

High Growth Small and Medium Enterprise Development: What Works?





Small and medium enterprises (SMEs), which form the majority of the business base and are significant drivers of both gross domestic product (GDP) and employment in many developing countries, are popular targets of donor assistance. To help the United States Agency for International Development (USAID) design activities that will best stimulate SME growth in profit and/or employment, the Bureau for Economic Growth, Education and Environment (E3) Office of Trade and Regulatory Reform (TRR) Trade and Competitiveness Activity (TCA) reviewed the latest research and interviewed SME development experts to articulate popular theories of change (ToCs) and to present available evidence around them. The analysis also provides an account of the debates, critiques, and demographic and contextual factors of each ToC, gaps in the evidence, and implications for project design.

INTERVENTIONS, EVIDENCE, AND IMPACT

As summarized in the following table¹, our research reveals that the level of impact varies greatly among different types of interventions. Our analysis also highlights gaps in the evidence base that make it more difficult to conclusively determine impact of other interventions. Donors should take both of these factors into consideration when designing projects.

INTERVENTION CATEGORY	INTERVENTION TYPE	LEVEL OF EVIDENCE	LEVEL OF IMPACT
Business Management	Training	STRONG	LOW
	Consulting Services	STRONG	HIGH
Access to Finance	Matching Grants	WEAK	MIXED-HIGH
	Access to Credit	MODERATE	HIGH ²
Business Registration and Taxes	Business Registration	WEAK	LOW
	Tax Policies and Administration	MODERATE	HIGH
Market Access	Market Linkages	MODERATE	HIGH ³
	Export Promotion and Support	WEAK	MIXED
Innovation	Product Innovation Support	WEAK	MIXED

GENERAL RECOMMENDATIONS

 Do What We Know Works	 Carry Out Context-Specific Project Design	 Conduct Additional Research	 Take Cost-Effectiveness into Consideration
Focus on interventions with moderate to strong evidence supporting high impact results (see table summarizing interventions, evidence, and impact)	Begin with a contextual analysis to identify target SMEs and understand their unique business needs and constraints to growth, and then develop appropriate ToCs	Fill gaps in the evidence base: lack of segmentation by firm lifecycle stage, age, and size as well as owner age and gender; optimal methods for selecting high-growth SMEs; analyses of cost-effectiveness	Weigh the trade-offs between estimated cost and potential impact, and seek to add to the knowledge base with better cost-efficiency data

¹ These findings summarize aggregated evidence collected from a variety of contexts. The level of evidence and/or level of impact of each of the types of intervention may look different if focused on one context.
² This ranking is dependent on the access to credit intervention type. Information access and collateral laws have a high impact on SME growth, while findings on credit guarantees and loan subsidies were mixed or low.
³ Although the impact is high, market linkages must be paired with information transfer from lead firms.

INSIGHTS AND RECOMMENDATIONS BY CATEGORY

In addition to reviewing the evidence that exists surrounding SME development interventions, this report highlights a number of recommendations for donors:

BUSINESS MANAGEMENT	<ul style="list-style-type: none"> • Business and Technical Training <ul style="list-style-type: none"> – Tailored consulting services and coaching are more effective than classroom-style trainings. – The type of training should match your goals, e.g., marketing training typically leads to greater sales and employment while finance training often results in cost-control measures that may actually decrease employment. – Training is expensive relative to other interventions, so it should be targeted and ideally paired with access to finance initiatives. • Consulting Services <ul style="list-style-type: none"> – Identifying existing constraints to the use of consulting services (e.g., information gaps, risk aversion, and credit constraints) and addressing them in program design is critical. • Matching Grants <ul style="list-style-type: none"> – Programs should seek to identify and address underlying market failure(s), mitigate externalities (e.g., market distortions), and assess the potential for additionality (i.e., whether firms would have paid for the goods or services anyway) when using matching grants.
ACCESS TO CREDIT	<ul style="list-style-type: none"> • Credit Information and Collateral Laws <ul style="list-style-type: none"> – Reducing information asymmetries (e.g., via the creation or strengthening of credit bureaus) and expanding collateral laws to include moveable assets have positive effects on SME growth. • Subsidized Loans <ul style="list-style-type: none"> – Subsidized credit lines, in which financial institutions receive funds for on-lending below commercial rates, have not demonstrated a strong return on SME profitability. • Credit Guarantees <ul style="list-style-type: none"> – Credit guarantees can help SMEs grow faster. However, they are also associated with an increased risk of default. – Apply the following best practices from the World Bank, when using guarantee schemes: <ul style="list-style-type: none"> ◦ Leave credit assessments and decision-making to the private sector. ◦ Cap coverage ratios and delay the payout of the guarantee until the lender takes recovery actions. ◦ Price guarantees to consider the need for financial sustainability and risk minimization. ◦ Encourage the use of risk-management tools.
BUSINESS REGISTRATION AND TAXES	<ul style="list-style-type: none"> • Firm Registration <ul style="list-style-type: none"> – There is limited evidence that formalization has a positive impact on SME growth. • Tax Policies and Administration <ul style="list-style-type: none"> – Simplifying the costs of tax compliance and reducing the tax burden have been shown to increase SME profitability. – Tax policy reforms can also lead to broad SME growth. – Limited USAID program cycles pose a challenge to passing and implementing policy reforms.
MARKET ACCESS	<ul style="list-style-type: none"> • Market Linkages <ul style="list-style-type: none"> – Market linkages programs have been shown to increase SME sales and employment, most effectively through demand-side interventions. – Programs must go beyond basic matchmaking to include incentive-based SME capacity building. • Export Promotion and Support <ul style="list-style-type: none"> – Bundled services combining counseling, planning, and trade missions are most effective when they focus on helping firms break into new markets with new products—and can have an immediate impact on SME profits and employment—but their long-term impact is less clear.
INNOVATION	<ul style="list-style-type: none"> • Product Innovation Support <ul style="list-style-type: none"> – Support for product innovation has been shown to have an overall positive effect on SME employment. – The best ways to support innovation are by improving the enabling environment (e.g., increasing public support for innovation or ensuring a reliable intellectual property rights system), targeting capacity-building to improve SMEs' use of human and capital resources and facilitating access to finance. – Donors should consider accelerator models to help build effective, self-sustaining innovation systems.

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