SUPPORTING MICRO ENTREPRENEURS

TRANSFORMING THE MISSING MIDDLE

Roughly two billion people in the world live on $2 a day or less. Of these a staggering 50 per cent are estimated to be micro entrepreneurs, running a small business to make ends meet but employing only a handful of people. If just a small proportion of these entrepreneurs were encouraged to grow and invest in their business, and hire more employees, it could transform the fortunes of the developing economies, and billions of people living in poverty. But how? It is a challenge that ***Stephen Anderson-Macdonald*** *is hoping to help tackle.*

Small and Medium-sized Enterprises (SMEs), employing between 10 and 250 people, are the engine of economic growth and prosperity for the majority of developed economies. SMEs provide employment, many are great at innovation, and some go on to become major multinational corporations. Yet these essential elements of a thriving economy are absent in large numbers in most developing nations. In these countries there are millions of micro entrepreneurs employing few people, if any, and at the other end of the spectrum only a handful of large corporations exist. In between the two lies an entrepreneurial desert — the "missing middle".

For a number of reasons, only a very small percentage of the millions of micro entrepreneurs in countries such as South Africa, Ghana, Bangladesh and Chile, scale up their business to become SMEs. It is not for want of help. Each year billions of pounds in aid is given to the developing economies to help entrepreneurs establish and grow their ventures. Yet evidence suggests that this tide of money is having little impact in some of the key areas it is directed towards improving.

Stephen Anderson-Macdonald hopes to change that. He used initial seed funding from the Deloitte Institute of Innovation and Entrepreneurship to attract further grants of over £350,000 from groups such as the World Bank, US AID and the UK's DFID. He is now poised to advance the role of marketing and entrepreneurship in emerging markets. He is taking a methodology common in the world of pharmaceuticals and medicine, the Randomised Controlled Trial (RCT), and using it to discover what measures will really help populate the missing middle.

"Historically a lot of money goes into these countries through aid. Yet, although we keep giving money if you take simple indicators like GDP per capita, it does not seem to be having a big effect," says Anderson-Macdonald, a PhD candidate at London Business School. "By borrowing from the pharmaceutical industry we can use RCTs, a procedure where firms are randomly assigned into treatment or control groups then measured before, during and after an intervention, to evaluate in a rigorous way what types of business strategies and products work. Research so far has primarily focused on household, health and education outcomes. But we are using this methodology to focus on economic development and outcomes, and in particular, the role of marketing in stimulating growth for micro and small enterprises.

"We are implementing these live field experiments with actual firms because we want to know both the what — the main effect — and the why — the mechanism of change driving the main effect. Taken together, these insights let us better understand what's happening 'in the real world' and allow us to present a more complete picture to managers or policy makers."

More recently micro-finance has been touted as a solution to the lack of economic growth and prosperity in some of the developing economies. The result has been a glut of group lending and other micro finance initiatives. However, says Anderson-Macdonald, new evidence based on RCTs suggests that micro-finance may not be the miracle cure (at least not in isolation) for the economic challenges faced by these nations.

"Some researchers, including ourselves, have suggested that if it is not a lack of financial capital that is the problem then perhaps it is management capital," he says. "Management capital in terms of marketing skills hasn't been examined, until now, and that seems like an unusual oversight. First you need top-line revenue growth, and then you can worry about the expenses and finances. But without money coming in and growth at the beginning how can you expect to scale?"

Management capital as a catalyst for growth

Anderson-Macdonald is working with his doctoral dissertation advisor Rajesh Chandy, who holds the Tony and Maureen Wheeler Chair in Entrepreneurship at London Business School and is Academic Director of the School's Deloitte Institute of Innovation and Entrepreneurship, and Bilal Zia, an economist from the World Bank, to test this theory with an RCT in South Africa. With the help of an NGO, Business Bridge, the researchers provided a high quality business training programme to 900 growth-oriented entrepreneurs — i.e. individuals screened into the programme based on motivation and commitment to growing their enterprises. Of these, 300 received a short course in business management skills focused on marketing and sales, 300 received an identical course but only focused on finance and accounting skills, while the remaining 300 acted as a comparison group that did not receive any training but was otherwise similar in firm and entrepreneur characteristics.

The assignment of individuals to one of the three groups was done by lottery. The micro entrepreneurs did not know that they were part of a randomised control trial; they just knew that they qualified for a scholarship worth 15,000 Rand — some would get the scholarship this year and others would get it next year. The group receiving the marketing course ('treatment 1') attended 10 four-hour sessions in which they learned topics such as customer value creation, sales techniques, competitor analysis, pricing, promotions, packaging and distribution. By contrast, entrepreneurs assigned to the finance training group ('treatment 2') attended classes on separation of personal and business finances, cash-flow management, business investments, and record keeping (e.g. income statements, balance sheets, etc). Both courses have a strong emphasis on practical application and encourage entrepreneurs to implement the newly acquired skills and tools in their own businesses each week. The remaining entrepreneurs, who did not receive any business skills training in the first year, formed a comparison group ('control' group) which will be used to understand how such micro entrepreneurs perform in the absence of any marketing or finance training.

In order to evaluate the impact of the different training interventions, Anderson-Macdonald has designed

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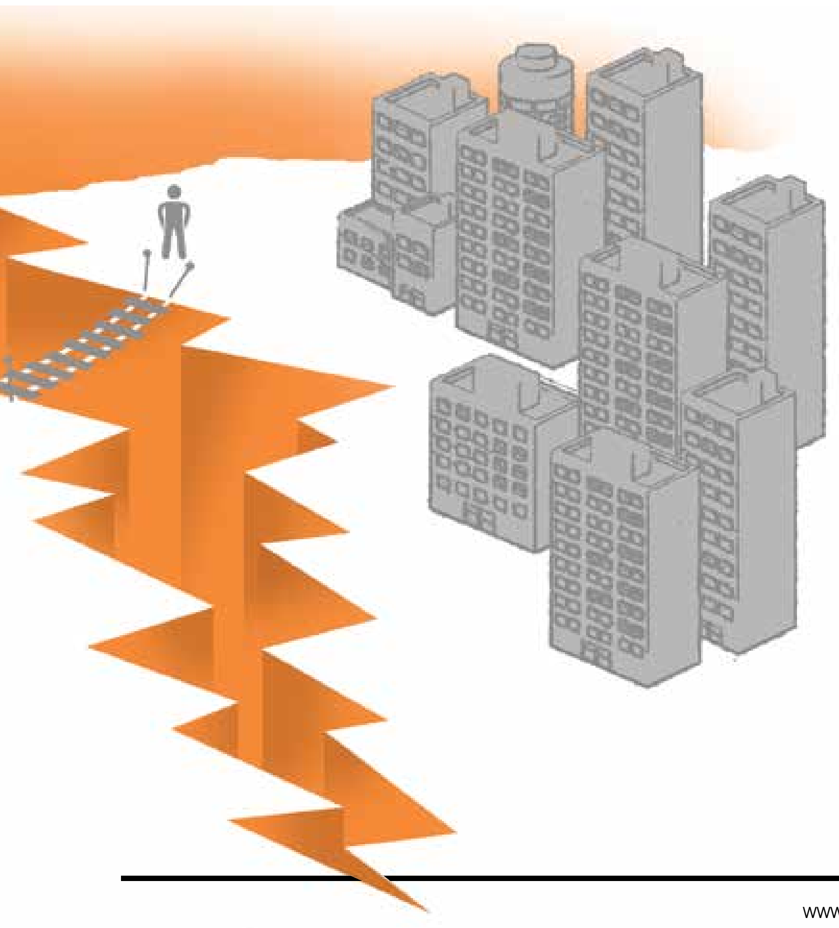
a rigorous and detailed benchmark baseline survey for the entrepreneurs which measures business performance (e.g. sales, employment and profits), as well as business practices and entrepreneur characteristics. All 900 entrepreneurs participating in the trial complete the survey prior to the launch of the business management training interventions, and again six months, twelve months and eighteen months after the interventions finish. By comparing outcomes before and after the intervention — and between treatment and control groups — the researchers can accurately assess changes in business performance and practices. In small pilots in India and Ghana, the marketing focused business management course led to increases in both sales and employment. However, without rigorous evidence from a large scale RCT it is difficult to conclude whether these results represented 'true effects' or simply good luck.

"The RCT project in South Africa links directly into the assumptions that underline the Business Bridge," says Michael Hay, Professor of Management Practice in Strategy and Entrepreneurship at London Business School and Director of the Deloitte Institute for Innovation and Entrepreneurship at the School, and founder of the Business Bridge Initiative. "You maximise economic well-being by maximising the number of people who are economically active, rather than passive. And one of the best ways of being an economic actor, rather than a spectator, is to start, build or work in a sustainable, employment-generating business. This research study is designed to prove empirically that you can develop the knowledge and skills and confidence — the management capital — to enable people to grow small businesses. We need to give emerging market entrepreneurs the tools and skills to build businesses which, in turn, will become the locomotive for economic growth." This is particularly relevant against a backdrop of widespread unemployment, which in South Africa is estimated to be at least 25 per cent (if not 40 per cent). In response, the government has committed to creating 5 million jobs by 2020. However, while it's an admirable goal, many experts share Professor Hay's view that "these [jobs] are not going to come from either the public sector or large corporations, but from strong, sustainable and employment generating small businesses."



Locked-in investment

In a second RCT project in Ghana, Anderson-Macdonald is testing a different approach to boosting the missing middle. There, with the help of a for-profit micro-finance institution called Financial Republic, he is examining the effectiveness of different types of savings and loan products.

Economists note the majority of micro entrepreneurs face a triple whammy of challenges due to their small, uncertain and risky income streams, explains Anderson-Macdonald. It is not only that the income they earn is negligible — $2 per day or less per member of the household — but it is also highly variable and vulnerable to risks. Thus, when a small business owner gets a sum of cash in her hands (e.g. from a savings or loan product) the triple whammy kicks in and often keeps the entrepreneur from investing large amounts in her business.

Another issue concerns the pressures and constraints that micro entrepreneurs face in their daily lives. "Even if an entrepreneur gets a cash grant, or a microfinance institute provides them with a loan, it is unlikely that the entrepreneur will invest all the cash in her business so it can grow," says Anderson-Macdonald. "They may have good intentions, and earmark the cash for stock or equipment, but when they get the large lump sum of money it often gets used for other things because of the pressures they face for that money."

Working with Financial Republic, Anderson-Macdonald decided to test whether banking products could be designed in a way that leads to greater investment in productive assets for firms run by micro entrepreneurs. Led by researchers from London Business School and the London School of Economics, including Dr. Anja Lambrecht, Professor Rajesh Chandy and Professor Om Narasimhan, the project team in Ghana is implementing an RCT to understand what product designs work and why.

The microfinance company agreed to allow Anderson-Macdonald to design a new hybrid savings-loan product. With existing products, he says, when a customer meets the lending criteria and is approved for a loan, she receives that loan in cash. So the loan funds are not locked into an asset purchase. The micro-entrepreneur can choose to spend the loan funds as she wishes, which often means for non-business purposes such as personal consumption, household expenditures or the demands of family and friends.

But not with the new product. "Right from the day you sign up, the way the product is designed — from the marketing brochures and sales scripts to the application packages and approval processes — the entrepreneur knows that her money is locked into an investment that will eventually result in a productive asset added to her business," he says. The next step is to take this product design to the real world, testing the new 'locked in' savings-loan product versus an 'unlocked' version in which there are no restrictions on how capital from savings and loan funds is invested by the micro-entrepreneur.

The RCT involves 4,000 entrepreneurs, all small business owners and existing clients of Financial Republic, across four different locations in Accra. At each location, 500 entrepreneurs are randomly offered the usual unlocked cash product ('control' group). Another 500 entrepreneurs receive the locked in product ('treatment' group). During the next few months, customers who have signed up for one of the new savings-loan products (locked or unlocked) will make savings deposits with the goal of reaching the target amount required to apply for a loan. On an individual basis, Financial Republic will then conduct its credit procedures and determine whether a given entrepreneur is approved for a loan. Once all loans have been processed and approved, Financial Republic will either release the cash funds (customers in control group) or purchase the pre-specified firm asset (customers in the treatment group). For the people in the latter group, a bank representative invests the loan directly for the entrepreneur, depending on which of four Productive Asset categories they opted for — equipment, construction, inventory, or vehicle.

Once again, baseline measurements are taken using detailed surveys — before anyone is assigned to a treatment or control group — so that the performance of entrepreneurs who sign up for the new 'locked in' product can be judged against those who sign up for the 'unlocked' product and receive cash. The researchers track the adoption, repayment and investment behaviour of all 4,000 entrepreneurs, as well as changes in their firm practices and performance over time. Since all the participants are banking clients of Financial Republic, the researchers can also monitor their weekly deposit behaviour, both prior to the product offer, during a six month repayment period, and once the loan is paid off. For the individuals receiving the new product the hope is that, having invested in productive assets for their business, the amount they deposit will increase over time reflecting growth in the business.

"Will this allow the entrepreneurs to overcome the pressures, both internal and external, to spend their savings and loan funds outside the business? We hope so. Because if you spend some of that cash, even though a portion may be invested, there is not usually enough left to make the difference in your business that will allow it to scale. So the idea here is that entrepreneurs who receive the 'locked in' product will hopefully increase their investment in productive assets and firm performance more than those who do not get the new product. The main aim of the RCT is to evaluate whether the 'locked in' product can actually help micro-sized firms grow and, in the long run, help some of them to improve sales, profits or employment so they can scale up and fill in the missing middle."

And if the RCT does show better results with the treatment group, then what? "We would work with the partner bank on scaling up this new product across all branches, offering it to tens of thousands of entrepreneurs in Ghana, and eventually into other African countries and other emerging markets. In addition, we would publish the results in top academic journals and work with our research partner Innovations for Poverty Action (IPA), and London Business School's Deloitte Institute for Innovation & Entrepreneurship, to disseminate findings to managers and policy makers," says Anderson-Macdonald.

"Hopefully, with a rigorous design and significant positive effects, some decision-makers in multinationals and governments would take an interest in our innovative product and work with

us. They could potentially fund the scaling up of this product in Ghana, as well as the launch of it in other emerging markets, and also the design of similar products aimed at improving investment in other business assets."

"We are very pleased to be partnering with researchers from London Business School on this evaluation project," says Nana Abadji Banton, Founder and Director of Financial Republic. "We all share a passion for learning what works to help the world's poor but, importantly, there is also a close alignment between our business objectives and the project's research objectives. Given our target customers, current product offerings and distribution model, Financial Republic is an ideal partner for implementing an RCT on a 'savings-loan product' designed to promote business investment by entrepreneurs in developing countries," explains Banton, an Executive MBA graduate from London Business School. "We eagerly await the research findings from this project, and the lessons that these findings will provide for Financial Republic products and solutions moving forward. I think more multinationals should be open to product 'experimentation' so as to learn more about how to market and service emerging market customers more effectively."

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Possibilities not limitations

The South African mini-MBA trial is underway, and the loan product RCT in Ghana began early in 2013. Anderson-Macdonald, who shuttles back and forth from the UK to field locations, is keen to complete the RCTs, collect the data and assess the results as they may have very important implications for the way we think about the role of marketing in promoting growth in developing economies.

As far as Anderson-Macdonald is concerned, it may herald a welcome switch in strategy. A move from focusing on the limitations of the market and its consumers, selling cut-down products to bottom-of-the-pyramid customers, instead towards considering what may be possible, using proven techniques to support entrepreneurs in creating a healthy population of SMEs in these countries.

"In addition to policy makers, this work has implications for managers of multinational companies. Maybe we have to redesign how we finance and service products in these markets. Let's not profess to know best what the people at the bottom of the pyramid can afford. Product design could play a key role in increasing the affordable purchase size of this market segment. Moreover, this research can shed light on interesting business-to-business strategies. If I am a large multinational and I want to enter a particular emerging market, then it's crucial for me to identify and develop the skills of growth-oriented entrepreneurs who I can invest in as partners to distribute my products and further enhance my market reach." ◻

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NEXT ISSUE

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