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Managers through classroom training?

Editor's note: This piece originally appeared in The Broker

Business training programs are a popular tool used by policy-makers to promote SME growth. However, recent evidence suggests that these programs rarely lead to firm growth or job creation. What do we know about how to effectively support SME development?

Each year, millions of dollars are spent by donors, non-profit organizations, and governments on programs that aim to support the development of small and medium enterprises (SMEs). However, successful transitions from small to medium-sized or large firms are still infrequent in developing countries. Despite the widely recognized contributions of SMEs to job creation and economic development,[1] little is known about the constraints that limit firm growth and, most importantly, how those constraints can be alleviated. The SME Initiative at Innovations for Poverty Action conducts rigorous research to help bridge this knowledge gap and identify the most effective ways to promote SME growth and entrepreneurship in developing countries. In this article, we share some of the emerging evidence on the impact of business training programs on SME development and point to key questions that remain unanswered.

Poor management practices are commonly viewed as an important constraint to business growth in developing countries due to their negative impact on productivity. Lack of managerial knowledge can also make it difficult for business owners to effectively deal with other challenges, such as restricted access to finance or poor regulatory systems. At the same time, recent evidence suggests that management education and practices are of a lower quality in developing countries than in developed countries.[2] For these reasons, business training programs are a popular tool used by policymakers to promote SME growth.[3] However, recent evidence suggests that firm owners often implement only a few practices taught in these trainings, and in many cases those changes are not enough to significantly increase profits or employment.[4]

These findings raise a number of questions. At a fundamental level, are management practices really a binding constraint to firm growth? If so, is the type of information covered in business training programs actually valuable to business owners? Does the format of such programs effectively transmit this type of knowledge? And more generally, what types of training programs create the largest positive impact on the performance of SMEs?

Do improved management practices enhance firm performance?

To address this initial question, researchers evaluated the impact of a consulting program for textile firms in India. The study showed that adopting the advised changes in management practices raised productivity by 17% in the first year through reduced inventory and improved quality and efficiency. This corresponded to an approximate annual increase in firm profitability of over $300,000. Within three years, adoption of the advised management practices led to the opening of more production plants. The consulting provided in this study was tailored to each individual firm and led by a prestigious international consulting firm, costing approximately $75,000 per firm for two years at an already-subsidized rate. But can an intervention like this be sustainably scaled to reach a large number of firms?

In Puebla, Mexico, researchers evaluated a similar consulting program targeting micro, small, and medium enterprises, but this time the intervention was run by local consulting firms and was much less expensive ($11,856 per firm per year). The consulting had a positive impact on the productivity and return on assets of the participating firms after one year. There was no observed impact on sales, profits, or the number of workers employed within the first year, but administrative data collected from the Mexican Social Security Institute did reveal important impacts on employment about two to three years after the consulting intervention, with a 44% higher number of employees and 57% higher total wages relative to firms that did not participate in the consulting program.

Can managerial skills be learned through classroom training?

The results from these two studies indicate that improved management practices can indeed result in firm growth, suggesting that the underwhelming impact observed in other studies may be attributed in part to the content or format of those training programs. Indeed, it could be that managerial skills are very hard to teach, so programs that bring in an expert to help improve firm management have a greater impact than programs that train business owners to become better managers. These studies also highlight the fact that firms face a range of unique problems that need to be addressed individually. The topics and issues addressed by the consultants varied widely from firm to firm, pointing to the difficulty in developing standardized training curricula that can effectively support many firms at once.

In an effort to identify effective means of transmitting information that can also be affordably scaled, a study in the Dominican Republic looked at different methods of conveying relevant business information in a classroom setting. Researchers partnered with a savings and credit bank that serves primarily low-income urban individuals and small businesses to evaluate two methods of financial literacy training: one emphasized classic accounting principles, while the other focused on simple “rules of thumb” for financial decision-making. Results indicate that the “rules of thumb” training had significant effects on clients’ business practices and revenues. The likelihood that clients were separating business and personal cash and accounts, keeping accounting records, and formally calculating revenues increased by 6-12% relative to the group that received no training. Training participants also reported an increase on an index of revenue measures. In contrast, the classic accounting training seems to have had no impact on business practices or revenue.[5]

Bridging the knowledge gap

These studies are part of a growing body of evidence showing that managerial skills do matter for SME productivity and development, but many training programs currently implemented around the world have less impact than expected. We need more evidence to better understand how these skills can be developed, and how it can be done in a cost-effective and scalable way. The SME Initiative is currently evaluating other such programs in Bangladesh, Colombia, Ghana, India, the Philippines, South Africa, Sri Lanka, and Uganda, which together will further contribute to this discussion and help identify better ways to support SME growth.

References

1. Ayyagari et al. (2011) find that SMEs create the majority of formal jobs in many developing countries. Beck et al. (2005) find a strong association between the SME sector and GDP/capita growth, although no evidence of causality.
2. Bloom, Nicholas and John Van Reenan. 2010. “Why Do Management Practices Differ across Firms and Countries?” Journal of Economic Perspectives 24(1): 203-224.
3. For example, the International Labor Organization’s Start and Improve Your Business program has trained 4.5 million people in more than 100 countries.
4. McKenzie, David and Chris Woodruff. 2014. “What are we learning from business training evaluations around the developing world?” World Bank Research Observer, 29(1): 48-82.
5. Drexler, Alejandro, Greg Fischer and Antoinette Schoar. 2014. “Keeping it Simple: Financial Literacy and Rules of Thumb.” American Economic Journal: Applied Economics 6(2):1-31.

October 06, 2014