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Self-Employment in the Developing World

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Summary. — This paper analyzes heterogeneity among the self-employed in 74 developing countries, representing two-thirds of the population of the developing world. After profiling how worker characteristics vary by employment status, it classifies self-employed workers outside agriculture as “successful” or “unsuccessful” entrepreneurs, based on two measures of success: whether the worker is an employer, and whether the worker resides in a non-poor household. Four main findings emerge. First, jobs exhibit a clear pecking order, with household income and worker education highest for employers, followed by wage and salaried employees, non-agricultural own-account workers, non-agricultural unpaid family workers, and finally agricultural workers. Second, a substantial minority of own-account workers reside in non-poor households, suggesting that their profits are often a secondary source of household income. Third, as per capita income increases across countries, the structure of employment shifts rapidly, first out of agriculture into unsuccessful non-agricultural self-employment, and then mainly into non-agricultural wage employment. Finally, roughly one-third of the unsuccessful entrepreneurs share similar characteristics with their successful counterparts, suggesting they have the potential to be successful but face constraints to growth. The authors conclude that although interventions such as access to credit can benefit a substantial portion of the self-employed, effectively targeting the minority of self-employed with higher growth potential is important, particularly in low-income contexts. The results also highlight the potential benefits of policies that facilitate shifts in the nature of work, first from agricultural labor into non-agricultural self-employment, and then into wage and salaried jobs.

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1. INTRODUCTION

Although most workers in developing countries are self-employed, relatively little is known at a broader level about their characteristics and prospects, and how types of employment differ between countries at different levels of economic development. This paper uses a comprehensive set of household surveys to document the heterogeneity of the self-employed, by which we mean both employers and own-account workers. In developing countries, self-employed workers are often classified according to their perceived prospects for growth. A small minority of self-employed are innovative, successful entrepreneurs with further growth potential and ambition (Bennett & Estrin, 2007; de Soto, 1989). On the other hand, the majority of the self-employed work for themselves and earn little, either because they are rationed out of wage jobs (de Mel, McKenzie, & Woodruff, 2010; Fields, 1975; Tokman, 2007) or because they prefer the autonomy and flexibility of self-employment (Maloney, 2004).

The less successful self-employed workers, whether self-employed by choice or not, are also heterogeneous. For example, Grimm, Knorringa, and Lay (2012) distinguish between two types of unsuccessful entrepreneurs in several West African cities. The first type has the profile, in terms of age, education, and sector of work, of more successful entrepreneurs, but has yet to acquire significant capital. Although it is impossible to know exactly why these entrepreneurs' enterprises have failed to grow, the authors assume that their lack of success is partly attributable to personal and environmental constraints, such

as inadequate skills and experience, access to capital, or physical infrastructure. The second group of unsuccessful self-employed, on the other hand, does not share the same observed characteristics as successful entrepreneurs, and are therefore assumed to more likely be constrained by their age, education, and sector of work than unobserved features of their skill set or external environment.

In this paper, using data from nationally representative micro-level household surveys from almost 100 countries, we examine the characteristics of the self-employed throughout much of the developing world. Building on our profile of the self-employed, we use two admittedly coarse but nonetheless meaningful measures to classify the self-employed as successful: whether a self-employed worker is an employer as opposed to an own-account worker, and whether the self-employed worker lives in a non-poor household. Given data limitations, the analysis is unable to isolate which characteristics or factors

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cause some self-employed to be successful along these measures. Nonetheless, we can characterize the extent to which the currently unsuccessful self-employed possess basic traits that are correlated with success, which may lead them to have greater potential to become successful.

We first examine the characteristics associated with agricultural workers, and of non-agricultural employers, own account workers, non-paid employees, and wage and salary employees. Employers and own-account workers are classified as successful or unsuccessful based on two coarse measures of entrepreneurial success that are present in the data: (i) whether the self-employed are employers (*vs.* own account workers) and (ii) whether the worker lives in a household with per capita consumption above the \$2/day poverty line. While these measures, particularly household per capita consumption, are rough and imperfect measures of the entrepreneur's success, they convey meaningful information about the economic position of the self-employed. We then measure the percent of the self-employed that are successful, according to these criteria, in each country, and describe the characteristics associated with successful self-employment. Finally, we estimate the percentage of unsuccessful self-employed that share the basic characteristics of their successful counterparts, and therefore can be considered to have greater likelihood to become successful.

Throughout the analysis, we are particularly concerned with how the characteristics of the self-employed change at different levels of economic development. We examine this issue by comparing the profile of the self-employed in countries at different levels of per capita GDP. For example, as per capita income increases across countries, how does the proportion of successful, lower-potential, and higher-potential self-employed change? As per capita GDP increases across countries, do more lower-potential self-employed become high-potential or successful entrepreneurs, or are they absorbed into wage employment?

Our results have implications for labor market strategies at different stages of countries' development. For example, if a high proportion of workers are unsuccessful self-employed with little potential to become innovative and successful, policies to promote entrepreneurship, such as microlending or extension services, may be more effective if they are targeted to the narrow set of entrepreneurs with greater potential. Furthermore, if the unsuccessful self-employed are absorbed into wage employment as countries develop, this suggests that the growth of the private wage and salary sector is a key priority for development. On the other hand, if countries develop by creating a larger share of higher-potential or successful entrepreneurs, then broadly targeted investments in human capital and access to finance may be more important. Although there has been research investigating the heterogeneity of the self-employed in several countries (*i.e.*, [de Mel *et al.*, 2010](#); [Djankov, Miguel, Qian, Roland, & Zhuravskaya, 2005](#); [Djankov, Qian, Roland, & Zhuravskaya, 2006](#); [Grimm *et al.*, 2012](#)), this is to our knowledge the first analysis that takes a more global perspective on the nature of self-employment across a wide set of middle and low income countries.

2. PREVIOUS LITERATURE

Our analysis is inspired by three strands of the literature. The first strand compares the characteristic of entrepreneurs in developing countries to those of wage and salary employees and other workers. The second strand attempts to measure the extent to which the self-employed are self-employed by

necessity (and would rather be wage and salary employees) or are potentially successful entrepreneurs, while the third attempts to identify and measure the characteristics of those self-employed who have the potential to be successful but are constrained by lack of access to capital or other reasons.

A recent and growing literature studies the characteristics of entrepreneurs in developing countries. [Djankov *et al.* \(2005\)](#) collected data on the personal, family and business characteristics of approximately 1500 entrepreneurs and non-entrepreneurs in 2004 in China. [Djankov *et al.* \(2006\)](#) use similar data (from 2003 to 2004) to examine the characteristics of entrepreneurs in Russia.¹ They find that compared to non-entrepreneurs, entrepreneurs in China and Russia are more mobile, more willing to accept risk, have parents who are more educated, are more likely to have parents and other family members who were entrepreneurs, and are more willing to trade away leisure for more money. [Djankov *et al.* \(2005, 2006\)](#) further distinguish between entrepreneurs and "failed entrepreneurs" (who at one point were entrepreneurs but are not now). Failed entrepreneurs score worse on aptitude tests compared to entrepreneurs, but have the best self-reported performance in school.

[De Mel, McKenzie and Woodruff \(2008\)](#) perform a similar analysis using data from surveys carried out in Sri Lanka during 2005–07 of employers in small and medium sized firms, own account workers, and wage and salary employees. Although they do not find that entrepreneurs are more willing to accept risk, they do confirm other patterns from China and Russia. Compared to own account workers and wage and salary employees, employers are older, more educated, have parents who are more educated, and lived in wealthier households as children. Employers and own account workers are more likely than wage and salary workers to have parents who were self-employed. Years of schooling is highest for employers, followed by wage and salary workers, and lowest for own account workers. Finally, own-account workers score lower on measures of cognitive "ability" than both employers and wage and salary employees.

In part, this literature examining the characteristics of entrepreneurs in developing countries stems from a recent debate about the extent to which self-employment reflects voluntary exit *vs.* involuntary exclusion from the wage sector. For several years, the dominant view was that the large numbers of self-employed workers in developing countries reflected the rationing of employment opportunities in the wage sector, due to regulations or efficiency wages that pushed wages above their market clearing level. This consensus was challenged by a series of studies of job mobility from Mexico and Brazil, which found high rates of mobility into self-employed jobs as well as several self-employed who report moving by choice ([Bosch & Maloney, 2010](#); [Maloney, 2004](#)).

The current consensus is that both types of self-employed are present in developing countries, and subsequent research has tried to assess their relative prevalence. [De Mel, McKenzie, and Woodruff \(2008\)](#), for example, use discriminant analysis to discover whether the characteristics of own account workers are more similar to the characteristics of employers or wage and salary employees. They find that roughly two-thirds of own account worker have characteristics that make them more similar to wage and salary employees than to the employers of small and medium firms. This is consistent with relatively low rates of mobility from wage work into own-account work, as over half of own-account workers reported being self-employed throughout their entire working lives. On the other hand, the remaining more dynamic entrepreneurs were in many cases able to grow, as nearly 10% of

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