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Offering Cash and In-Kind Transfers to Grow and Sustain Microenterprises in Sri Lanka

Researchers:

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Sector(s): Finance, Firms, Labor Markets

Fieldwork: AC Nielsen Lanka

Location: Kalutara, Galle, and Matara divisions

Sample: 408 firms

Target group: Entrepreneurs Small and medium enterprises

Outcome of interest: Earnings and income Asset ownership Firm survival and sustainability Long-term results

Intervention type: Cash transfers In-kind transfers Unconditional cash transfers

Dados: http://www2.warwick.ac.uk/fac/soc/economics/staff/academic/woodruff/data

Research Papers: Returns To Capital In Microenterprises: Evidence From A Field Experiment, One-Time Transfers Of Cash Or Capital Have Long-Lasting Effects On Microenterpr...

Partner organization(s): National Science Foundation (NSF), World Bank

Small and informal firms are a source of employment for a large proportion of the labor force in many low- and middle-income countries. However, it is often unclear whether these businesses have the potential to dramatically increase income for their owners and how to best support them in doing so. Researchers provided small one-time grants to microenterprises in Sri Lanka to measure the impact of the additional capital on business profits two and five years later. They found that cash and in-kind grants increased business profits for male owners in the short and long term, but did not lead to an increase in business profits for female business owners.

Policy issue

Small and informal microenterprises are a source of employment for a large proportion of the labor force in many low- and middle-income countries. However, it is often unclear whether these microenterprises have the financial resources to grow and sustain their business, thereby increasing owners' income, or whether they are simply a source of subsistence income for individuals who may prefer and are unable to find alternative work. The rapid spread of microfinance organizations has been one response to relieving the constraints to growth for microentrepreneurs who do not have access to formal credit. Based on the belief that these microenterprises can earn high returns if given the opportunity, repeated borrowing of micro-loans is deemed necessary to relieve owners' credit constraints and grow the business.

Microfinance loans are often offered conditionally, tying payments to certain investments or behaviors, but an important debate is whether these grants should be offered unconditionally to firm owners to allow for flexibility in spending. Though there is a body of literature analyzing the effects of microfinance programs on borrowers, randomized evaluations on credit for firms have typically focused on tracking short-term outcomes since unconditional, one-time business grants are thought to have, at most, temporary effects on growth. Is repeated engagement necessary, or can one-time conditional or unconditional grants help relieve the short and long-term constraints of microentrepreneurs?

Context of the evaluation

The majority of enterprises in Sri Lanka are relatively small businesses. This study targeted microenterprises in three southern and southwestern districts of Sri Lanka: Kalutara, Galle, and Matara. In order to participate, microenterprise owners needed to meet specific eligibility criteria: they were aged 20 to 65, worked at least 30 hours per week in their business, had no paid employees, and had less than LKR 100,000 (~US$1,000) in capital, like materials and inventories excluding land and buildings. About half of the participating firms were owned by men. The median owner in the study was 41 years old, had about 10 years of education, and had been running his or her firm for 5 years. At the start of the study, the median male-owned firm had LKR 25,000 (US$250) of invested capital and LKR 4,700 (US$47) in average monthly profits, while the median female-owned firm had LKR 10,000 (US$100) of invested capital and LKR 2,800 (US$28) in average monthly profits. About half of the firms in the study operated in retail sales, like small grocery stores, while the other half worked in manufacturing and services, including tailoring, making lace or bamboo products, repairing bicycles, and producing and selling food.

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Details of the intervention

To measure the impact of an influx of capital on firm profits, researchers provided one-time cash or in-kind grants to microenterprises in Sri Lanka. The grant amounts were large relative to the size of the firms; specifically, the smaller grant was equivalent to about three months of median profits reported by firms in the baseline survey, and the larger grant was equivalent to six months of median profits. The 408 participating firms were randomly assigned to one of five groups:

	Unconditional cash grant		**In-kind grant**		**Comparison group**
After wave 1	LKR 10,000 (US$100) (42 firms)	LKR 20,000 (US$200) (21 firms)	LKR 10,000 (42 firms)	LKR 20,000 (19 firms)	No grant
After wave 3	LKR 10,000 (29 firms)	LKR 20,000 (21 firms)	LKR 10,000 (33 firms)	LKR 20,000 (21 firms)	No grant
Total firms	71	42	75	40	180

- *Unconditional cash grants*: Those offered cash were told that they could purchase anything they wanted, whether for their business or for other purposes.
- *In-kind grants*: Those offered in-kind grants selected goods among inventories, raw materials, machinery, or construction materials, which were shopped for and purchased with research assistants.
- *Comparison group*: Those in the comparison group did not receive any grant. However, members of the comparison group were offered LKR 2,500 (US$25) two years after grants were dispersed for their participation in the study and future surveys.

Researchers surveyed the firms quarterly from April 2005 to April 2007 to measure capital stock (e.g., assets, inventory, machinery, and equipment), reported profits, and the number of hours worked by the business owner. Researchers also collected descriptive data on education levels, numeracy recall (the ability to recognize and name a number), and cognitive ability of firm owners to measure their entrepreneurial ability. For logistical reasons, about half of the grants were awarded after the first wave of the survey, and the other half after the third wave.

To measure the long-term impacts of the grants on profits and the likelihood that firms were still in business, researchers re-interviewed the same firms in June and December 2010, between 4.5 and 5.5 years after the grants were distributed and again between September 2015 and March 2016 as well as May 2019, ten and thirteen years later. Long-term data analysis is ongoing.

Results and policy lessons

After about three years of being offered the grants, male business owners experienced relatively large increases in business profits, but there was no change in business profits for female business owners. Five years later, male-owned firms that received the grants had higher survival rates and profits, suggesting that one-off grants may have lasting impacts on some types of subsistence firms.

Participation: Participation throughout the study period was high; over 90 percent of firms completed the final survey in 2007. In 2010, researchers were able to re-survey over 90 percent of the firms included in the study, demonstrating the feasibility of conducting long-term follow-up meetings with firm owners.

Capital stock and hours worked: Receiving cash or in-kind grants led to short-run increases in microenterprises' capital stock by about LKR 5,000-23,000 relative to a baseline stock of LKR 26,530. Microentrepreneurs who were offered either the cash or in-kind grant at LKR 10,000 also increased the number of hours they worked by 4.5 to 6 hours (8.6 to 11.5 percent) relative to a baseline average of 52.6 hours worked per week. However, there was no change in the hours worked among those who were offered the LKR 20,000 cash or in-kind grant.

Monthly profits by gender: About three years after receiving the grant, male-owned businesses earned on average LKR 750 (US$7.5) more per month in profits, an 11 percent increase relative to the comparison group. Five years later, male-owned firms that were offered any grant earned about LKR 1200 (US$12) more per month in profits, a 17 percent increase relative to the comparison group average profits over the course of the study. Furthermore, researchers found that firms offered a one-time grant in 2005 had a higher survival rate by 10 percentage points relative to the comparison group, where 29 percent of firms closed down. While the grants increased capital stock and profits for male business owners, female business owners did not experience any positive returns in the short or long term.

Effects by ability: Researchers also found that owners with higher entrepreneurial ability—or, those with more schooling, better numeracy scores, and short-term cognitive ability—experienced larger impacts after being offered any grant. An additional year of schooling increased profits from the LKR 10,000 grant by LKR 156, and an additional number recited increased profits from the same grant by LKR 380, a four and 9.8 percent increase relative to baseline profits, respectively.

The researchers suggest that one-off grants may have lasting impacts on some types of subsistence firms, such as male-owned microenterprises. However, the lack of an effect for female-owned microenterprises may be due to the fact that the grant may not be fully invested in the business, but instead may be diverted to household uses. Women may also be more likely to work in low profit-yielding industries, meaning that the money invested in their business likely has lower returns. Capital alone thus did not appear to be enough to grow and sustain subsistence-level female-owned firms, and other work should explore whether complementary interventions may help, such as business skills training.