The Dynamics of Entrepreneurial Human Capital: Evidence from Indonesia

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Micro and Small Enterprise Entrepreneurship in Indonesia

- Analysis of the formation and development of micro and small enterprises in Indonesia, 1993-2008.
- Key questions:
  - What is behind the formation and growth (or lack thereof) of small enterprises in Indonesia?
  - If enterprises fail to form or grow, is it due to lack of credit, or something else?
  - To what extent are differential outcomes due to differences in ability and business experience?
- Keep in mind: analysis based on observational data, not on testing a specific policy intervention.

Relevant Evidence

- A number of existing studies find that access to credit is not necessarily the binding constraint to most poor households in *starting new* enterprises (e.g., Banerjee et al., 2010; Karlan and Zinman, 2010).
- Emerging literature on entrepreneurship-specific and managerial human capital finds that standard training is not so effective for microentrepreneurs (e.g., Karlan and Valdivia, 2011), but some promise to more contextually-relevant interventions such as consulting (e.g., Bruhn et al., 2012).
  - A number of studies on training/consulting interventions, little evidence on the value of real-world experience (potential learning-by-doing effect).

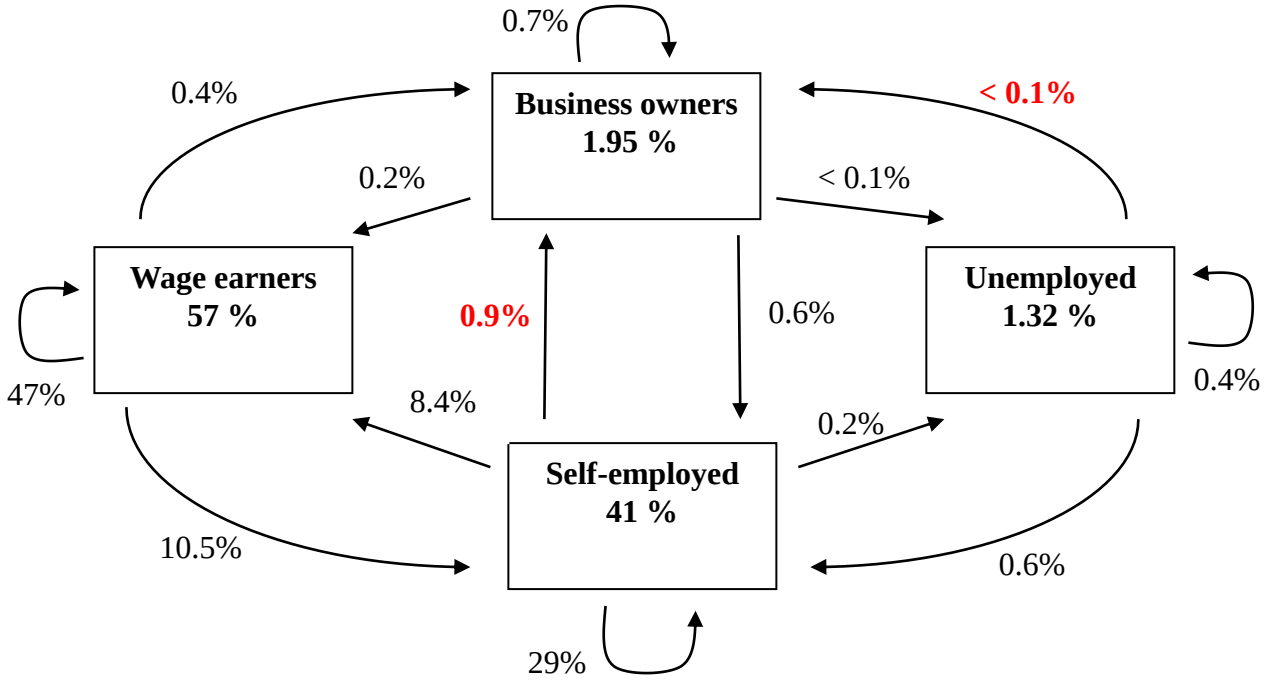
The Data

- Based on 4 survey rounds (1993, 1997, 2001, 2008) of Indonesia Family Life Survey (IFLS).
- IFLS tracks the same 7300 households and their splits over time (grows to 10,500 households).
- Representative of 83% of Indonesian population.
- Each round contains thousands of detailed surveys of household enterprises.

Descriptive Evidence (from IFLS)

1. Vast majority of micro-enterprises lack significant investment in physical assets.
2. Vast majority of micro-enterprises fail to "transition upward" in terms of capital or employees.
3. Vast majority of micro-enterprises show little dynamism in terms of increased earnings.
4. Female-owned enterprises less dynamic than male-owned ones.

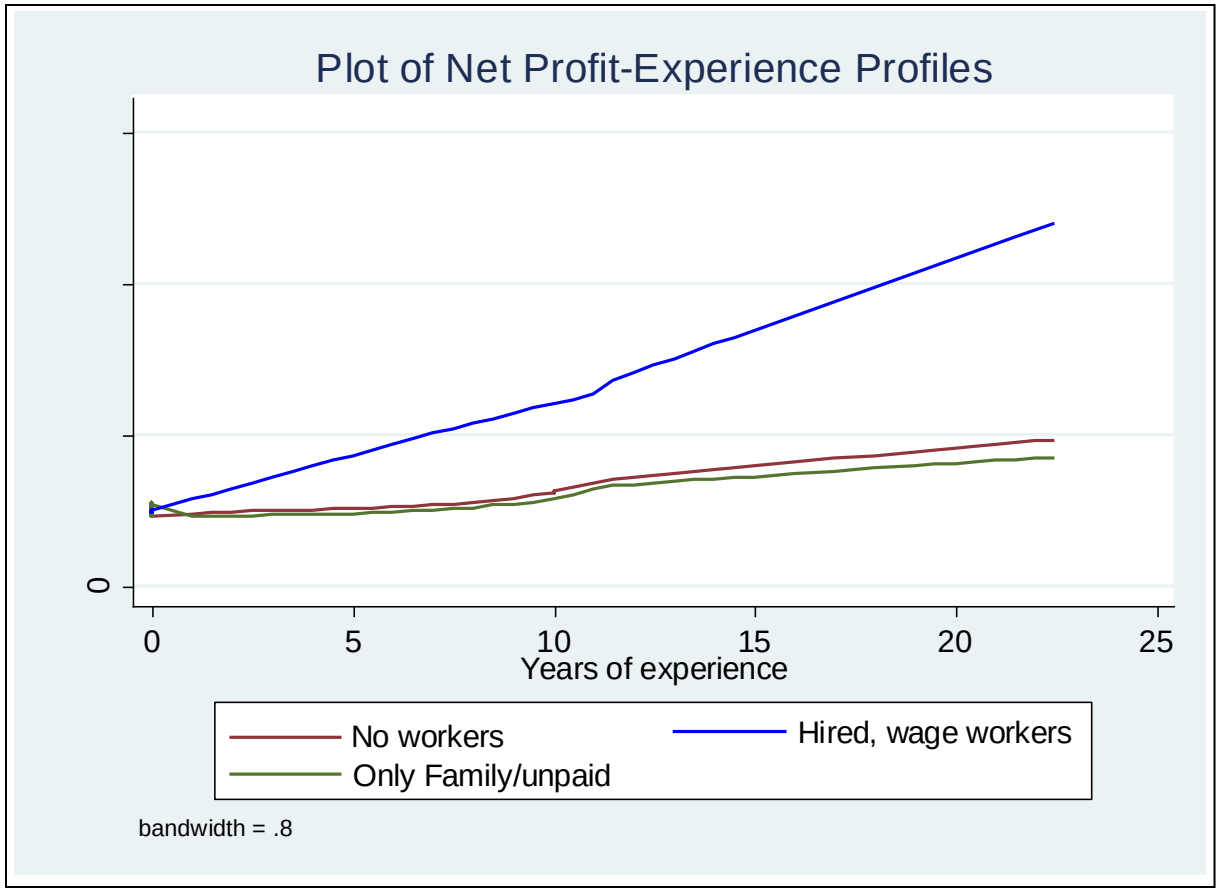
Most MSMEs: Lack of Dynamism and Failure to "Transition Upward"



• Occupational transitions 2000 to 2008, between business owners, unemployed, pure self-employed and wage earners.

•Evidence generated from Indonesia Family Life Survey (similar to Mongragon-Velez and Pena for Colombia).

Most MSMEs: Lack of Dynamism (Toth, 2010)



- Plot of profit growth amongst Indonesian MSMEs. Data from Indonesia Family Life Survey (IFLS).
- Distinguishes (1) pure self-employed, (2) those with only family/unpaid employees, (3) those who hire wage workers.

Female-owned enterprises less dynamic

- Female-owned enterprises:
  - Less likely to operate outside home (63 vs 83%)
  - Less likely to apply for business permits (47 vs 52%)
  - Startup with less wage workers (0.2 vs 0.8 on average)
  - 30% less startup capital
  - 30% lower earnings

Descriptive Evidence

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→ If this is true, what is driving observed enterprise activity?

Possible Forces: Access to finance

1. Lack of access to finance.

- Empirical analysis uses descriptive evidence combined with a number of positive, exogenous shocks in access to funds.
- Consistent with RCT-based studies (cited above) from other countries, **access to finance does not seem to be the key binding constraint for *most of the poor* to *starting a new enterprise*.**

Possible Forces: Human capital

2. Variation in entrepreneurial and managerial human capital.

- Parental background important correlate enterprise startup and at what size.
- Exploit two "natural experiments" to estimate the role of enterprise experience (potential learning-by-doing effect).

i. Cross-regional variation in formal sector labor market churning,

ii. Studying relatively high-ability individuals who plausibly involuntarily started enterprises due to 1997-98 E Asian financial crisis.

Possible Forces: Human capital

2. Variation in entrepreneurial and managerial human capital.

   - **→ Provide some of the first rigorous evidence of a potential "learning-by-doing" effect in enterprise activity.**
   - **→ Effect of experience on earnings 2.5-3% in general population and 5-6% among the crisis-period entrants who are totally new to running an enterprise.**

Policy Implications

- **On access-to-finance:**
  - **Consistent with other studies, find that access-to-finance is not a very responsive policy variable in increasing *startup activity* amongst potential poor microenterprise owners.**
- On human capital

Policy Implications

- On access-to-finance
- **On human capital:**
  - **Find evidence consistent with direct experience as an important source of entrepreneurship-specific human capital formation.**
  - **Consistent with other evidence that context-relevant entrepreneurship-specific human capital and business knowledge interventions can be effective.**
  - **Raises policy design questions: (1) how to design cost-effective, context-relevant interventions, (2) value of direct enterprise experience (perhaps complemented with consulting/mentoring interventions) for individuals with potential as high-performance entrepreneurs.**