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Business size and stages of economic development

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Small and medium-sized enterprises (SMEs) are the backbone of an economy. As they enter and leave the marketplace, they act as a mechanism for quickly distributing employees and other resources from areas where they were previously needed to new ones. They also maintain competitive pressure and distribute new technologies. However, companies must reach a certain minimum size before they can operate successfully in the marketplace and this size changes depending on the sector concerned. The mix of sectors within an economy therefore has an influence on the distribution of companies between different size groups and overall average business size.

Average business size and structural change

As per-capita income within an economy rises, that economy generally undergoes a structural transformation, first changing from an agrarian society into an industrial one and finally becoming a service economy. As the economy is transformed, the mix of sectors changes accordingly. Starting from a society where non-industrial farming is the norm, the average size of a company will (initially) rise as industrialisation progresses and manufacturing becomes more significant. This is because the average manufacturing company is larger than the average agricultural company. However, even in farming, mechanisation gives rise to larger businesses.

The significance of the manufacturing industry (which is characterised by benefitting from economies of scale) and basic materials / primary industry declines with the emergence of the service economy. This in turn leads to smaller average business sizes. There are also other factors at work. More individualised demand, combined with higher per-capita income, along with increased flexibility in production and a trend towards outsourcing, also favour smaller businesses.

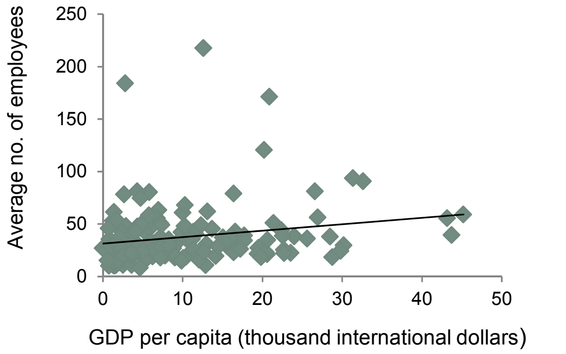
Medium-sized companies at a disadvantage

Overall, data from the World Bank shows that the average business size is generally smaller in countries where per-capita income is lower. Among other factors, specific barriers to the creation of medium-sized companies have been identified in developing and emerging countries.

Thus, small companies may be denied the opportunity to grow into medium-sized companies, principally because of financing constraints, difficult access to markets, a lower level of protection for proprietary rights, as well as industrial policies that result in market interventions in favour of large companies. Another example is that some regulatory requirements in respect of labour markets only apply once a company reaches a particular size. However, while large companies can spread the resulting (fixed) costs across larger production volumes or else receive subsidies to cover such costs, these options are not open to medium-sized companies.

The presence of a large informal sector is also a problem in developing and emerging countries. This is because informal companies are particularly small and often only provide unstable employment opportunities. In addition, poor business conditions lead to unproductive companies. Accordingly, it is important to form a favourable environment that allows a formal SME sector to develop, as it is there that growth and employment are created. ■

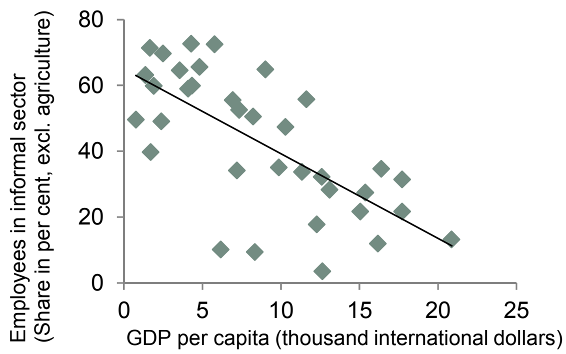
Figure 1: Average business size



Note: Companies with five or more permanent full-time employees, 143 countries; countries with >100 employees: Bangladesh, Malaysia, Thailand, Chile.

Source: World Bank, IMF.

Figure 2: Size of the informal sector



Note: 35 countries, latest available figures.

Source: ILO, IMF.