many institutions addressing productive development ... less known about their effectiveness

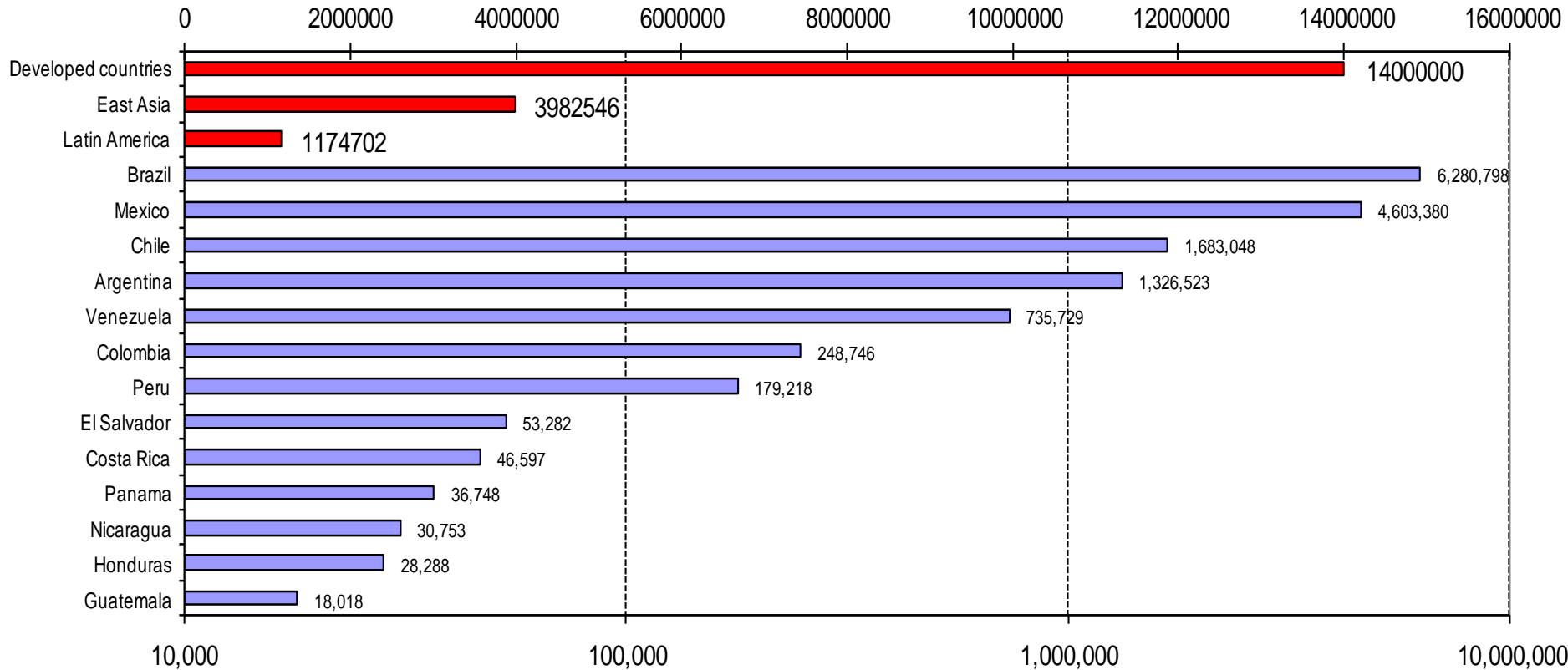
.. Where are the SMEs?



Source: Author's based on International Finance Corporation (2011)



Regional Comparison of the Size of Large Companies (In thousands of US\$)



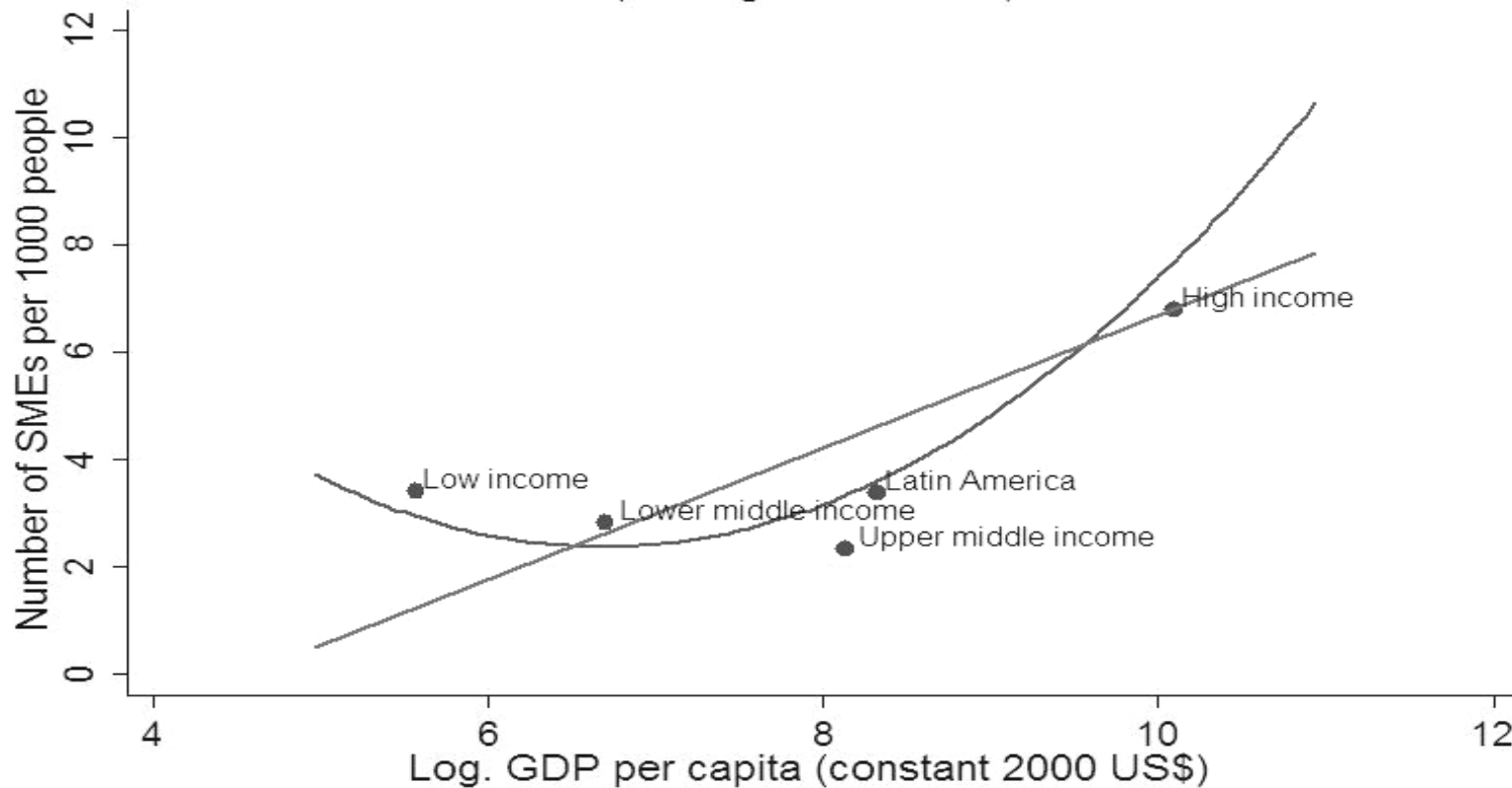
Asset average of the 25 largest firms in the country (thousands of dollars)

Source: IDB based on World Scope and América Economía.
Note: In some countries the database includes less than 25 firms.



.. missing middle of productive SMEs

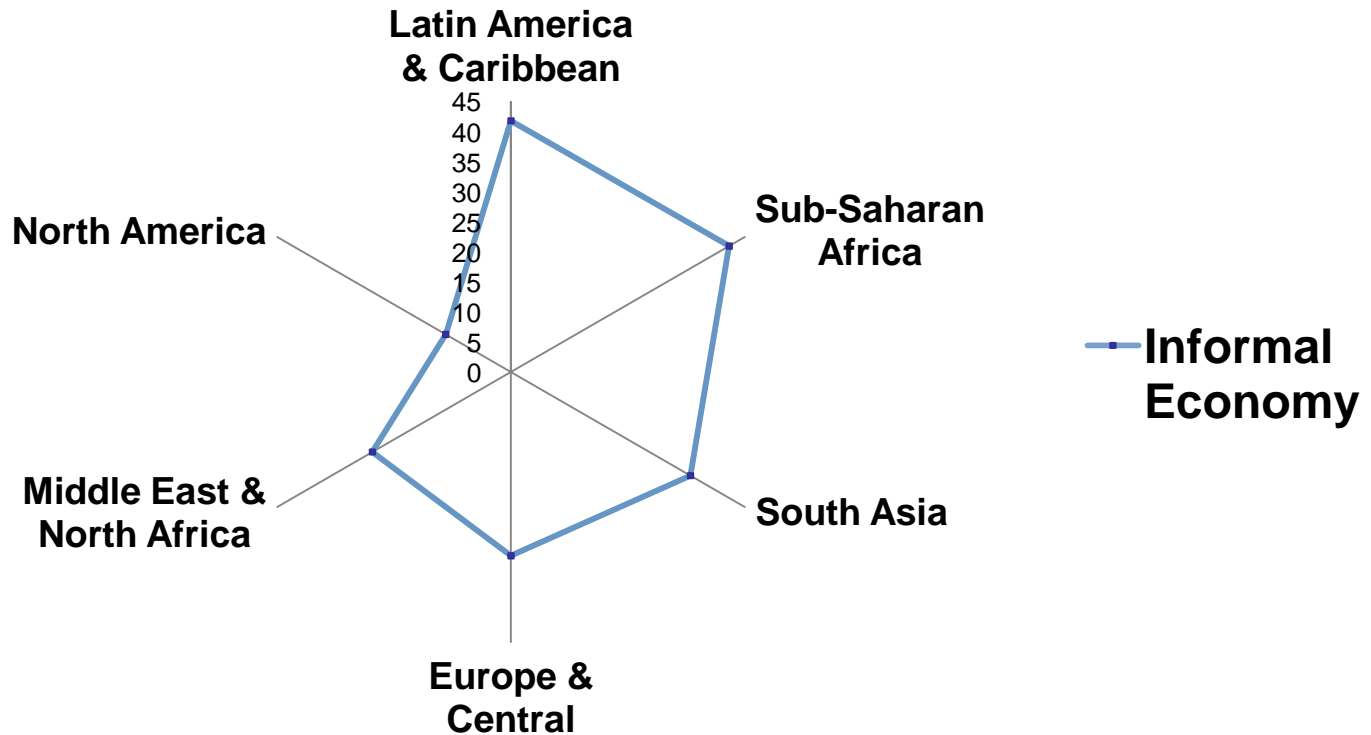
Figure : SMEs and GDP per capita
(Average 1990-2010)



Source: Prepared by IDB



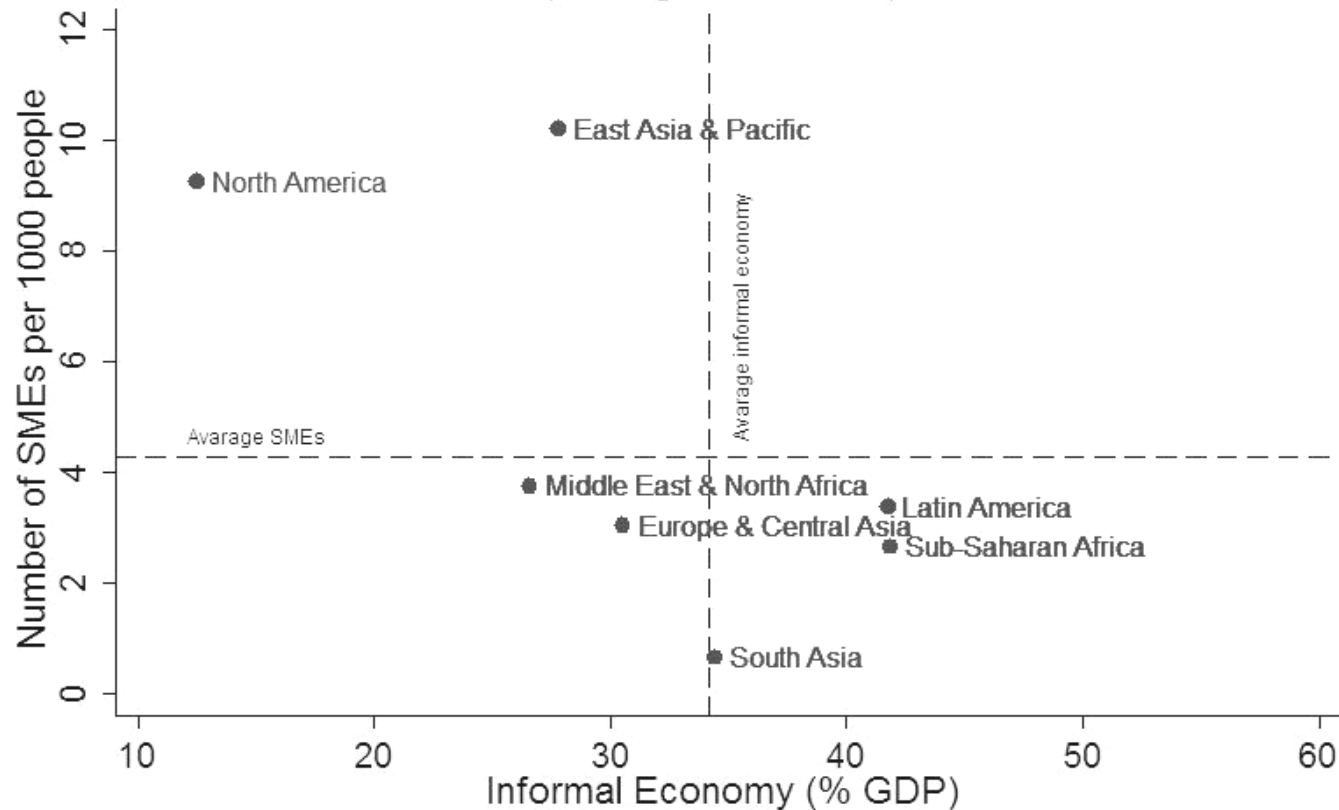
... High levels of informality



Source: Prepared by IDB

... A result associated with high levels of informality

Figure : SMEs and Informal Economy
(Average 1990-2010)



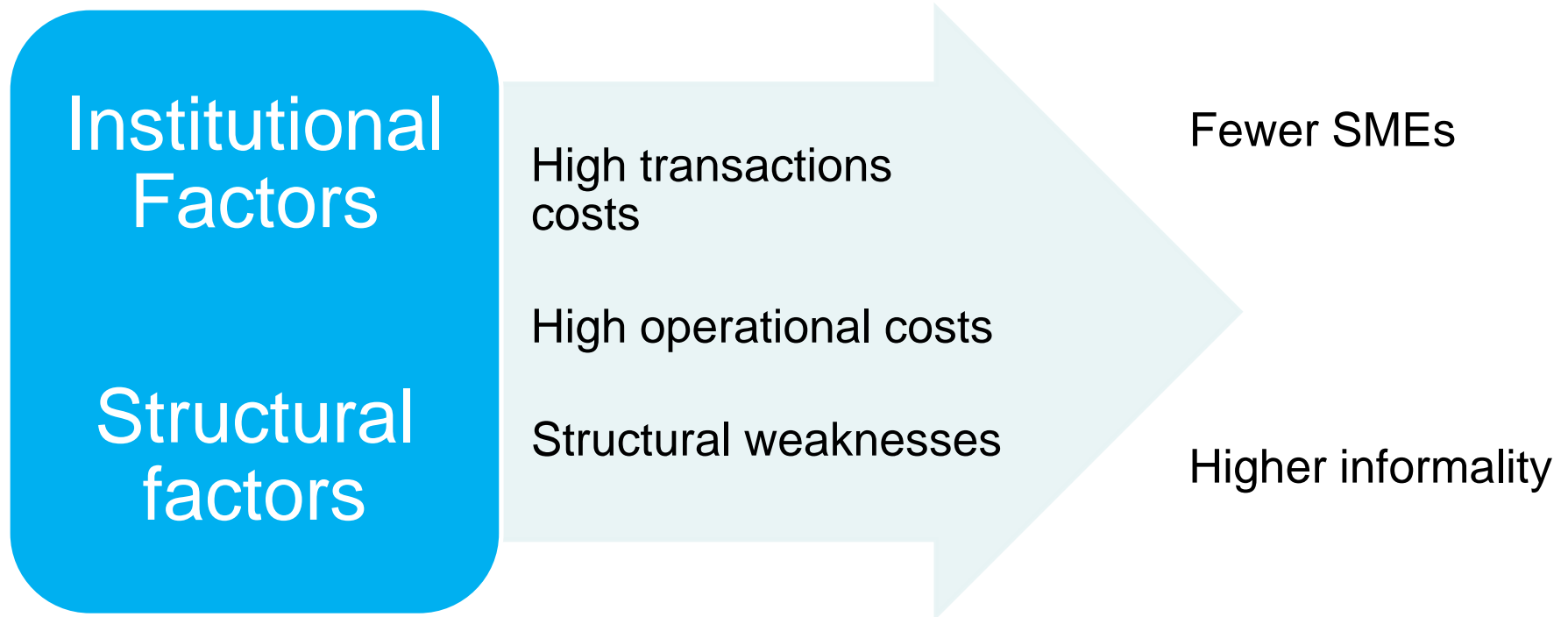
Source: Prepared by IDB

2. What do the firms tells us?: Costs, incentives and structural factors

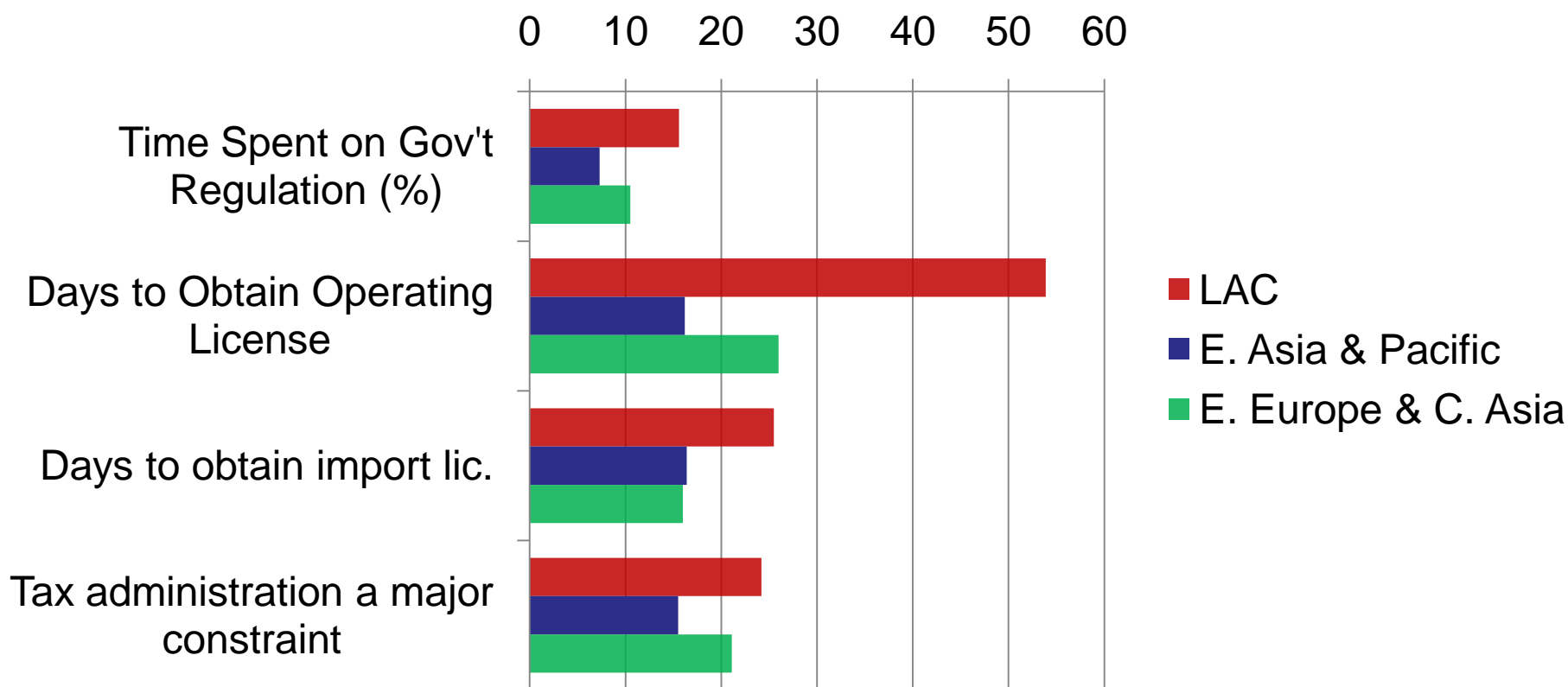
❖ In LAC SMEs are typically smaller than in developed economies and have lower productivity (Pages, 2010).

Why?

... role of costs, incentives and structural factors



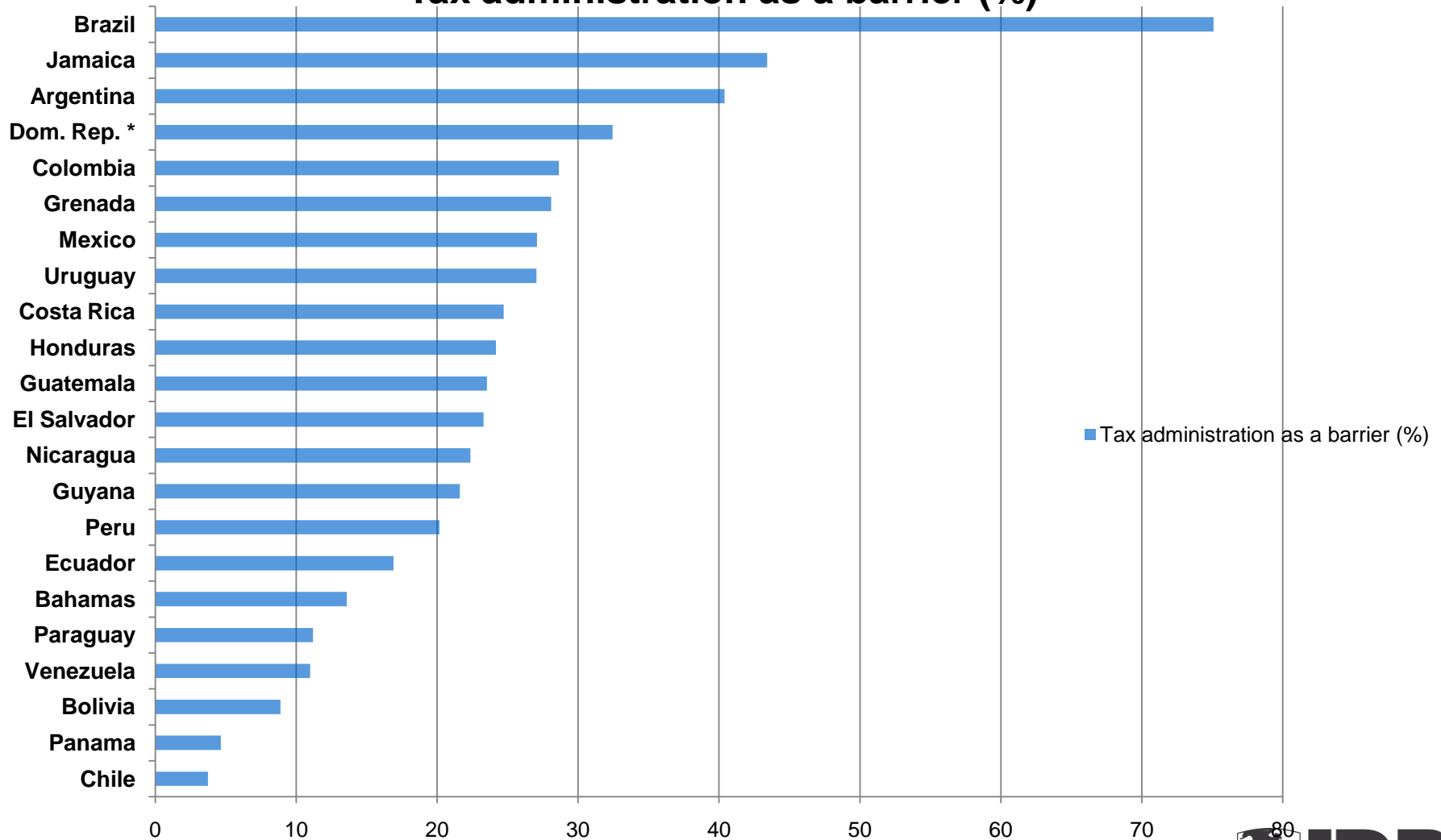
Weak institutional capacity leads to high transactions costs ...



Source: IDB, Compete Caribbean, World Bank data 2011

Wide variation among countries

Tax administration as a barrier (%)



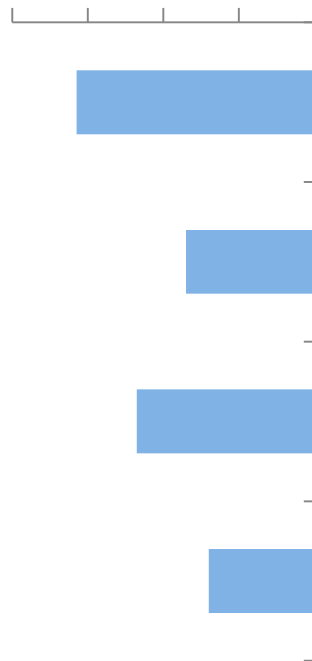
Source: IDB, Compete Caribbean, World Bank data 2011



... and is linked to linked to poor performance

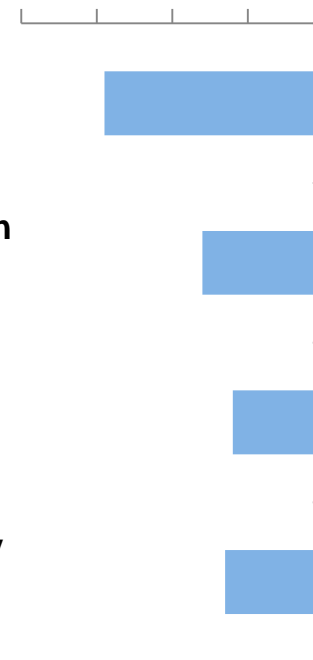
Labor Productivity

-0.8 -0.6 -0.4 -0.2 0



SMEs/1000

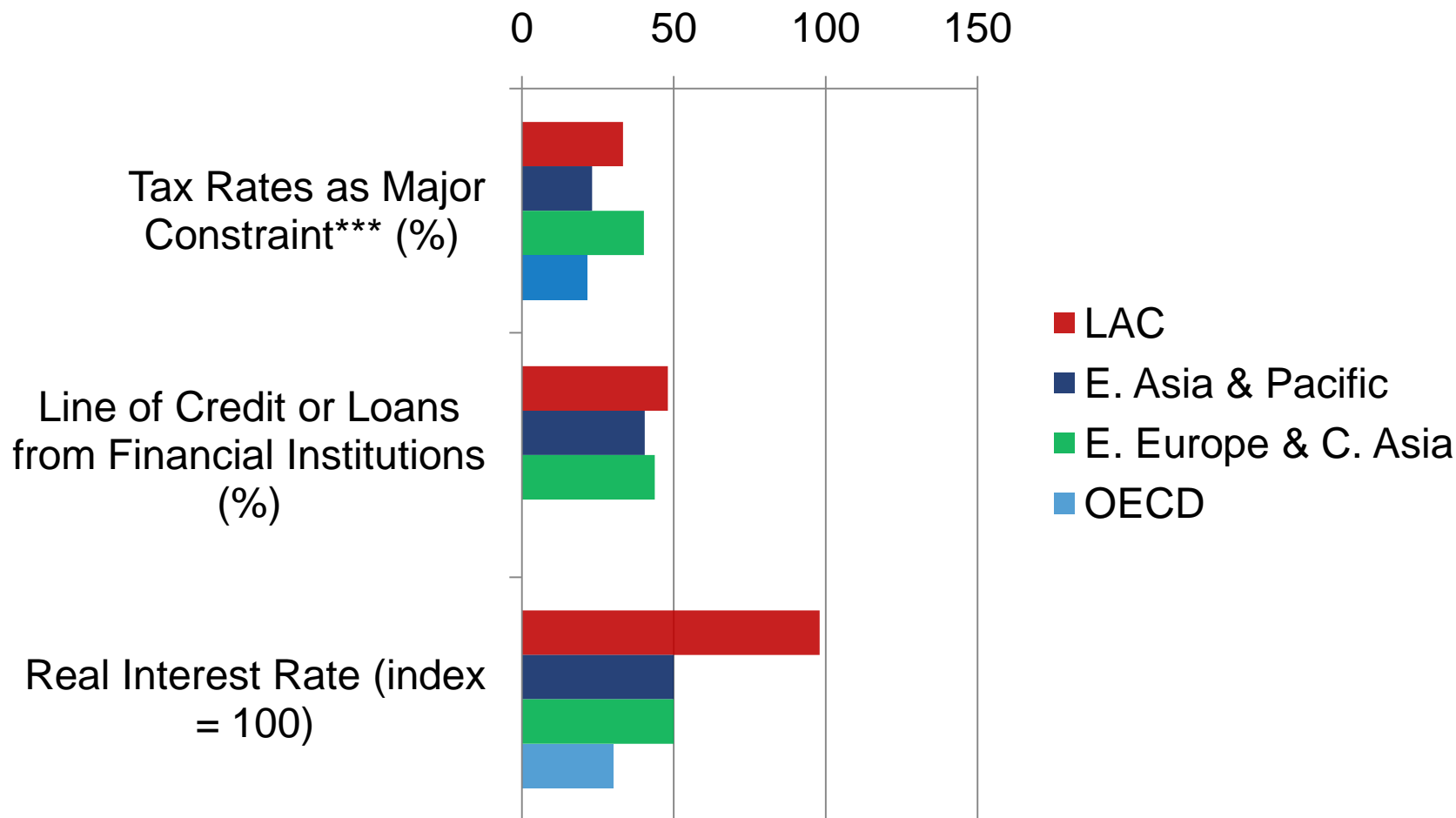
-0.4 -0.3 -0.2 -0.1 0



Source: Prepared by IDB



... operational costs are also high



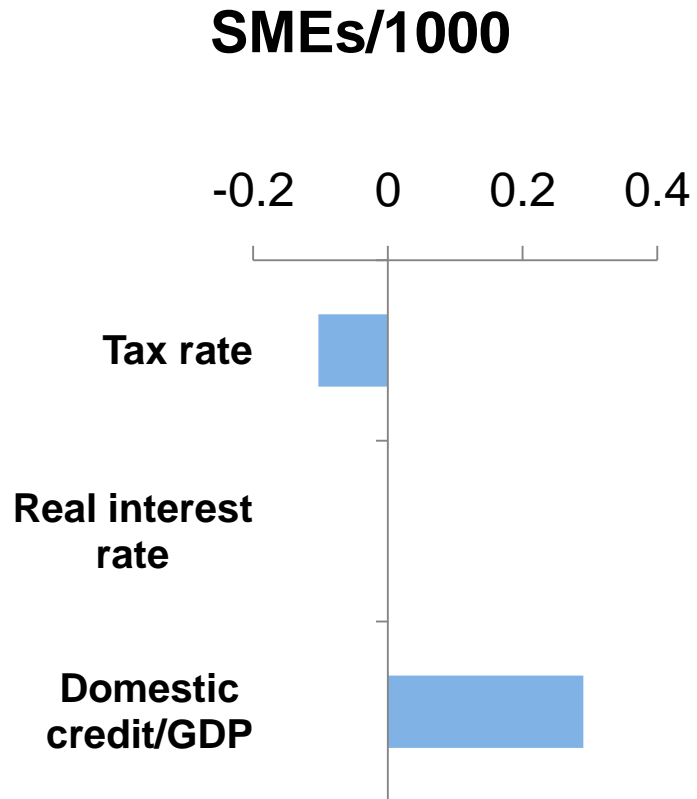
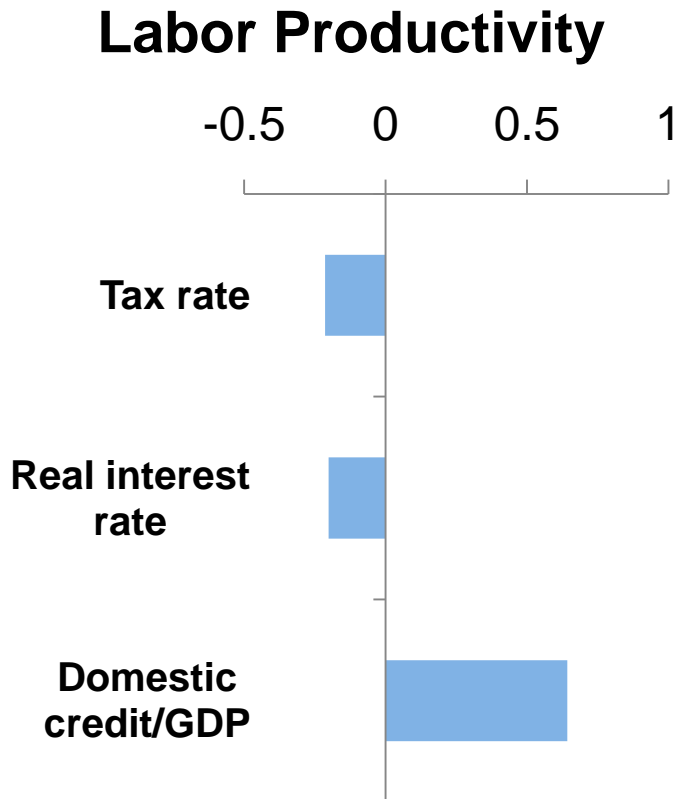
Source: IDB, Compete Caribbean, World Bank data 2011



Firms also report ..

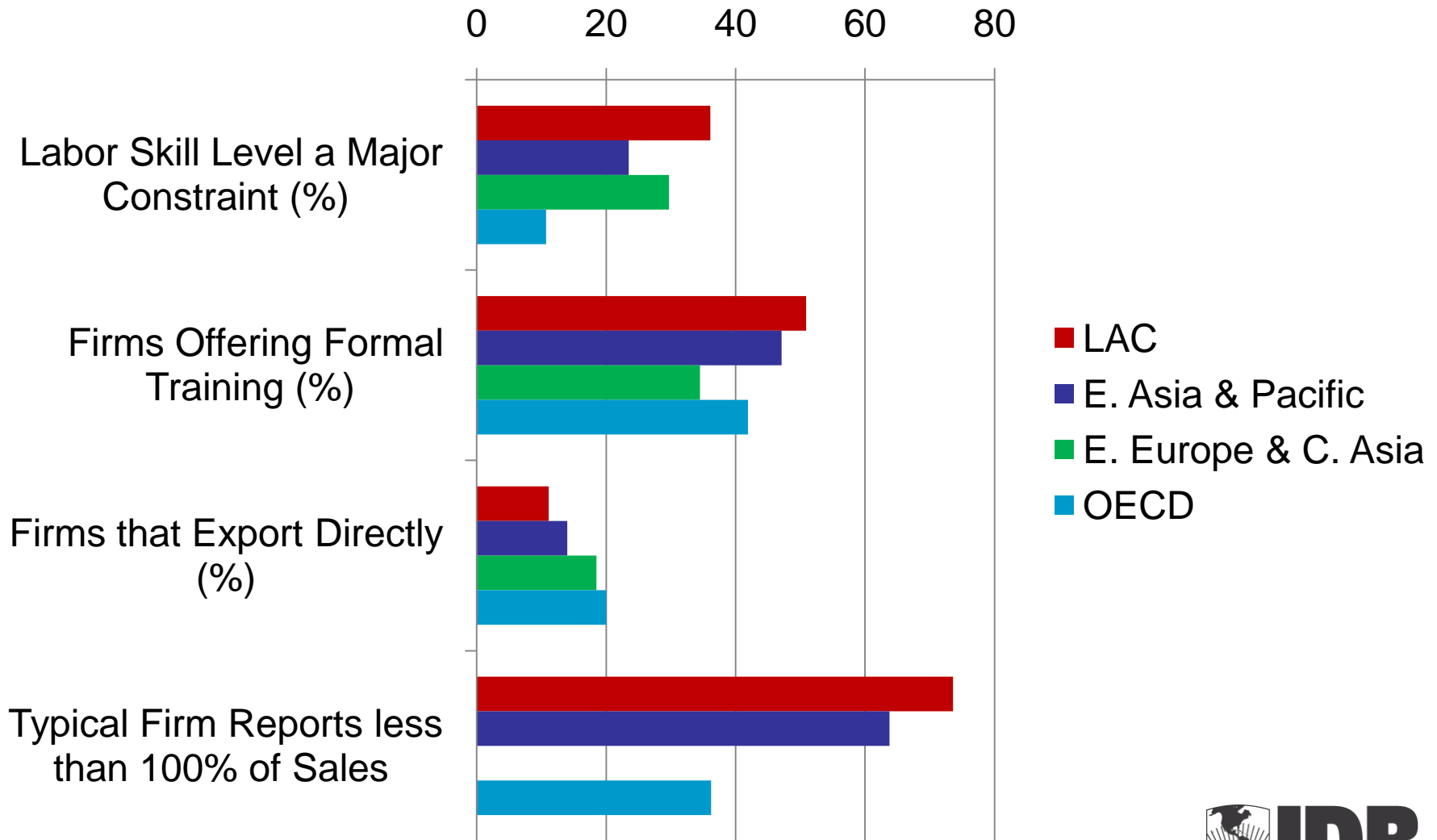
- High security costs and losses from theft
 - 1% of sales vs. 0.2% in OECD
- Losses from power outages
 - 4.3% vs. 2.2% in OECD
- Transportation a constraint
 - 23.1% vs. 16.4 in E. Asia and 27.1% in Sub Saharan Africa
- Less confidence in courts as fair and impartial
 - <29% vs. >54% in E. Asia

... and is linked to linked to poor performance



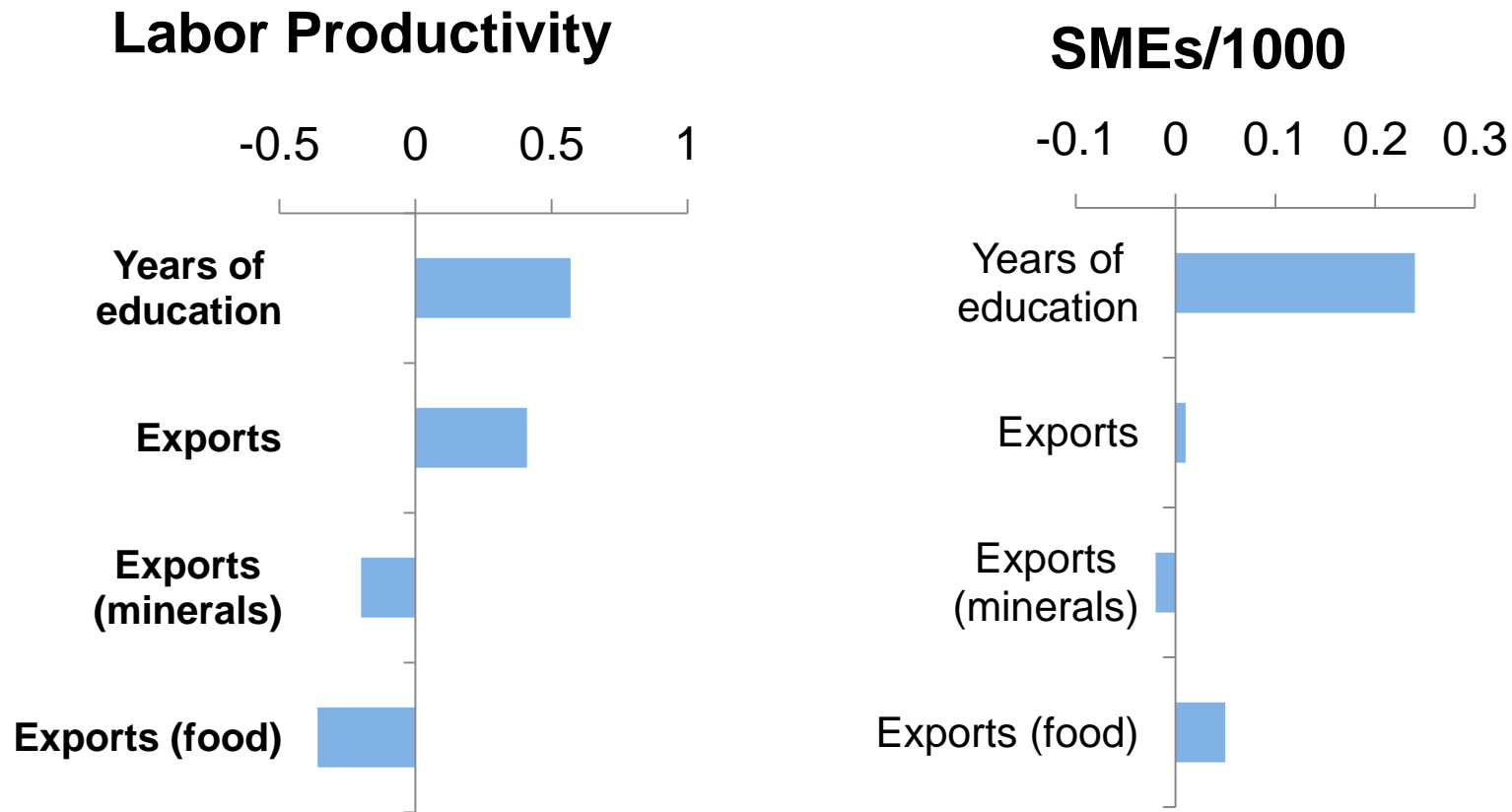
Source: Prepared by IDB

Structural factors also a concern for firms.



Source: IDB, Compete Caribbean, World Bank data 2011

Structural factors also affect productivity, SMEs and informality



Source: Prepared by IDB

4. What can policymakers do?

❖ Goal: Increase productivity through increases in output and/or greater efficiency.

How?

Improve the business climate

- ❖ Measures aimed to improve regulation and make institutions more effective should be *scaled up*.
- One-stop shops for business opening (Bruhn, Kaplan)
- Simplify labor registration procedures (Ronconi)
 - impact on new firms, new workers; less so on reducing informality.
- Combine reducing red tape with lower taxes (Pagés)
 - Impact on informality
- Larger cost reduction, greater impacts (1/2 of initial cost) → Growth in number of firms

Calibrate fiscal policy for impact on productive SMEs

❖ Carefully assess impact of tax measures on SMEs and incentives for informality

- Tax burden can impede growth of firms and increase incentives for informal behavior (tax rate and administrative burden) → VAT less distortionary
- Simplified tax regimes can lead to downsizing of firms (Chong, et. al 2009, Mckinsey, 2009)
- Complexity of tax regime adds incentives for informal behavior (and rent seeking).

Greater access to financial services

❖ Improve institutional conditions for financial and capital markets, design appropriate interventions targeted to SME segments

- Create institutional architecture: credit bureaus; improved regulation/supervision; guarantees and registries; and creditor protection

- Differentiate instruments

 - Dynamic SMEs: access to seed capital, equity markets

 - Mid-growth SMEs: working capital, leasing and factoring



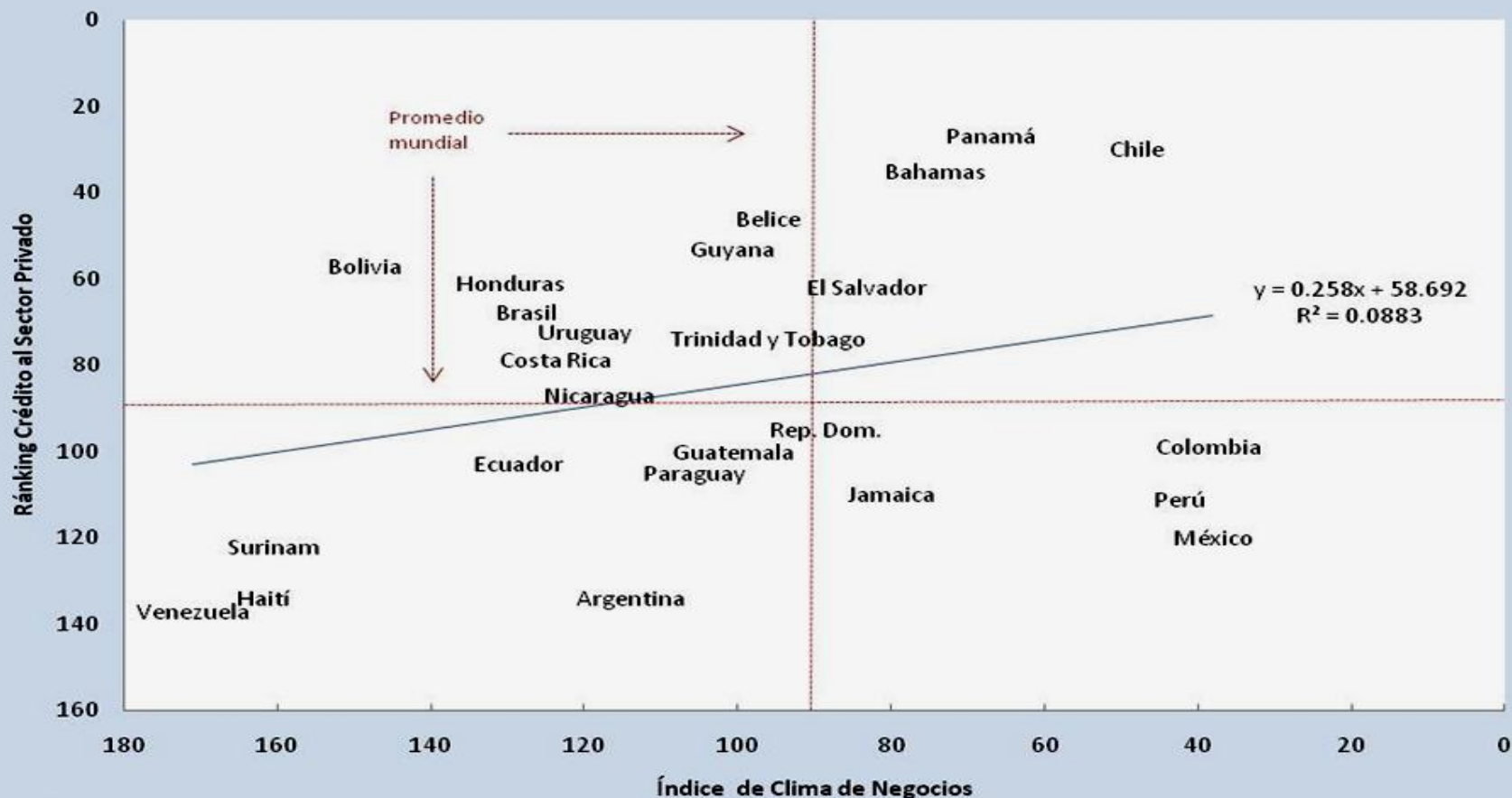
Lessons for targeted policies ...

❖ Improve performance of sectors with greatest potential for productivity gains.

- Deploy productive development policies: business services, cluster programs, labor training, export promotion, and incentives for R&D and innovation.
- Target productive SMEs (*cost sharing*)
- Ensure that synergies exist between financial and non financial services → greater impact (Lopez Acevedo 2010)

Lessons: Tailor institutional reforms and policies

**Clima de Negocios y Profundidad Financiera
(Promedio 2000-2010)**



La situación de cada una de las economías en el gráfico viene determinada por la posición que ocupa cada una de ellas en el ránking de las variables objeto de análisis. El puesto alcanzado en el Índice de Clima de Negocios determina su posición en el eje horizontal (0=más fácil, 183=más difícil), mientras que la posición obtenida en el ranking de Crédito al Sector Privado determina su posición en el eje vertical (0= mayor %, 183=menor %)



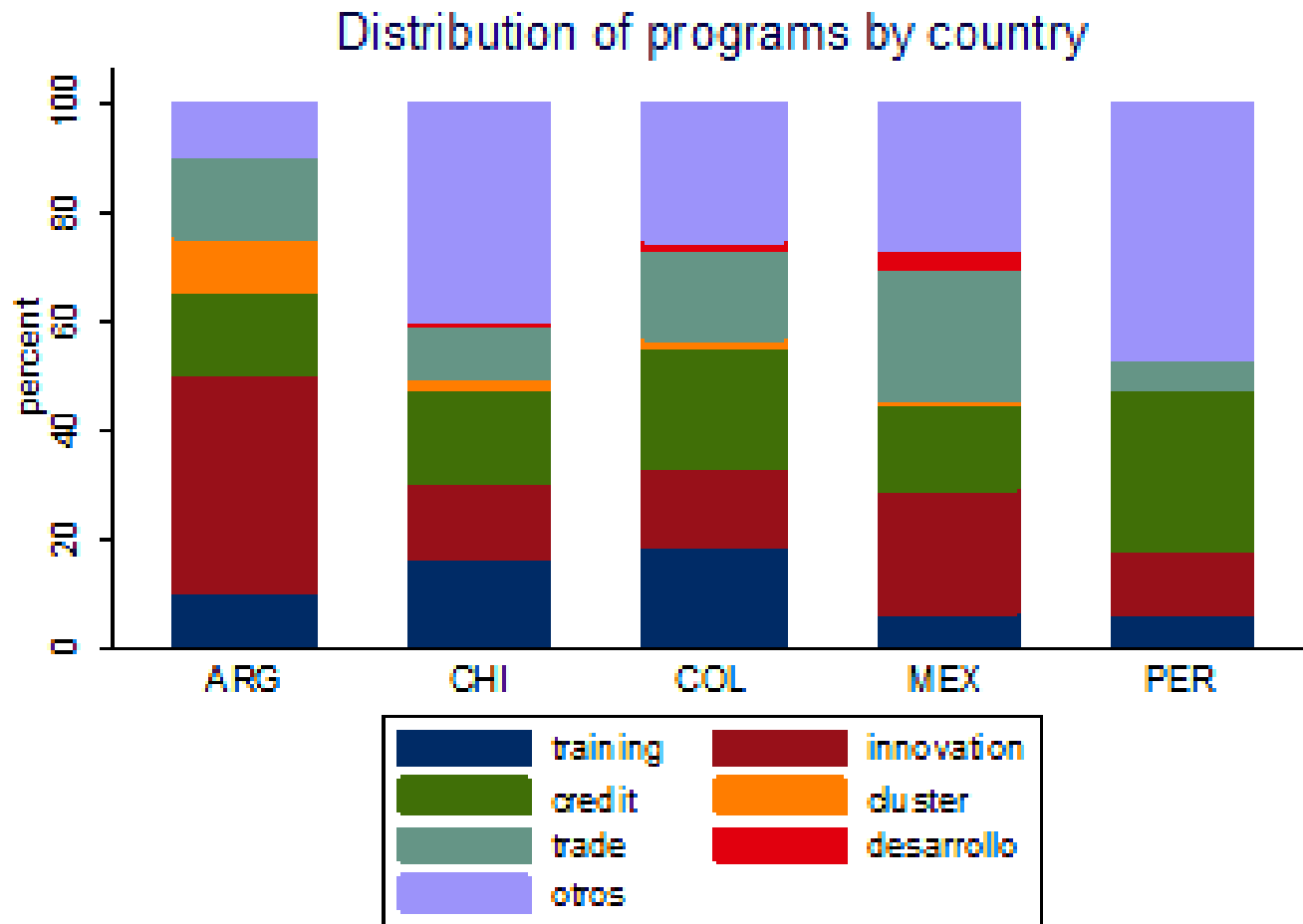
3 lessons for public support to firms:

- ❖ The lack of productive SMEs is a symptom of various factors, including the large scale presence of informality → reducing informality and supporting SME growth are complementary activities.
- ❖ Fiscal, financial and productive development policies need to be targeted to the needs of productive firms: especially targeting SMEs in different segments → services, exports, technology.
- ❖ Improved data is needed to appropriately evaluate both the needs of SMEs and the effectiveness of productive policies.



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Target development policies to have greatest impact on productivity



Growth Policies

Classic Policies

Horizontal

Vertical

Public
Goods

Roads, Schools
Trade Policy
Competition Rules
Business Climate

Industry Research
Institute
Quality Standards
Specialized
Infrastructure

Market
Intervention

R&D tax incentives
Grants to firms
Subsidized training
Micro/SME credit

Sector tax holidays
(EPZ)
Industry subsidies
Directed credit

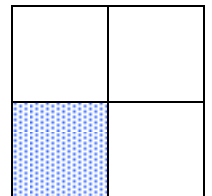
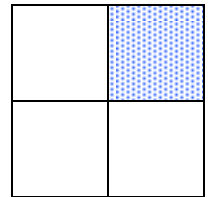
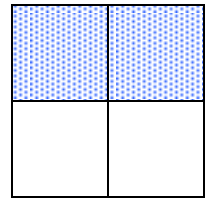
Productive development Policies

Industrial Policies

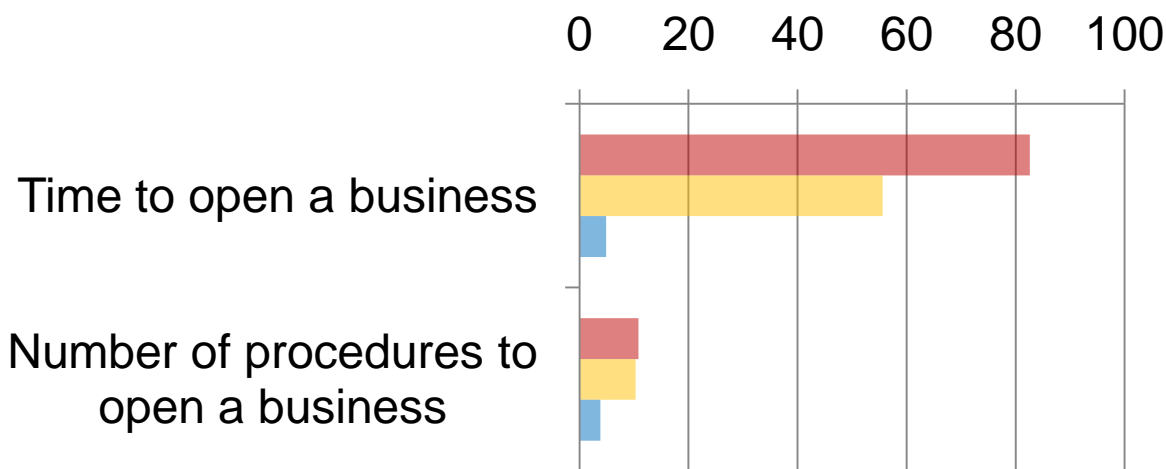
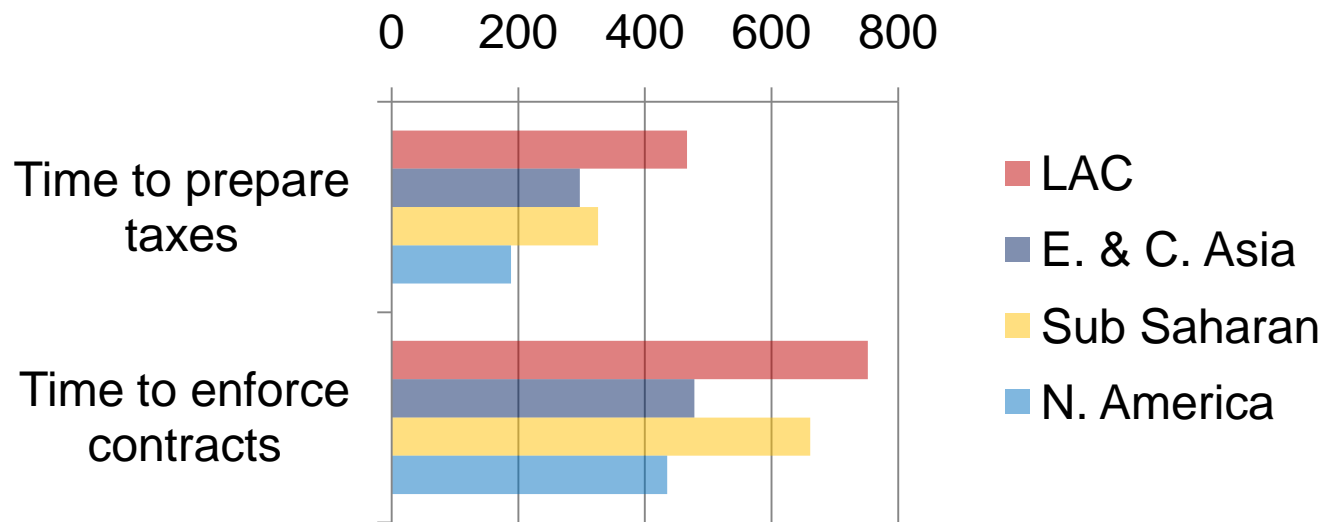


New Institutional Roles

- Public Private Dialogue
 - Business climate reform
 - Competitiveness Councils
- Public Private Partnerships
 - Case studies
 - Cluster Development Model
- Productive Development Policies

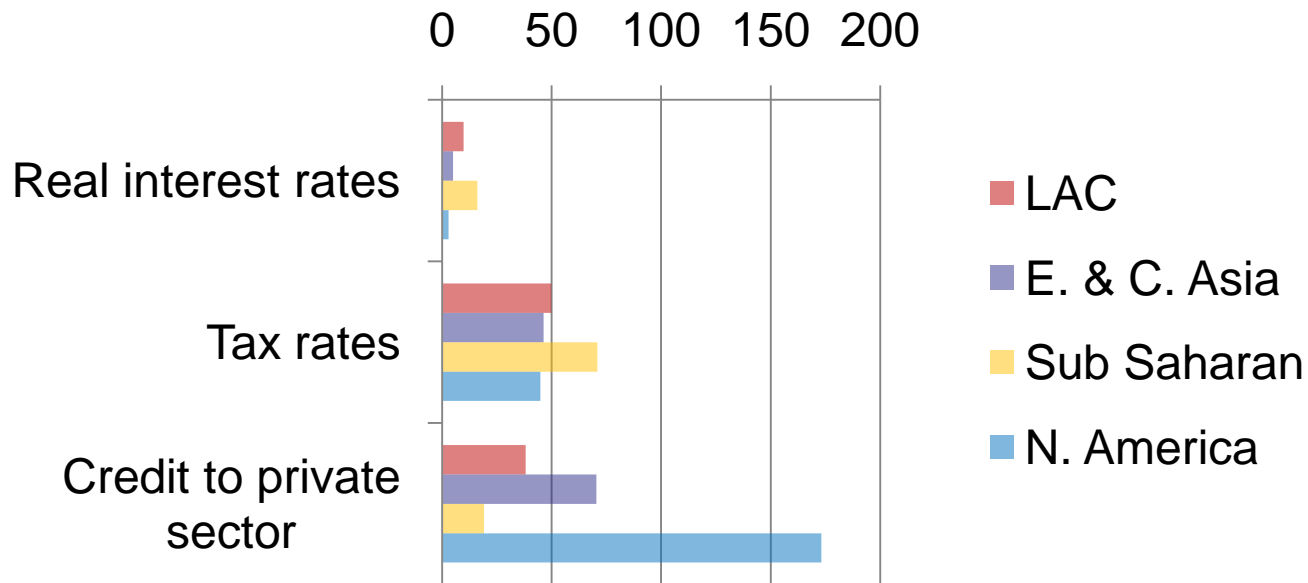


Weak institutional capacity leads to high transactions costs



Source: Prepared by IDB

... operational costs are high for businesses



Source: Prepared by IDB