

IFC JOBS STUDY

ASSESSING PRIVATE SECTOR CONTRIBUTIONS
TO JOB CREATION AND POVERTY REDUCTION

SUMMARY | JANUARY 2013



Ministry of Foreign Affairs of the
Netherlands



Schweizerische Eidgenossenschaft
Confédération suisse
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Confederaziun svizra



**International
Finance Corporation**
World Bank Group

Why jobs matter

Global employment by the numbers

Number of unemployed: 200 million

Unemployment rate for youth: 2.5 times higher than for adults

Highest unemployment rates: more than 10 percent in the Middle East and North Africa

Number of jobs needed by 2020 to maintain current employment levels: 600 million

Sources: World Bank (2012): World Development Report 2013; ILO (2012): Global Employment Trends 2012.

Where the jobs are now in developing countries

The private sector: provides 9 out of 10 jobs

SMEs: represent 66 percent of permanent, full-time employment.

Share of employment by sector: services increases the most, followed by manufacturing (the agricultural sector shows a steady decline)

Sources: World Bank (2012): World Development Report 2013; Aayagari, Demirguc-Kunt, and Maksimovic (2011); ILO (2012).

High levels of unemployment, especially among youth, and large numbers of low-quality jobs are problems in developing countries around the world, and therefore creating more and better jobs is an urgent priority. Jobs are much more than monetary income; they are the cornerstone of development. Jobs boost living standards, raise productivity, and foster social cohesion, and they are the main path out of poverty.

Currently 200 million people are unemployed globally, and the unemployment rate for youth is more than 2.5 times higher than that of adults. By 2020, 600 million jobs must be created in developing countries—mainly in Africa and Asia—just to accommodate young people entering the workforce. In developing countries, the quality of jobs is just as important. Almost a third of workers are poor, and about half—particularly women—are vulnerable, often working in informal jobs, which frequently provide fewer rights and protections for workers.

The private sector provides 9 out of 10 jobs in developing countries, and therefore plays a key role in creating the new jobs needed and fostering growth. It is crucial to understand the constraints that prevent the private sector from growing and generating jobs. Governments and development finance institutions must help build an environment where these constraints are minimized or removed.

Preface

This report is the result of an open-source study to assess the direct and indirect effects of private sector activity on job creation. The report examines how and under what conditions the private sector can best contribute to job creation and poverty reduction, drawing on a review of the literature and evaluations; surveys of more than 45,000 businesses in over 100 countries; a website, blog, and essay competition to solicit outside views; macro and micro case studies of IFC clients; and IFC's own operational experience and lessons learned.

The report aims to elicit practical lessons that can be applied to the work of IFC, policy-makers, and other financial institutions focused on the private sector.

IFC, as the largest global development institution focused on the private sector in developing countries, is well placed to lead this study. The study has been closely coordinated with the World Bank's World Development Report (WDR) 2013 on Jobs and draws upon the experience of relevant departments within the World Bank and IFC as well as the expertise of our external consultants, partners, and clients.

The report was prepared by a team led by Roland Michelitsch under the overall guidance of Nigel Twose, director of IFC's Development Impact Department. The core team of authors included Gabriela Armenta, Ferran Casadevall-Massuet, Namita Datta, Anastasiya Denisova, Rijak Grover, Luz Leyva, Junko Oikawa, and Anqing Shi. The report greatly benefited from the inputs of an external technical advisory panel, whose members were Arlete Georgete Jonass Patel Alves (CEO, Supermercados Ka da Terra), Ragui Assaad (University of Minnesota), Major Gen. (Retired) Amjad Khan Chowdhury (CEO, PRAN Group), Mary Hallward-Driemeier (World Bank), Rafael Lalive (University of Lausanne), Martin Rama (World Bank), and Raymond Torres (International Labour Organization). Romina Bandura (ILO) and Kathleen Beegle (World Bank) also actively contributed to the panel's feedback.

IFC and World Bank colleagues helped with several case studies and research that were conducted as part of the report. Ruchira Kumar, Hayat Abdulahi Abdo, and Oxana Miliaeva produced the micro case studies for the manufacturing and

agribusiness sectors. Mahima Khanna and Govinda Timilsina participated in the micro case study for the infrastructure section. Garima Sahai made possible the micro case study for access to finance. The consulting firm Steward Redqueen led the production of the macro case studies. Alla Khodakivska and Jean-Luc Park also produced background documentation relating to the financial sector. Gloria Paniagua and Anastasiya Denisova produced the meta-evaluation, and Miriam Bruhn contributed as peer reviewer. Finally, Federica Saliola and Jon Vierk Bernt conducted the analysis of Enterprise Survey data.

The report also includes the inputs of many operational colleagues in IFC and the World Bank, among them Alejandro Alvarez, Gokhan Akinci, M. Assaid Amlaiky, Belinda Amoah, Clive Armstrong, Victoria Bakhtina, John Barham, Najy Benhassine, Antoine Courcelle-Labrousse, Daniel Crabtree, Daniel Goldblum, Rapti Goonesekere, Douglas Grayson, Neil Gregory, Juliana Guaqueta Ospina, Pierre Guislain, William Haworth, Armando Heilbron, Richard Henry, Zenaida Hernandez Uriz, Syed Estem Dadul Islam, Sebastian James, Alan Johnson, Arthur Karlin, Mohammed Ali Khan, Mary-Jean Lindile Moyo, Liane Asta Lohde, Amy Luinstra, Syed Mahmood, Mouayed Makhoulf, Sumit Manchanda, Martha Martinez Licetti, Andrei Mikhnev, Melina Mirmulstein, Carmen Niethammer, Aminur Rahman, Sreekala Ramanathan, Thomas Rehermann, Carlos Roberto Griffin, Elsa Rodriguez Felipe, Adam Sack, Massimiliano Santini, Katherine Scaife Diaz, Warrick Smith, Mathieu Verhaeghe, and Leanne Viviers.

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The full version of this report and detailed version of all associated case studies can be found at www.ifc.org/jobcreation.

Message from Jin-Yong Cai, IFC Executive Vice President and Chief Executive Officer

600 million. The number is so large, it's almost incomprehensible. Yet that's how many new jobs the world needs by 2020 just to keep up with the globe's surging population.

Getting there won't be easy. It will be impossible without the private sector.

Joblessness, especially among the poor, is a global crisis. And for IFC, the world's largest development institution focused exclusively on the private sector, it's a top priority. Most of the world's 200 million unemployed are women and young people living in developing countries. Without work, they can't care for themselves or their families.

The result: poverty, and social and economic unrest.

The private sector, which provides nine out of 10 jobs in developing countries, offers the best solution to the challenge of unemployment. IFC can play a critical role.

By targeting the private sector, we complement the World Bank's work with governments. In fiscal year 2012, we invested more than \$20 billion, including funds mobilized from other investors, and spent almost \$200 million on more than 630 advisory projects in 105 countries. This investment and advice helps countries address factors that can be the most important obstacles to job growth: the investment climate, infrastructure, access to finance, and education and skills.

Our clients create jobs. We know it because we've actively tracked direct employment for the past seven years. But we also know that the impact of our work goes far beyond the jobs created directly by investment clients. In fact, those jobs are only a small portion of the employment generated by IFC's work.

Take our client Orissa Cement in India, for example. A loan from IFC allowed it to set up a plant and expand its capacity, directly creating around 300 jobs in four years and indirectly creating 7,200 more.

To get a better look at how IFC contributes to job creation we commissioned this study. Our team left no stone unturned as it examined how the private sector can best contribute to job creation and poverty reduction. It reviewed reams of literature, evaluated surveys of more than 45,000 businesses in over 100 countries, solicited outside views through a website, blog, and essay competition, conducted case studies of IFC clients, and sought to learn from our own operational experience.

The study focuses on practical lessons, and seeks to find out what types of activities are most likely to have the greatest impact on job creation, and how these activities affect different societal groups. It complements the World Bank's recent World Development Report on Jobs by offering practical lessons and recommendations to help the private sector create more high-quality jobs.

The Jobs Study provides useful insights into how IFC and the World Bank Group can further strengthen the employment-creation effects of our activities and contribute even more to improving the quality of those jobs.

Much more work lies ahead. We will tackle it forcefully—supporting our clients and helping policy makers gain new practical insights into the private sector's role creating jobs in developing countries.

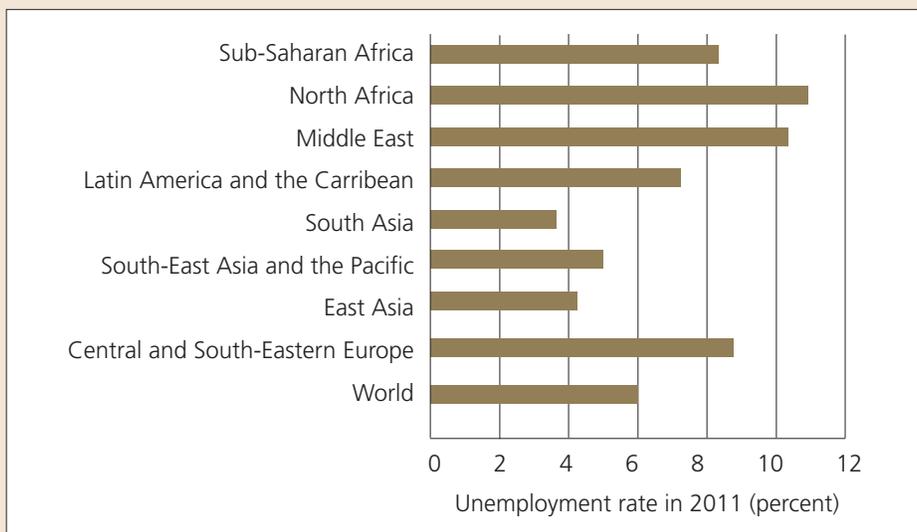


Specific needs in specific regions

The nature of the jobs challenge varies by region, due to different demographic, institutional, and socio-economic factors. Unemployment, informality, working poverty, and underemployment are present in all regions but at different levels of intensity. Unemployment rates are the highest in the Middle East and North Africa (MENA) (at about 10 percent), more than double those of East Asia and South Asia, which have the lowest rates (at about 4 percent) (see figure 1). In addition, youth unemployment rates in the MENA region are particularly high (higher than 20%).

But unemployment rates tell only part of the story. There is a large informal sector in many countries, particularly poorer ones, where sometimes people give up looking for formal work and are no longer captured in unemployment statistics. For example, while unemployment rates are comparatively low in South Asia, both vulnerable employment and the working poor remain major policy challenges despite recent progress. The same is true of Sub-Saharan Africa. In Eastern Europe and Central Asia, migration and aging are potential threats. Aging also is a future concern for China.

Figure 1: Unemployment rates vary by region



Source: ILO (2012). Global Employment Trends 2012.

Constraints to job creation: a conceptual framework

This report builds on the World Bank Group conceptual framework for thinking about constraints to job creation known as **MILES**¹:

- **M**acroeconomic policies
- **I**nvestment climate institutions and infrastructure
- **L**abor market regulations and institutions
- **E**ducation and skills
- **S**ocial protection

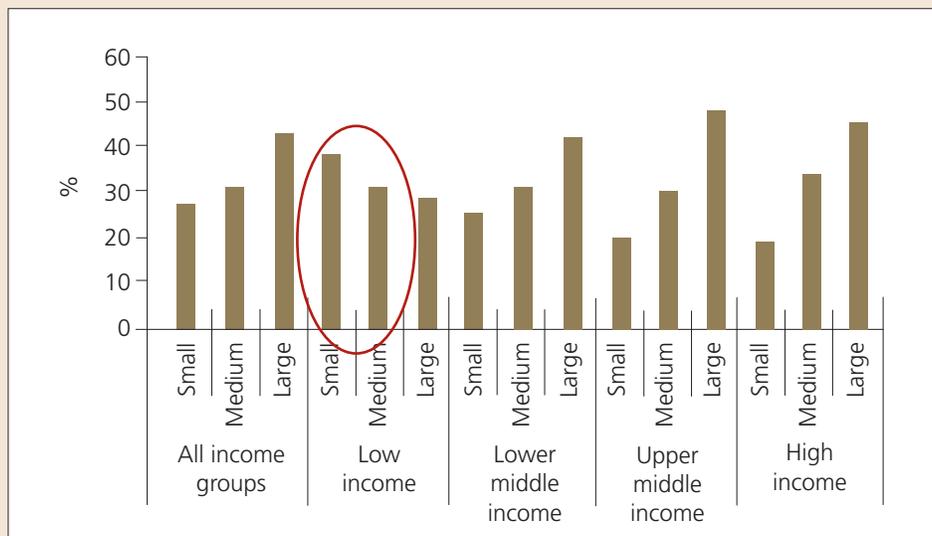
Using the basic framework of labor supply and labor demand, this report focuses on four main obstacles to job creation as identified by private sector firms – that can be addressed by the work of development finance institutions. Policy fundamentals such as macroeconomic and fiscal stability, investment climate, and infrastructure affect the demand side of job creation, while education and skills affect the supply side. The IFC Jobs Study focuses on four key constraints (that form part of I, L, E, and S² in the MILES framework), which are: access to finance, infrastructure, investment climate, and skills.³ This list is not all inclusive and does not include a variety of other factors that may be important, but typically are beyond the ability of private companies and financial institutions oriented toward the private sector.

What kind of firms create the most jobs and where?

Jobs in small and medium enterprises together (SMEs) account for more than half of all formal employment worldwide. This is especially true in low-income (Figure 2) countries, where SMEs represent on average about 66 percent of permanent, full-time employment.⁴

Small companies tend to have much higher rates of job growth (18.6 percent over a 2-year period in a representative sample from 106 countries, twice the average of all companies), but also are more likely to go out of business. Larger firms tend to be more productive, invest more in training, and offer higher wages (see figure 3).⁵

Figure 2: Small companies have the largest share of employment in low income countries



Source: Enterprise Surveys.

Note: In this graph, small firms are 5-19 workers, medium 20-99, and large ≥ 100 .

Even though small companies tend to have higher job growth rates, institutional and financial constraints prevent the smallest enterprises from formalizing and growing into larger, formal companies. In developed countries, many companies are born small and then grow into bigger businesses. In developing countries, this is frequently not the case: firms are either born large and do not grow much, or decline in size. As an example of the latter, when the sizes of 35-year-old companies in India, Mexico, and the United States are compared to their sizes at birth, in India the business shrinks by one fourth; in Mexico, it doubles in size; and in the United States, it is 10 times larger⁶ (see figure 4). A similar pattern is observed for productivity of firms in these 3 countries.

Removing such constraints will disproportionately benefit micro, small, and medium enterprises and allow them to grow into larger businesses. Additionally, efforts to help enterprises formalize, or making it easier for formal firms to start up or operate, can be beneficial, since informal enterprises tend to have lower productivity and poorer working conditions.

Employment trends vary by sector

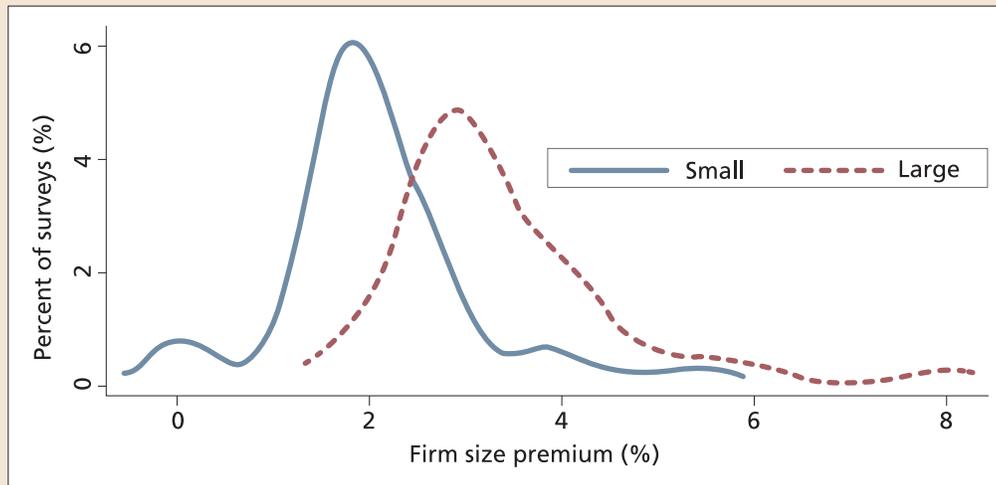
When aggregate job creation across industries is examined in more than 100 countries, the share of employment in the services sector increases, followed by manufacturing, while the agricultural sector shows a steady decline.⁷ Also, Enterprise Survey data show that services lead in terms of employment growth.⁸ However, the number of jobs created by each industry varies across countries, depending on the availability of natural resources, skills, institutions, and other country and regional characteristics.

Informality is a reality

- More than 40 percent of non-agricultural jobs in developing countries are informal.
- Can exceed 60 percent of GDP in low-income countries

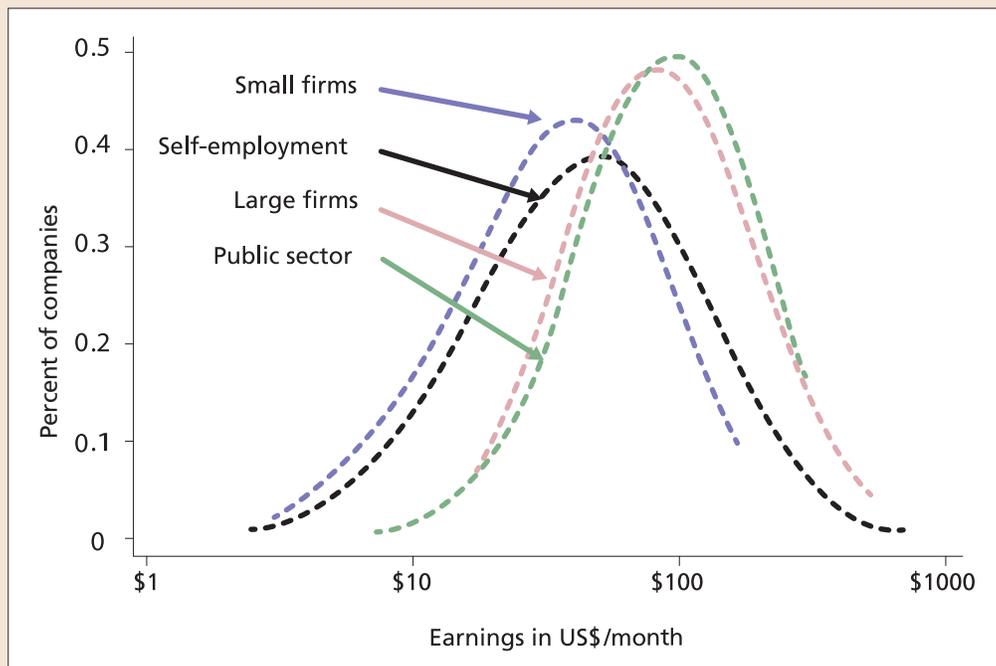
Sources: ILO (2012): World of Work Report 2012: Better jobs for a better economy; Schneider, Buehn, and Montenegro (2010).

Figure 3: Larger businesses pay higher wages



Source: WDR 2013 team based on Ayyagari, Demircug-Kunt, and Maksimovic (2007), and on Montenegro and Patrinos (2012) for WDR 2013.

Note: The panel uses 138 household and labor force surveys spanning 33 countries over 1991 - 2010. The figure compares the distribution of estimated wage premium of small (10 to 50 workers) and large firms (more than 50 workers) relative to microenterprises (less than 10 workers), controlling for worker characteristics.



Source: Sandefur, J., Serneels, P. and Teal, F. (2006). African Poverty Through the Lens of Labor Economics: Earning and Mobility in Three Countries. Global Poverty Research Group Working Paper 60.

Note: The figure shows Ghana earning densities.

Does increased labor productivity hurt employment?

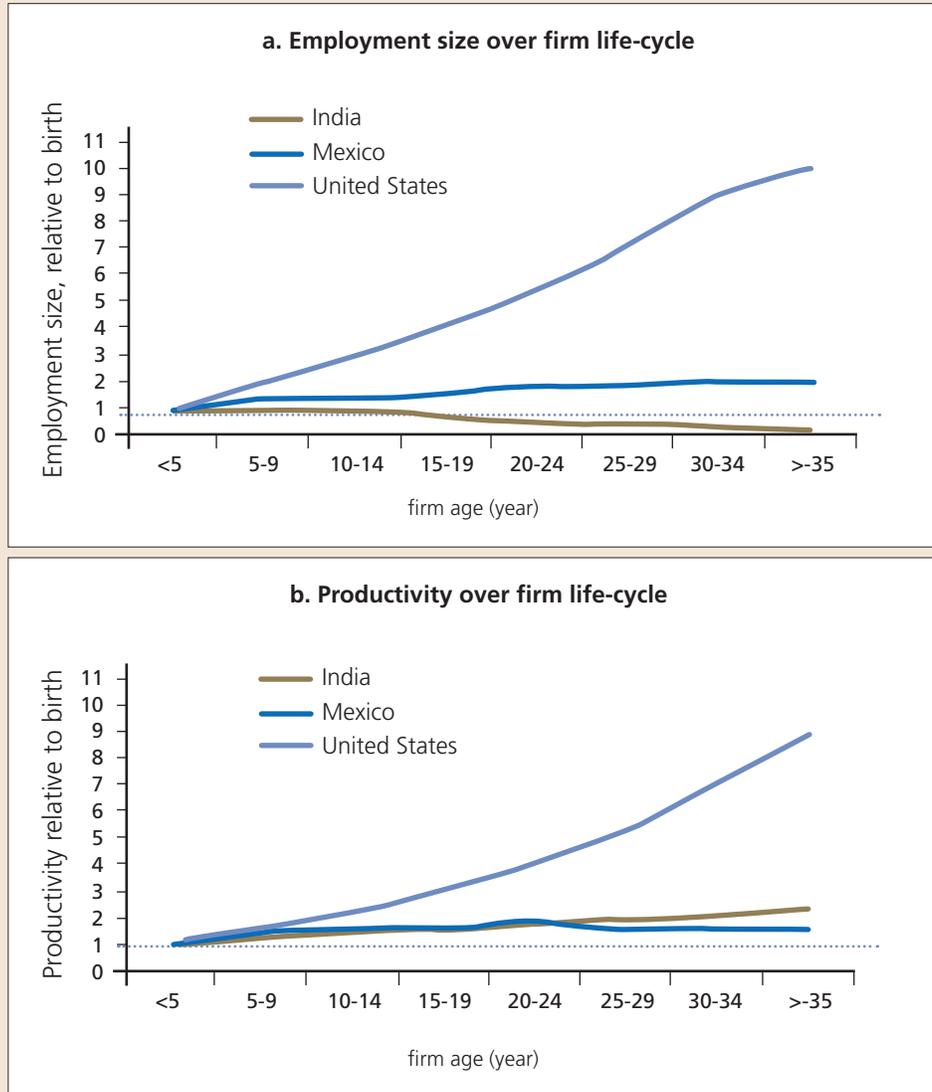
Contrary to popular belief, increased labor productivity does not necessarily mean job losses. Our analysis shows that in general higher productivity is associated with faster employment growth in subsequent years. However, the relationship between higher productivity of workers and job creation is complex and can depend on the reason for increased productivity as well as on the country and industry conditions.

Increased labor productivity does not always = job losses

Higher productivity is associated with faster employment growth in subsequent years.

Source: IFC (2012): IFC Job Study: Impact of labor productivity on job creation.

Figure 4: Majority of companies are born small and grow little in India and Mexico



Source: Hsieh and Klenow (2011).

Note: Figures present the average employment (or productivity) of firms in different age groups relative to the average employment (or productivity) at birth. Figures are computed using 1992 and 1997 data for the United States, 1998 and 2003 data for Mexico, and 1989-1990 and 1994-1995 data for India.

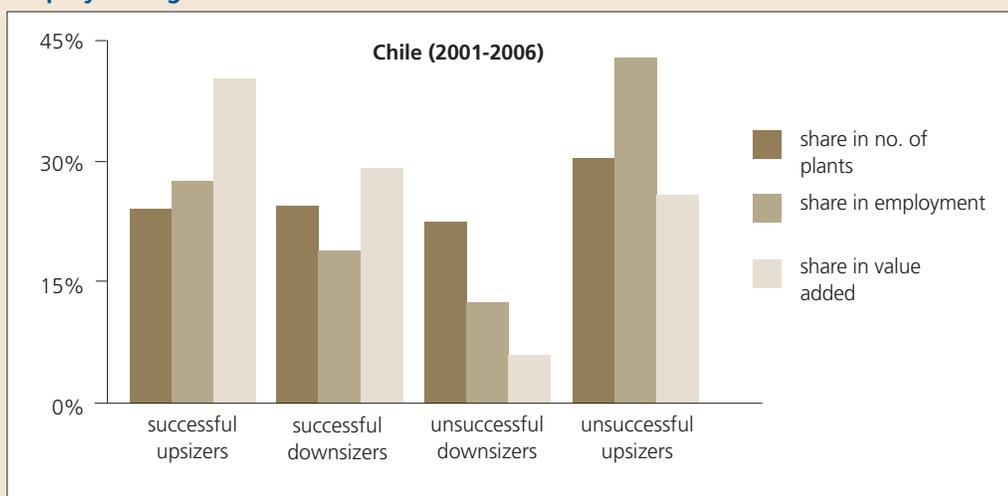
Higher productivity leads to job creation when the following happens: An increase in productivity makes it cheaper to produce goods. When prices fall and demand for the product increases, the industry becomes more competitive at the global level. In a competitive environment, this effect can more than offset the employment-lowering effect of increased productivity, in which fewer workers are needed to produce the same amount of goods or services.⁹

IFC's own experience shows that financially successful companies and investment funds tend to create more jobs.

There also is evidence of innovation, in particular product innovation, being associated with increases in hiring—with a high number of low-skilled people typically hired.¹⁰ In the case of process innovation, the effects are more mixed and sector-specific.¹¹

Lastly, there is evidence that employment growth coupled with increased productivity is more likely to result in a reduction in poverty. For example, when job growth in agriculture is associated with increases in productivity and thus contributes more to the overall economy, it can significantly reduce poverty.¹²

Figure 5: A large fraction of companies achieve both productivity and employment growth



Source: WDR 2013 team estimates based on data of the Annual Industrial Survey of Chile and Amadeus Database.

Note: The figure presents contribution to 5-year growth over the specified period by plants in each country. Plants considered are those with average employment above 10 that exist throughout the five-year period. Successful upsizers are plants that increased both labor productivity and employment; successful downsizers are plants that increased productivity but lost jobs; unsuccessful downsizers are plants that reduced both employment and productivity; and unsuccessful upsizers are plants that increased employment at the expense of productivity growth.

Estimating economy-wide job creation effects

Many development finance institutions, policymakers, and business leaders are interested in being able to estimate the job-creation effects of their activities. While data on direct jobs created may be available, it gives an incomplete and possibly misleading story. To properly estimate economy-wide job creation effects, it is important to consider the total job effects, that go beyond estimating the direct jobs created, and include (a) indirect jobs (jobs created in suppliers and distributors); (b) induced jobs (jobs resulting from direct and indirect employees spending more); (c) second-order “growth” effects such as, more reliable power, allowing enterprises to produce more, and more efficiently; and (d) net job creation (accounting for job losses in competitors).

Among IFC client companies, the number of direct jobs created, net of job losses, tends to be relatively small, but the number of indirect jobs generated can be significant, though more difficult to measure. In a variety of sectors—agribusiness, cement, tourism, steel, and infrastructure—the total job effects can be a large multiple of direct jobs, and vary by country, industry, and company. Job creation resulting from improved access to services, such as finance and electricity, also can be very large. For example, IFC client companies provided some 2.5 million direct jobs in 2011. But the number of indirect jobs ranged from 7 times to 25 times as many direct jobs in the case studies that IFC conducted. Moreover, these indirect jobs benefited the unskilled and the poor.

Not all jobs are created equally

- **Direct jobs** (jobs in a company)
- **Indirect jobs** (jobs created in the company's suppliers and distributors)
- **Induced jobs** (jobs resulting from direct and indirect employees of the company spending more money)
- **Second order growth-effect jobs** (jobs resulting from the removal of an obstacle to growth)
- **Net job creation** (accounting for job losses in the company's competitors)

Source: IFC Jobs Study.

Case Study: Cement

IFC granted a loan to Indian cement manufacturer Orissa Cement Limited to partly finance expanding its capacity and setting up a plant. This additional capacity created about 300 direct jobs and 7,200 indirect jobs in four years, of which 65 percent were in the company's distribution network. Every \$1 million that IFC invested helped generate an estimated 1.5 direct jobs but almost 40 indirect jobs, of which about 70 percent were unskilled.

Multipliers—theory and practice

Employment multipliers, such as the total number of jobs in an economy created per one direct job, are commonly used to estimate economy-wide effects of job creation. However, these multipliers vary significantly depending on factors like management style, the capital intensity of a particular project, the business cycle, and the regional and country context (see table 1). Since the employment multipliers can vary depending on the context, the exact number should be interpreted with caution, while keeping focus on the total job creation and not the multiplier alone.

An “investment multiplier,” assessing the total number of jobs per \$1 million invested, also can be informative. There is still variation, but less than with the standard employment multipliers that estimate indirect and induced jobs created.

Net job creation

“Net” job creation should be considered when estimating total employment. A study in the United States found that over five years, the initial gain of 100 jobs after the opening of a Walmart store was offset by a loss of 50 jobs in smaller competitors. So the net job effects were still positive but much smaller.¹³ This pattern of overall job growth in the retail sector, despite job losses in competitors, was also found in several Eastern European countries.

Table 1: Multipliers for indirect and induced job creation effects vary widely*

Sector / Industry	Total number of jobs (direct, indirect, induced) in the economy for each direct job in a sector			
Agriculture	1.2 (Chile)	2 (US and Scotland)	3 (Tanzania)	
Mining	2.5 (Scotland)	5 (US)	7 (Chile)	28 (Ghana)
Financial Services	14.9 (Indonesia)	19 (Ghana)		
Oil and Gas	7.5 (US)	13.4 (Scotland ¹⁴)		
Hotels	1.24 (Scotland)	2.66 (Tanzania)		
Retail	1.27 (Chile)	1.31 (Scotland)	1.89 (US)	
Cement	2.47 (Scotland)		4.45 (US ¹⁵)	

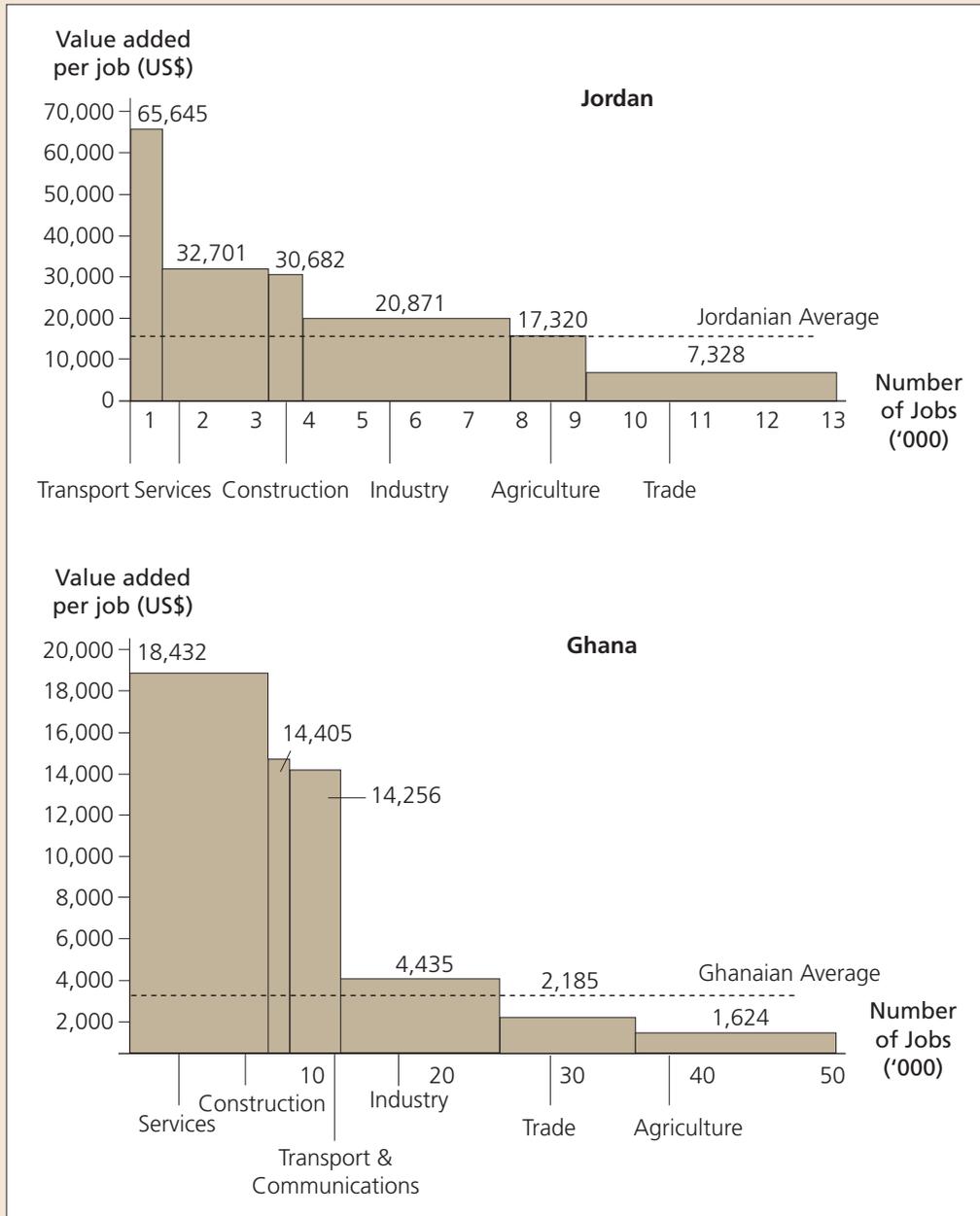
Source: Literature Review for IFC Jobs Study, available at www.ifc.org/jobcreation.

*These multipliers measure the number of direct, indirect, and induced jobs for every direct job.

Trade-off between value added and number of jobs

There often is a trade-off between the direct number of jobs supported and the value-added per job (see figure 6). Macroeconomic case studies from Ghana and Jordan show that some sectors that generate most jobs for every \$1 million invested in them (for example, agribusiness and trade) generate low value-added per worker. Conversely, sectors that contribute relatively few jobs (for example, mining and utilities) create the most value-added per job. However, the tradeoff may vary by country. Furthermore, when total value-added per \$1 million invested is considered, the sectors that generate the most jobs still can have the highest value-added. For example, in Tunisia, food processing and agriculture contribute significantly to value-added, and a large portion of it goes to workers.¹⁶

Figure 6: There can be a trade-off between the number of jobs supported and the value added per job



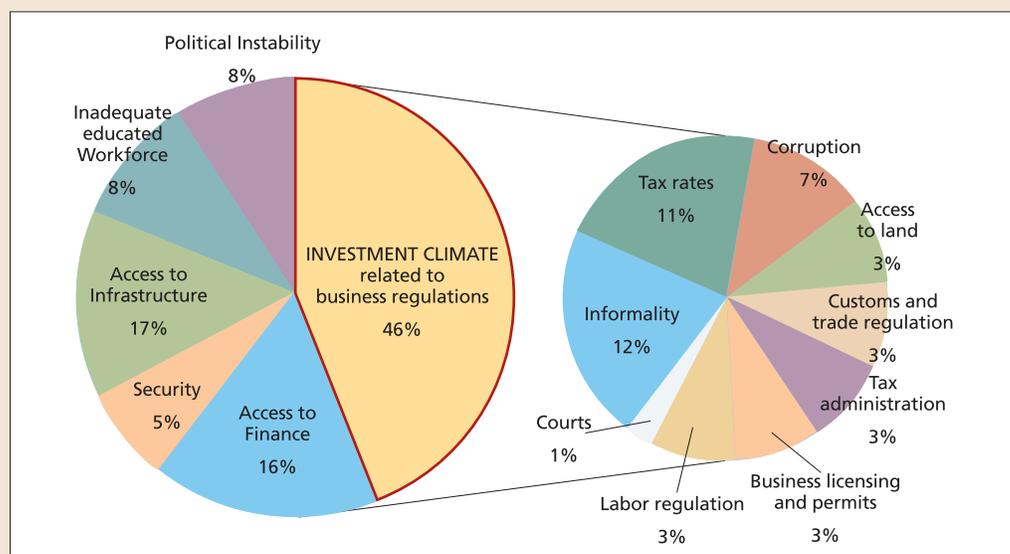
Source: IFC Jobs Study; macro-case studies conducted by Steward Redqueen (2012a) "Socio-Economic Impact of IFC Financing in Ghana," and Steward Redqueen (2012b) "Socio-Economic Impact of IFC Financing in Jordan."

Major constraints facing companies

Based on the responses of more than 45,000 companies in 106 developing countries to the World Bank Enterprise Surveys—which measure perceptions about the business environment based on companies' experiences—the top constraints facing their operations are a poor investment climate, including red tape, high tax rates, and competition from the informal sector; inadequate infrastructure, especially an inadequate or unreliable power supply but also transportation and water; lack of access to finance, such as credit lines, particularly for smaller businesses; and workers who lack adequate skills and training.

The Enterprise Surveys show that various concerns about the investment climate together account for more than half the constraints identified by businesses as most important (see figure 7).

Figure 7: Investment climate problems add up to the most pressing issue for companies



Source: Enterprise Surveys.

Four findings stand out: 1) informality is a major hindrance for small and medium enterprises in middle-income countries; 2) a reliable power supply is the most important issue for companies in low-income countries; 3) access to finance is particularly a problem for SMEs; and 4) a shortage of adequately skilled workers constitutes a key challenge for larger businesses and businesses in high-income countries.

Table 2: Constraints vary by business size and country income

Constraint (Top 3)	Firm size*			Country income group				All firms
	Small	Medium	Large	Low-income	Lower-Middle	Upper-middle	High	
Access to Finance	1	1	3	2	1	1	3	1
Electricity	2	2	1	1	3			2
Informality	3	3			2	3		3
Tax rate				3		2	2	
Skills			2				1	

Source: World Bank Group's Enterprise Surveys covering 46,556 enterprises in 106 countries.
 *For this analysis: Small = 5-20 employees, medium-sized = 21-99, large >= 100 employees.

While the assessment is based on subjective responses, findings also show that the perception-based responses are often closely correlated with more objective measures. For example, across country income groups, the higher the number of power outages per month (an objective measure), the higher the percentage of companies that consider power their most important constraint (a subjective measure).¹⁶

Constraints from a regional perspective

As has been established in the literature, the most important constraints differ by region.¹⁷ In Sub-Saharan Africa, more than one fifth (22.3 percent) of companies said access to power was their biggest obstacle. In East Asia and the Pacific, 16.6 percent of businesses ranked access to finance as their top constraint. In Europe and Central Asia, the tax rate was the top concern for 16.7 percent of firms. In Latin America and the Caribbean, informality was the top problem for 16 percent of companies. And in South Asia, nearly one quarter of businesses said political instability was the biggest issue, closely followed by access to power.

Therefore, obstacles differ significantly by country, and policymakers should consider the most binding constraints for businesses in their specific context.

Investment climate reforms can help generate jobs

A sound investment climate with a transparent and conducive regulatory framework is one of the fundamental prerequisites for the private sector to grow, increase investments, and create jobs. Macroeconomic stability, clear and transparent regulations, and the rule of law form the fundamental operating environment for the private sector.¹⁸ A good investment climate is therefore also important for tackling poverty. The international community clearly underscored the importance of an enabling business climate for private investment and job creation during the Group of 20 (G20) summit in Mexico in June 2012.

Examples from Africa illustrate the critical role that the investment climate plays in job creation. Four evaluations conducted of IFC-supported investment climate reforms in Burkina Faso, Liberia, Rwanda, and Sierra Leone estimate that about 50,000 jobs (about 0.3 percent of the total labor force) were created in those four countries from 2008 to 2010 (see table 3).¹⁹ The programs also generated cost savings for the private sector (about \$1 million to \$5 million in each of the four countries), helped attract private sector investment (ranging from \$5 million to \$51 million in each country), and helped increase formal registration of an additional 23,000 enterprises, of which about 10,000 were informal and chose to formalize because of the improvement in business regulations.²⁰ In all the countries, the results were achieved by reforms in multiple areas, including business registration, issuance of construction permits, procedures for paying taxes, and trade logistics.

Table 3: Comprehensive investment climate reforms generate jobs in four countries

	Burkina Faso	Liberia	Rwanda	Sierra Leone
<i>Number of Jobs Created</i>	1,700 - 2,000	16,300 - 20,400	15,000 - 17,600	13,500 - 16,800
Access to Business Land			X	
Business Entry	X	X		X
Business Exit	X			
Business Licensing Reform			X	
Construction Permits	X			
Contract Enforcement	X			
Doing Business Reforms*		X	X	X
Investment Promotion		X	X	X
Labor Regulation	X			
Property Registration	X			
Public Private Dialogue		X	X	X
Special Economic Zones		X		
Tax Policy and/or Administration	X		X	X
Tourism Development				X
Trade Logistics	X	X	X	

*This component specifically focuses on the investment climate measured by the World Bank's Doing Business report.

Source: Author's elaboration using information from Economisti Associati srl, Center for Economic and Social Research, and the Africa Group LLC (2011).

Note: Data from 2008 to 2010.

Regulatory simplification

Simple, clear, and transparent rules about how to register or close a business or pay taxes go a long way toward creating a friendly environment for the private sector. However, studies have confirmed that a multidisciplinary approach that includes a comprehensive package of investment climate reforms is much more effective than a stand-alone reform of business entry regulations. Such conditions encourage more entrepreneurs to set up a business and operate in the formal sector, and also encourage existing companies to grow. Well-crafted regulations also reduce the scope for corruption.

Business entry reform: A business entry simplification reform in Mexico launched in 2002 resulted in a 2.8 percent increase in total employment (including self-employed workers) in the eligible industries in one year.²¹ While there were also job losses in non-eligible industries, people who were previously unemployed or out of the labor force were more likely to obtain jobs after the reform.

Another aspect to consider while assessing job creation effects of business entry reforms is the survival rates of firms. In some cases businesses that enter the market after a reform may have lower survival rates than comparable incumbents that entered before the reform.²² But one can generally expect positive and sustainable job growth as a result of reforms, because job growth in surviving companies generally makes up for jobs lost in exiting firms.²³ In addition, even though some companies leave the market after a reform, this tends to be a positive market mechanism to reallocate resources to more efficient players in the economy.²⁴ Misallocation of resources among firms can contribute to low aggregate productivity in an economy.²⁵ Complex regulations are partly responsible for this misallocation.

Competition policy: Policies that help open markets and remove barriers promote competition, typically resulting in lower prices and better deals for consumers. They tend to stimulate innovation, productivity, and economic growth.²⁶ This economic growth then helps create jobs. A study based on Organization for Economic Cooperation and Development (OECD) countries found that reducing state controls and barriers to competition increased long-term employment rates by 2.5 percent to 5 percent.²⁷ Deregulation of shop-opening hours in the United States resulted in an increase in employment of about 5 percent.²⁸ Conversely, a French retail zoning regulation introduced in 1973 hurt employment. Without the regulation, retail employment would have been more than 10 percent higher at the time of the study in 2002.²⁹

Taxation: Modern, rational tax systems and administration are important concerns for companies. High tax rates, or taxes that are perceived as unjustified or difficult to implement, result in some businesses preferring to operate informally. Firms also identify the tax system as one of the most important factors when they are deciding whether to make an investment. Therefore, a streamlined tax system can increase the number of companies in the formal economy, facilitate investment, widen the tax base, and rationalize a business's tax compliance cost—and it need not decrease tax revenues. Brazil's introduction of a business tax reduction and simplification program in 1996 targeting micro and small enterprises led to an employment increase of 12 percent. The change also reduced eligible firms' tax burden by 8 percent, substantially reduced labor costs, and increased the number of enterprises that formalized. These enterprises subsequently recorded higher revenues, profits, and numbers of employees.

Inefficient administration of taxes imposes a significant constraint on the private sector, in particular small and medium enterprises. In Georgia, for example, 20 percent of small businesses identified tax administration as their main obstacle to operating, compared with 8 percent for medium-size businesses and 4 percent for large businesses. Similarly, in the state of Bihar in India, the cost of complying with the tax system is equivalent to a 3.5 percent tax on turnover for small companies (see figure 8).

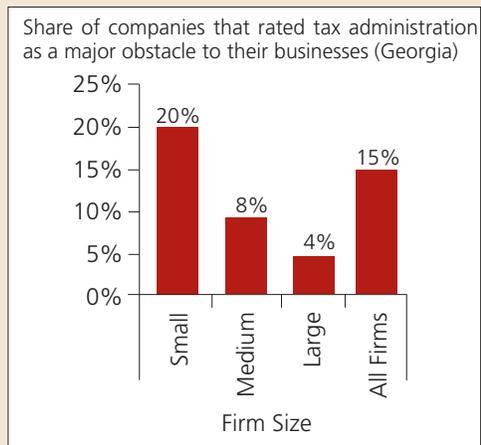
Removing red tape unleashes growth

- Reducing state controls and barriers to competition increases long-term employment rates by 2.5–5 percent
- A 1 percentage point increase in the tax rate reduces foreign direct investment (FDI) by 3.3 percent of GDP in OECD countries*
- \$488 billion in global FDI inflows in 1997 helped create 26 million direct jobs and 42 million indirect jobs

*a lower tax rate has much less effect in emerging markets

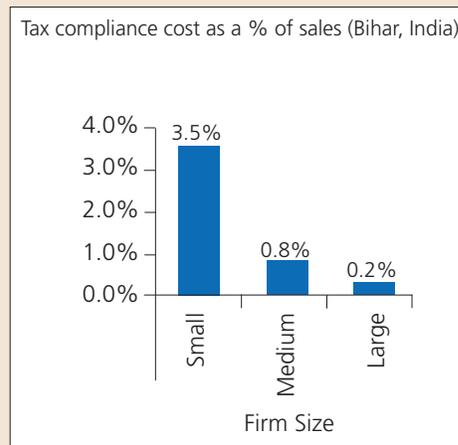
Sources: Nicoletti and Scarpetta (2005); Mooij and Enderveen (2003); Aaron (1999).

Figure 8: Small companies are most affected by inefficient tax administration



Source: Enterprise Surveys 2008.

Inefficient tax administration imposes a large cost on companies, especially small ones



Source: World Bank Group.

Tax rates, foreign direct investment, and investment climate: A meta-study of the literature concluded that, on average, a 1 percentage point increase in the tax rate reduced foreign direct investment (FDI) by 3.3 percent of gross domestic product (GDP)³⁰—mostly in OECD countries. A similar study of developing economies found comparable outcomes, although the impact of tax rates on investment was considerably smaller. A 10 percentage point increase in the corporate income tax rate lowered FDI by 0.45 percent of GDP in the developing economies.³¹ In general, a lower marginal effective tax rate has limited impact on FDI in countries with weak investment climates.³² This implies that tax policy is far less effective in attracting FDI in weaker investment climates. This conclusion is supported by other regional studies that found tax incentives were been much less effective in attracting FDI in West and Central Africa than in Caribbean countries.³⁴

Foreign direct investment provides an opportunity to augment scarce internal resources of capital, skills, and technology, especially in many developing countries. Moreover, this investment creates more jobs and good-quality jobs. The rate of growth in employment related to FDI (28 percent) has far outpaced the growth of the global labor force overall (16 percent) in the last decade. FDI can help create significant numbers of both direct and indirect jobs.³⁶ Studies estimate that companies owned by foreign investors pay wages that are much higher than those of domestically owned businesses³⁷ and that FDI has resulted in productivity gains of up to 40 percent, with increasing demand for labor in the long run.³⁸

Some countries, such as Nicaragua, create special agencies to help attract FDI. A recent study shows that expenditures on investment promotion are positively associated with FDI inflows.³⁹ However, one must be careful in attributing all the increase in FDI inflows to expenditures in investment promotion only. Governments willing to spend money to attract FDI may simultaneously use other measures to attract investment.

Secured transactions and collateral registries: Lending based on collateral provided by movable assets—such as inventory, accounts receivable, livestock, and machinery—unleashes credit potential, especially for smaller enterprises. An evaluation of a reform in China to promote such lending found that SMEs that received accounts-receivable financing increased their workforce. Of the SMEs surveyed, 21 percent confirmed that the reform boosted their job creation.³⁹

Inspections: Inspections can be a time-consuming and expensive burden, affecting business productivity and deterring owners from joining the formal economy.⁴⁰ Poorly written, complex inspection regulations leave room for inspectors to demand bribes. Based on an IFC-supported inspection reform in Jordan, these reforms could increase efficiency and transparency and save significant costs for the private sector (\$2 million a year expected in Jordan), which would allow businesses to produce more and provide more jobs.

Business licensing and permits: Several experiences show that a license simplification reform leads to a substantial increase in license applications (263 percent in the first six months of such a reform in Peru in 2006). However, in a study of the reform in Peru, statistical evidence has not been found on the effect of such reforms on business performance, based on indicators such as profits per worker, investment in machinery, and number of employees. This could mean that the license itself does not help improve business performance, or that such effects may take longer to materialize.

Targeted investment climate reforms

Many governments proactively promote and facilitate investments in targeted sectors or regions of strategic interest, using methods such as setting up special economic zones or formulating investment policies for specific sectors such as tourism. For example, the government of Panama established a special economic zone on a former U.S. military base—managed in the form of a public-private partnership—that led to the creation of 4,800 jobs. These methods are even more effective when they complement a package of investment climate reforms.

Special economic zones: With good connectivity and infrastructure, governed by a comprehensive and integrated set of laws and regulations often compatible with international trade agreements, special economic zones have been an instrument for governments to develop and diversify exports, support local industry and clusters, attract FDI, create jobs, and pilot new policies. While special economic zones represent less than 1 percent of global employment, they can be an important source of jobs in some countries, especially smaller ones. These jobs' effects are significant in countries with high rates of

unemployment and underemployment.⁴¹ It is estimated that in 1975, there were 79 zones in 25 countries, employing about 800,000 people. Today, some 3,500 zones operate in 130 countries. Of these, more than 2,300 zones are located in 119 developing and transition countries—mainly in Asia and the Pacific and Latin America and the Caribbean—and employ 66 million. For some countries, including Bangladesh, China, Korea, Mexico, Malaysia, and Mauritius, special economic zones have been transformational. Bangladesh has generated more than \$113 million in investments and over 15,000 gross direct jobs in the last three years.

Special economic zones also promote formality and compliance with labor, social, environmental, health, and security standards.⁴² The impact on women has been far-reaching.⁴³ Worldwide, 60 percent to 70 percent of employees of special economic zones are women, who tend to be engaged in labor-intensive, assembly-oriented activities requiring manual dexterity, such as garments, textiles, and production of electrical and electronic goods.

However, special economic zones have not been uniformly successful. One way to mitigate the risks of implementing a poorly designed special economic zone is to follow private sector principles, that is to design zones that are responsive to local, economic, and global market demand and that are consistent with the countries' comparative and competitive advantages.

Industry-specific investment climate policies: Several economies rely heavily on tourism for growth and jobs. The travel and tourism industry generates 234 million direct and indirect jobs, or about one in twelve jobs worldwide.⁴⁴ These jobs are particularly valuable as they often are in remote locations where other employment opportunities may be limited. Tourism is a labor-intensive industry and employs a high share of unskilled or medium-skilled youth and women workers, maximizing its potential impact for the poor and marginalized. Targeted investment climate interventions by the governments of Mozambique and Sierra Leone are expected to generate investment that would create 60 and 400 jobs respectively, along with positive spillovers of the resulting tax revenues. However, maximizing development returns from the tourism sector requires careful planning and stakeholder engagement.⁴⁵

More generally, industry-specific interventions require very careful assessment of country-specific competitive advantages and growth barriers. This type of assessment requires detailed information and a strong government capacity to make objective choices.⁴⁶ The risks of such decisions are that preferential policies toward any sector could affect other stakeholders, sometimes unintentionally, and create opportunities for corruption.

The informal sector

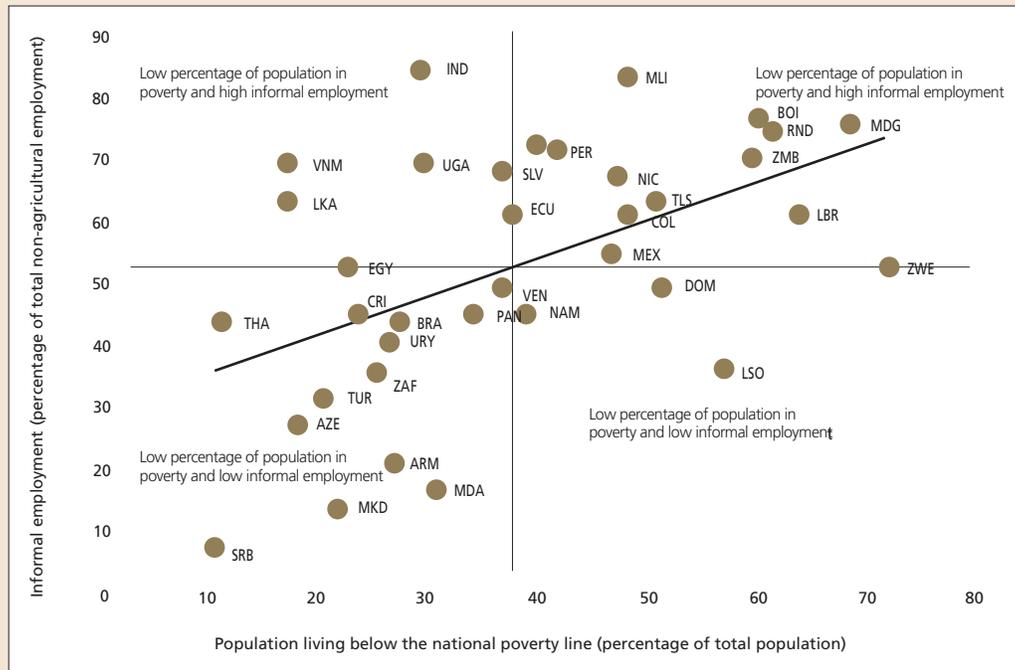
Informal employment accounts for more than 40 percent of non-agricultural employment⁴⁷ in developing countries and can exceed 60 percent of GDP in low-income countries.⁴⁸ Formal companies perceive as a major constraint the unfair competition from informal economic activities that do not abide by the same regulatory and financial requirements. Informality includes not only informal enterprises and informal jobs, but also informal activities engaged in by formal companies. For governments, informality results in lost tax revenue and limits policy outcomes, while for workers, informal jobs tend to be suboptimal solutions.

Based on a study,⁵⁰ many informal entrepreneurs tend to prefer a wage job and are “entrepreneurs out of desperation,” but there also are “entrepreneurs out of aspiration” who are more likely to formalize their enterprises in an improved regulatory environment. Informal jobs are often associated with poverty (see figure 9), and have a higher concentration of lower-skilled workers. In addition, women are three times more likely than men to be hired informally and are much more likely than men to be unpaid workers in a family business.

A large informal sector typically is the result of a poor investment climate, in the form of cumbersome regulations and weak enforcement. Enterprises often find that formalizing imposes excessive costs and time and is not commensurate with the potential benefits. Therefore, any reforms in investment climate that ease regulatory barriers would make it more attractive for enterprises to formalize.

Formalization of companies and jobs can provide more security for workers and give companies the benefits associated with the formal sector, such as licenses and access to finance, which help them grow. One obvious policy approach, which many countries are trying, is to ease regulatory constraints and reduce costs that prevent businesses from formalizing. A study based in Sri Lanka found that modest in-

Figure 9: Informal employment is positively associated with poverty



Source: ILO, Department of Statistics, and IMF, World Economic Outlook.

creases in the perceived benefits of formalization could lead to a potentially large increase in the number of informal firms deciding to formalize.⁵¹ An insight from a study based in Mexico is that business entry reforms may not be enough to persuade companies to formalize and that it may be necessary to use a dual-pronged approach, targeting both firm formalization and job creation. As mentioned earlier, an integrated approach combining various types of investment climate reforms tends to be more effective. Another approach is to introduce other reforms, for example tax reform.⁵² Additionally, a review of the Brazilian experience suggests that an intervention to motivate informal enterprises to formalize could be particularly successful in a fast-growing economy.⁵³

While not a focus of this report, another aspect of informality is the illegal shadow economy. Informality, poor governance, and corruption generally reinforce one another in many developing countries.⁵⁴ Therefore, governments must focus on strengthening institutions, governance, and enforcement capability, in addition to improving regulations,⁵⁵ in order to discourage illegal activities and encourage the rule of law.

Access to infrastructure

Infrastructure is a critical input for companies; therefore improving and expanding infrastructure allows higher economic growth and, in turn, job creation. In addition, infrastructure is a sector with a special capacity for promoting inclusive growth, particularly by providing productive opportunities for the poor and by facilitating access to basic services, including water, education, and health.⁵⁶

Infrastructure plays a crucial role in urbanization, an integral process in the development of countries. Well-integrated power, transportation, and water and sanitation networks avoid congestion and establish a cohesive link between the urban and rural sectors.

Perception data from Enterprise Surveys show that inadequate infrastructure, in particular power, is a key constraint for the private sector. These data also show that companies that rank infrastructure problems as severe are often the most productive, because they tend to be businesses that sell in larger markets and are more dependent on infrastructure.⁵⁷ It is particularly common for firms in developing countries to spend their own resources on buying infrastructure services or providing them on their own. For example, in low-income and lower middle-income countries, companies often buy power generators to deal with power supply disruptions. But this dependence on back-up generators represents a drain on resources, since it costs substantially more to obtain power from generators than from the regular grid.⁵⁸

Access to infrastructure is crucial for women's empowerment

Access to infrastructure is also a very important aspect of women's empowerment. Numerous studies show that access to services such as water, sanitation, power, transport, and communications helps women get better jobs. However policy makers must adopt gender-sensitive policies when planning and designing infrastructure projects to ensure that such investments reach women equitably. Men and women have different roles, responsibilities, and constraints because their respective demand for infrastructure services often vary. For example, evidence from village-level travel and transport surveys and case studies in Africa shows that women are responsible for up to 65 percent of total transportation related to agriculture.⁵⁹

Rural women pay a particularly high price for a lack of infrastructure, because they tend to spend most of their time carrying water for domestic or agricultural uses, processing and marketing food and other products, collecting firewood, and obtaining health services for themselves and their families.⁶⁰ This "time poverty" in turn limits their ability to attend school or engage in income-earning activities.⁶¹ If households get access to electricity, saving large amounts of time spent on household activities, women are more likely than men to substitute income-earning work for this time. Electrification of rural communities of South Africa led to a 13.5 percent increase in female employment there.⁶²

Direct job creation in the infrastructure sector, both construction and maintenance, disproportionately benefits men.⁶³ Also, women are more likely to be employed in clerical categories, occupying low-level positions, while men are concentrated in production-related technical or managerial positions, which usually are the better-paid jobs.⁶⁴ However, increased involvement of women in construction does not always bring financial benefits, and in some cases puts more of a burden on women. For example, a road maintenance program in Lesotho paid women for their maintenance work only in food. In self-help housing projects, the women are often relegated to secondary chores such as carrying water and wetting bricks.⁶⁵

Investment in infrastructure creates jobs

There are two main categories of jobs created through infrastructure investments:

Jobs associated with construction and maintenance:

These jobs can be direct, indirect, or induced. Construction and maintenance activities generate employment not only for those workers directly involved (direct effect), but also for the corresponding suppliers and distributors (indirect effect), and for the providers of goods and services that are consumed by the direct and indirect workers (induced effect). For example, it has been estimated that \$1 billion spent on road construction in the United States generates about 6,000 direct jobs, 7,790 indirect jobs, and 14,000 induced jobs.⁶⁶ A study of a power transmission line that IFC financed in India also showed that many more indirect and induced jobs were created than direct jobs.⁶⁷

It also is important to distinguish between construction, which generally provides short-term jobs, and maintenance and operation, which tend to provide long-term jobs. Other factors that affect the number of direct and indirect jobs created are the labor intensity of the project, the percentage of imports used in production, and the availability of local skilled labor.

Jobs associated with improved services and lower costs for companies (second-order "growth-related" jobs):

Many studies focus on the immediate job-creation effects described above (for example, in construction), but a reliable in-

Power transmission lines and job creation: the Powerlinks project

In 2003, IFC committed a loan of \$75 million to Powerlinks Transmission Limited (PTL), a joint-venture company, to construct power transmission lines to help carry hydropower from Bhutan to a number of states in northern and eastern India.

Using a mix of methodologies, including input-output tables and econometric time series analysis, this report estimate that the construction, maintenance, and operation of the lines will create almost 243,000 person-years of employment (very roughly, about 9,700 direct, indirect, and induced jobs) over the 25-year life of the project. This project has a significant effect on poverty, as the transmission lines were constructed through some of the poorest states in India. In addition, the second-order growth effects of the increased supply of power and its improved reliability have generated 75,000 jobs from 2006 to 2012, of which 4,600 were in West Bengal. The improved reliability of power in West Bengal helped decrease power outages, which in turn helped create additional jobs. The transmission line also contributed to development in Bhutan by boosting GDP growth and increasing government revenues.

Source: IFC Jobs Study (2012) "Linking Power Supply to Jobs; Estimating Employment Effects of Powerlinks Transmission Limited Project in India and Bhutan."

Infrastructure has an even greater effect on employment, and this is often overlooked in studies and policy analyses. Access to power, information, and communications technologies, or improved transportation, can add significantly to job growth by allowing businesses to increase their output and hence create more jobs (see figure 10). This growth effect can be substantial. IFC has estimated that electricity provided by the new power transmission lines in India has generated a total of about 75,000 jobs from 2006 to 2012, a much larger number than the direct creation of about 2,000 jobs associated with construction and maintenance of the lines.⁶⁸

The private sector plays an important role in addressing the infrastructure deficit in low-income countries

The private sector is playing an increasing role in providing infrastructure, notwithstanding the public-good nature of the assets, which is particularly important given the large amount of resources needed to improve infrastructure. The involvement of public-private partnerships in infrastructure investment in low- and middle-income countries has increased significantly in the last decade, especially in the energy and telecommunications sectors but also in transportation (see figure 11). Private sector involvement in water and sanitation systems has been more limited.

The private sector can play a very important role in augmenting public funds and bringing in technology, efficiency, and results-based approaches to infrastructure through market solutions. Studies show that a larger involvement of the private sector improves infrastructure performance and productivity, for example by raising the labor productivity in electricity suppliers (connections per employee) or by increasing the technical efficiency of ports.⁶⁹

However, harnessing the potential of the private sector, especially in complex sectors such as infrastructure, also requires an effective regulatory framework. For example, there have been frequent renegotiations of concessions in public-private partnerships in Latin America because of weak regulatory frameworks and weak accountability on the part of local governments.⁷⁰

Another often-discussed concern is that efficiency gains in infrastructure could result in a reduction in jobs. In general, privatization of previously state-owned companies could lead to a lower number of di-

Figure 10: The growth-related job effects of infrastructure investments are the largest and affect the overall economy

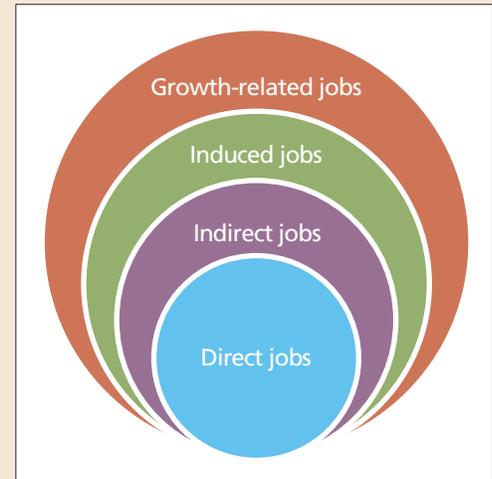
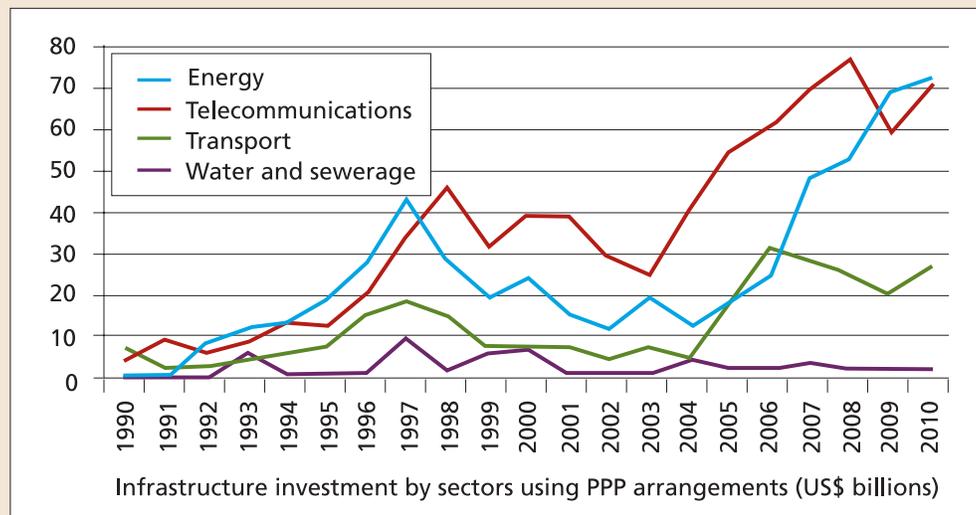


Figure 11: The private sector has increasingly invested in providing infrastructure



Source: Private Participation in Infrastructure Database.

rect jobs in the short run, but new investments by the private sector tend to promote economic growth and hence have a positive effect on employment, which may offset potential job destruction in the public sector during the privatization.⁷¹

Infrastructure sectors differ in their propensity to generate jobs

Power is a key constraint to job growth, especially in low-income countries. Estimates using Enterprise Surveys data show that a reliable power supply could increase annual job growth in low-income countries by 4 percent to 5 percent.⁷² Since this estimate is based on relatively expensive power from generators, the job effects of reliable power from the grid could be significantly higher. Evidence from the Powerlinks project further reinforces how relieving a critical constraint like reliable power can help generate jobs (see box above).

Since construction and maintenance of **roads** is more labor intensive than most other infrastructure investments, road projects tend to have large direct job effects, while multipliers for indirect and induced effects are comparatively more moderate because other inputs are less intensively used.⁷³ Nevertheless, some studies point to large numbers of induced jobs being created as a result of road transportation projects.⁷⁴ Direct jobs are mostly temporary and also tend to benefit men over women.⁷⁵ Improved transport infrastructure reduces transportation costs, thus supporting economic growth and job creation, especially through the development of trade and markets. Workers from rural villages with better roads have access to new non-agricultural activities and also have a better chance of finding productive employment in nearby cities, thus benefiting from urban jobs that tend to be more regular and permanent.⁷⁶

The **telecommunications** sector fulfills similar goals to roads and highways, reducing communications costs and facilitating and spreading access to information and services. Information and communication technologies have expanded rapidly and have a large growth impact.⁷⁷ Studies using Enterprise Surveys data conclude that companies' use of websites and e-mails for business operations is positively and significantly associated with employment creation, as well as with labor productivity.⁷⁸ A 2006 World Bank study found that businesses using the new technologies experienced annual job growth of 5.6 percent, a higher rate than the 4.5 percent for other firms.⁷⁹ As in other infrastructure sectors, the growth-related employment effects can be larger than the direct, indirect, and induced effects.

IT-based services offer many direct and indirect employment opportunities, particularly for youth and women. It is estimated that the IT industry will create 4 million additional direct jobs by 2016, while indirectly creating as many as 12 million to 16 million more jobs in other sectors.⁸⁰

It is evident that better access to **water** and sanitation services is important for growth and a good quality of life. Improvement in health increases labor productivity, especially through an increase in school attendance and a reduction of worker absenteeism. Time spent collecting water can be used for more productive activities, especially for women. A study conducted in Latin America and the Caribbean estimated that investments in this sector created more direct jobs than investments in other sectors. For every \$1 billion invested, expansion of water and sanitation networks generated an estimated 100,000 jobs, rural electrification projects generated 23,000 jobs, and coal-fired power-generation projects generated 750 jobs.⁸¹ Agribusiness is the biggest water user. A study in Peru found that villages with irrigation hired 30 percent more agricultural workers than comparable villages without irrigation, and that poor farmers benefited more than non-poor farmers.⁸²

In general, it is very important for policymakers to focus not on the short-term direct jobs that could be created, but on the growth-related second-order effects of infrastructure projects on employment. The second-order effects not only create more jobs, but also have possible transformational effects on the economy as a whole.

Reliable electricity powers job creation

- A reliable supply of electricity could increase annual job growth in low-income countries by 4–5 percent
- Jobs resulting from an improved supply of electricity can be a large multiple of the jobs in companies that generate or transmit electricity

Source: IFC Jobs Study (2012): The Role of Reliable Power in Employment Growth.

Water and sanitation projects stimulate new jobs

For every \$1 billion invested, number of jobs created*:

Water and sanitation projects—100,000

Rural electrification projects—23,000

Coal-fired power-generation projects—750

(But there are big job creation effects from a reliable power supply)

*Estimates from Latin America and the Caribbean

Source: Schwartz, Jordan Z., Luis A. Andres, and Georgeta Dragoiu (2009).

Access to finance

Lack of access to finance is a key constraint to job creation, particularly for micro, small, and medium enterprises. Companies in less-developed countries tend to face more financial obstacles, given the lower level of financial development. Evidence shows that improved access to credit lines and other types of finance can help generate jobs, and the results tend to be larger and more significant for small businesses and businesses in developing countries. A main challenge for the financial sector is to improve the sources of financing available for firms with growth potential that are unserved (do not have a loan or overdraft but need credit) and underserved (have a loan and/or overdraft facility but face financing constraints).⁸³

The recent financial crisis spurred questions about the role of financial markets and possible negative effects when they become too large. A study found a positive association between financial development and employment growth. However, the study also found that banking crises affect employment growth more in industries that depend on financing and in financially developed economies.⁸⁴ A recent study found that financial depth⁸⁵ and economic growth are positive and significantly related until the ratio of private credit to GDP reaches levels of 60 to 70 percent.⁸⁶ Ratios in lower-income countries are below these levels, suggesting that the expansion of credit can boost their growth.

Unmet credit needs in developing countries

Formal SMEs: \$850 billion

Micro, small, and medium enterprises, both informal and formal: as much as \$2.5 trillion

Source: Stein, Goland, and Schiff (2010).

The credit gap

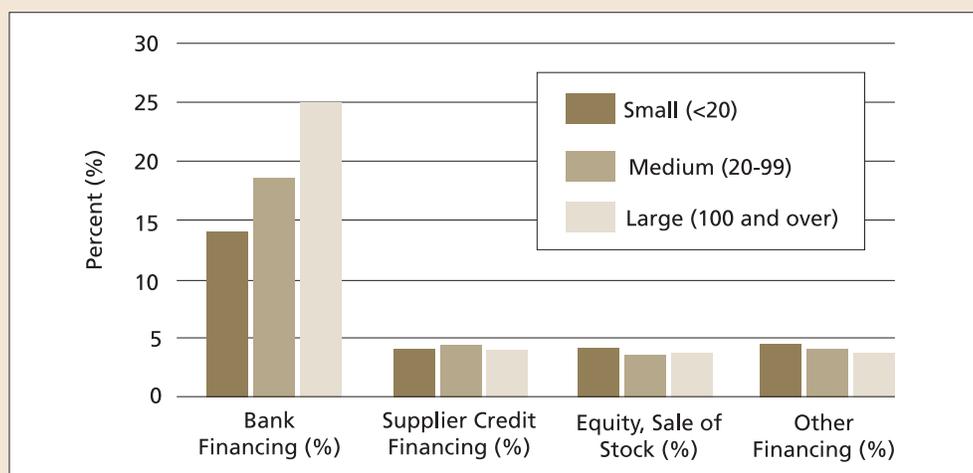
Developing countries still lag behind high-income countries in companies' access to finance: less than 20 percent of micro, small, and medium enterprises in developed economies are unserved, while in regions such as South Asia and Sub-Saharan Africa, more than 59 percent of these small businesses are unserved.⁸⁷

The lack of access to finance for small and medium enterprises, a large sector which is not served by microfinance institutions and not effectively covered by commercial banking institutions, is known as the missing middle. An estimated 45 percent to 55 percent of formal SMEs are unserved and 21 percent to 24 percent are underserved.⁸⁸ The unmet credit needs of formal SMEs in the developing world add up to \$850 billion.⁸⁹

Of 365 to 445 million micro, small, and medium enterprises in developing countries, including informal and formal establishments, about 70 percent do not use external finance.⁹⁰ Their unmet credit needs total as much as \$2.5 trillion, or around 14 percent of GDP in the developing world.⁹¹

When companies cannot borrow directly from financial institutions, they have to use alternative financial sources, including their own funds or informal credit sources⁹² that can be costlier or might

Figure 12: Smaller companies have less access to financing



Source: IFC (2010). Scaling-up SME Access to Financial Services in the Developing World.

not cover their funding needs. Alternative external sources such as trade finance and equity markets might not be available for these businesses, either. If they are unable to obtain enough financial resources, they might not be able to grow into larger firms and create more jobs.

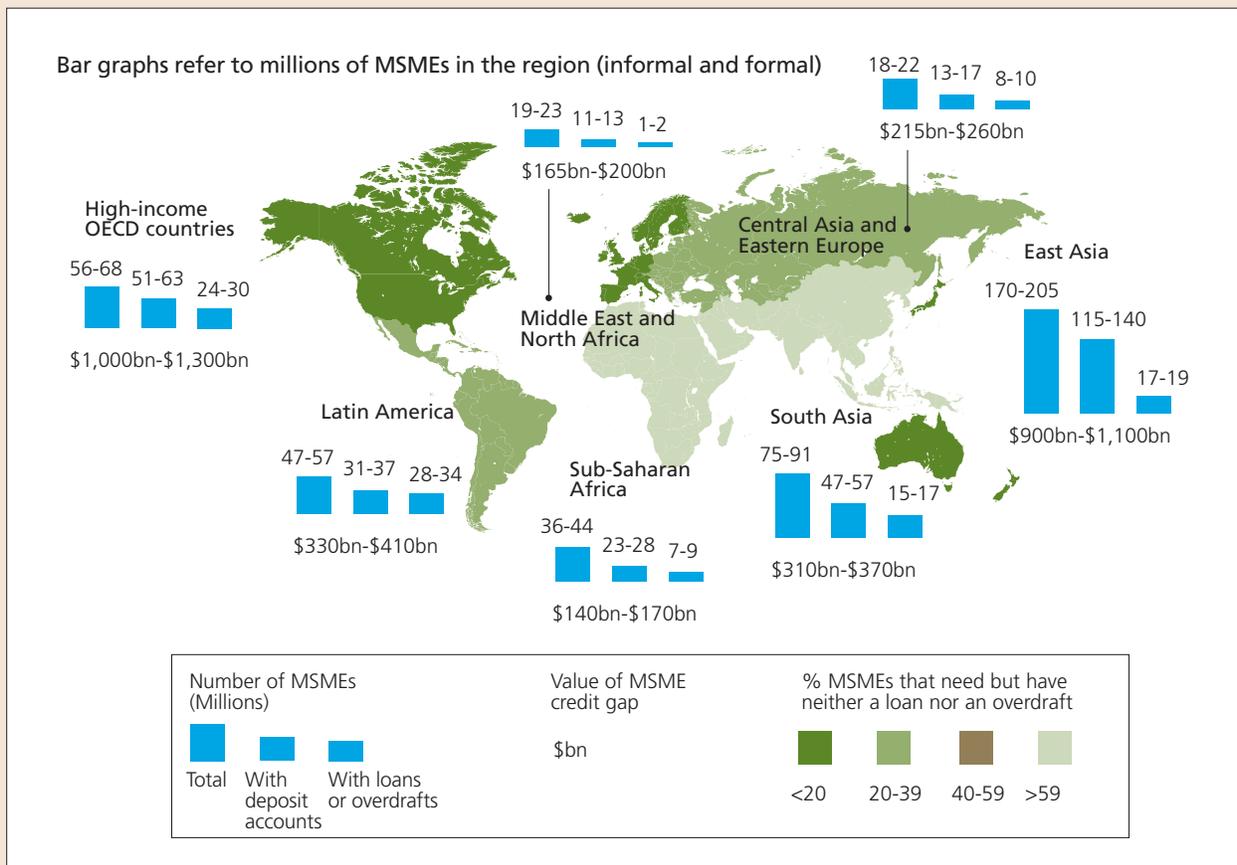
Why credit markets are constrained

The structure of credit markets is different from other markets because imperfect information on companies can often lead to an inefficient allocation of resources.⁹³ Supply-side constraints to access to finance include weak property rights and enforceability, an overly restrictive regulatory framework, high risk management and credit costs, an underdeveloped financial system, and costly government intervention and corruption.

SMEs have intrinsic characteristics that discourage financial institutions from providing them with loans and instead directing the resources to larger companies. SME lending usually has higher transaction costs because of small loan amounts and higher default risks. Additionally, SMEs usually lack credit history, have poorer credit indicators compared to larger or publicly traded companies, do not have financial statements or projections, and have fewer assets to cover collateral requirements.⁹⁴

On the other hand, companies can choose not to apply for loans. According to one study, approximately 80 percent of the SME credit gap can be linked to high credit costs.⁹⁵ Potential borrowers also can be discouraged by convoluted application processes, fear of being rejected, or fear that they could not repay the loans. Other businesses could lack the financial literacy to apply. Furthermore, informal enterprises may not have the documents that lenders require.

Figure 13: Micro, small, and medium enterprises lack credit mainly in developing countries



Source: Stein, Goland and Schiff (2010).

The link between access to finance and job creation

The literature confirms that companies with access to finance have higher job-growth rates than businesses without it.⁹⁶ Even when the relationship has proven positive, it is difficult to attribute job-creation effects solely to access to finance. The channels by which access to finance can lead to job creation are diverse (see figure 14):

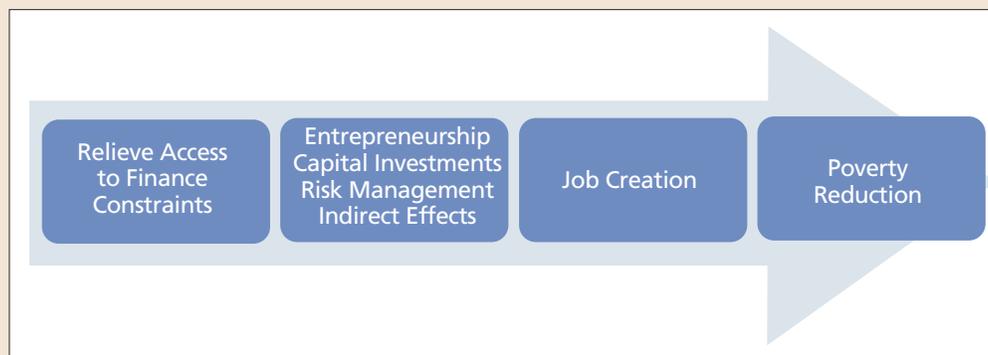
- There is a positive relationship between access to finance and the number of start-up enterprises.⁹⁷
- Access to formal financial sources allows companies to make larger investments in capital, new technologies, research, and innovation.
- This access also provides businesses with liquidity, improves their risk management, and allows them to acquire productive assets.⁹⁸
- Access to finance also has indirect employment effects in the supply and distribution chains of the borrowers.

A study using data for 98 developing countries showed that companies with a loan or an overdraft facility had 3.1 percent higher growth in the number of permanent employees than businesses without the financing. Meanwhile, external investment funds in a firm were associated with 4.2 percent higher employment growth.⁹⁹

A micro case study conducted in Sri Lanka to estimate job growth in micro, small, and medium enterprises that received financing from an IFC bank client showed a rapid annual job growth of 12 percent from 2009 to 2012—more than twice the country rate. This was accompanied by growth in labor productivity (sales per worker). The two main channels of job creation in companies were expansion of the business and investment in technology.¹⁰⁰ But the effects cannot be solely attributed to financing, since some enterprises had multiple loans, the job losses in competitors were not accounted for, and the sample did not include firms with nonperforming loans. Also, the bank probably picked winners that were likely to have higher growth rates—a sign of an efficient allocation of credit.

Studies have shown that access to finance has the largest employment effects for SMEs,¹⁰¹ which have less access to credit than larger companies. In developing countries, access to finance results in a higher rate of job growth for micro and small businesses than for larger ones.¹⁰² Research also has found that it is often a relatively small number of firms with rapid and sustained job growth—sometimes called “gazelles”¹⁰³—that account for a large portion of employment growth in countries. The majority of these enterprises typically are SMEs.

Figure 14: Relieving credit and financing constraints can have an effect on job creation and poverty reduction



Case studies from Ghana and Jordan

When companies expand operations after obtaining access to finance, there can be indirect and induced employment effects that can be larger than direct effects, but more difficult to estimate.

Two studies measured IFC financial sector intervention in Ghana and Jordan to estimate direct and indirect job effects. The results showed that investing in financial institutions led to more jobs supported than when IFC invested directly in companies, in part because these firms were more labor-intensive than the ones IFC had invested in directly. An investment of \$1 million in financial institutions had an estimated economy-wide effect of supporting 228 jobs in Ghana and 107 jobs in Jordan.¹⁰⁴

Finance, jobs, and poverty reduction

Ultimately, better access to finance—especially microfinance—can reduce poverty, because it decreases inequality and gives low-income people access to basic financial services. Financial development reduces inequality through a more efficient allocation of lending, especially in higher-income countries where more individuals have access to finance.¹⁰⁵ Also, microfinance gives low-income people access to financial services that would be difficult if not impossible to obtain otherwise.

Evaluations of microfinance investments done in six different countries (the Philippines, Mexico, Bosnia, Mongolia, Morocco, and India) found that five of the projects resulted in the creation of more enterprises, or higher rates of self-employment.¹⁰⁶ Self-employment can be an important way out of poverty when few jobs exist in an economy. The study found that in agricultural villages that received financing, households hired more people from outside the immediate family.

A study of lending to small enterprises in Bangladesh showed that 17 percent of their employees were poor, and that five key factors that would be reasonably easy to assess in companies (number of employees, percent of female workers and unskilled workers, location, and economic sector) were positively associated with poverty levels among the workers. It would be worthwhile for financial institutions and development financial institutions to consider these indicators when targeting low-income people or underserved groups.¹⁰⁷

Lack of access to finance is magnified during crises

So far, this report has analyzed the effects of finance on job creation in times of economic stability. The recent financial crisis presents a very different scenario. The crisis started in the financial sector and spread to other sectors through shocks to trade, private capital flows, remittances, and aid.¹⁰⁸ World unemployment jumped to 197.7 million in 2009 from 170.7 million in 2007,¹⁰⁹ with developing countries accounting for 45 percent of the rise, and higher rates of vulnerable employment in Latin America and the Caribbean, North Africa, and Sub-Saharan Africa.¹¹⁰

An ILO analysis found that the unemployment crisis particularly hit youth,¹¹¹ with the rate increasing 1.1 percentage points to 12.8 percent from 2007 to 2009.¹¹² Furthermore, a large number of discouraged young people—estimated at 6.4 million in 2011—gave up searching for jobs. In developing countries, youth account for a considerably higher share of the working poor.¹¹³

The crisis further constrained access to finance in developing economies. The credit crunch in global financial markets and lower levels of activity by foreign banks reduced both liquidity and confidence in emerging markets' financial sectors. The private sector was hit through lower capital flows, higher costs of lending, and increased vulnerabilities to price volatility and foreign exchange shocks. Lending to emerging markets still had not recovered to pre-crisis levels as of the first semester of 2011.¹¹⁴

SMEs were disproportionately affected by the decrease in business lending after the crisis,¹¹⁵ and credit conditions have become more stringent for small businesses.

Measures that can improve access to finance

The intervention of governments, development finance institutions, financial institutions, and other private-sector actors is needed to relieve constraints and spur job creation.

- **Improve financial sector regulations:** Financial liberalization can promote the creation of new companies and the closure of inefficient or unprofitable ones, which can cause a decrease in lending costs and allow profitable businesses to flourish. It is also necessary to improve enforcement of regulations. For example, better protection of property rights can increase access to finance, especially for small firms, because it safeguards lenders and supports the collection of collateral in event of a default.
- **Improve financial infrastructure:** A more developed financial infrastructure can make more information available about potential clients, and therefore reduce transaction costs and expand credit, particularly for SMEs. The probability that small companies can obtain loans increases from 28 percent to 40 percent when they operate in countries with credit bureaus.¹¹⁶
- **Step up bank competition:** Governments can promote competition in the sector, for example by encouraging entry of financial intermediaries or diversification of their lending,¹¹⁷ which can result in financing to previously unserved groups. Heightened competition can reduce interest rates, thus benefiting companies that obtain credit.
- **Increase funding to financial institutions or other financial intermediaries:** Policies that help financial institutions broaden their lending activities to underserved groups can help generate jobs. For example, partial credit guarantees mitigate the credit losses of financial institutions in the event of default and therefore promote lending to SMEs.
 - IFC obtained employment data from more than 3,100 companies that received loans from 34 banks, which is a broadly representative sample of IFC's large portfolio of SME-focused banks. Based on that data, this report estimates that about 100 million jobs were provided by 23 million micro, small, and medium enterprises financed by IFC client financial institutions as of the end of 2011. It is important to note that this estimate is for the number of people employed (not additional jobs created).
 - An analysis of companies financed by IFC-supported growth equity funds showed that they had annual job growth rates of 14.7 percent from 2000 to 2010, and created—net of job losses—nearly 300,000 jobs. The analysis also showed that while growth rates were highest in small businesses, the largest numbers of jobs were created in firms that were already large (300 employees or more) when the funds invested.
- **Cater to unserved or underserved groups:** Establishing new financial institutions or products targeting previously unserved or underserved groups can entail high up-front costs, but have significant public benefits.

The skills gap

Approximately 45 million job seekers join the labor force every year in the current challenging macroeconomic environment,¹¹⁸ yet more than one-third of companies in 41 countries around the world report an inability to find the workers they need.¹¹⁹ This dynamic suggests a global mismatch between the demand and supply of workers, and the availability of relevant job training. The world's labor force is concentrated in developing economies, the majority of whose workers possess low levels of skills, while advanced skills and training are more prevalent among workers in developed economies. The mismatch has thus also become a cross-country challenge. In general, there are not enough jobs for low-skilled workers, and not enough workers for high-skilled jobs.

More advanced skills become even more important as countries aim to reach higher levels of development by switching to industries that require workers to be more productive, such as more sophisticated manufacturing and business services. Adequate skills are important not only for workers; managers and business owners sometimes also lack the skills required to direct their companies, which also limits the potential for these to grow and create more jobs.

The global skills gap

- Around 45 million job seekers join the labor force each year
- More than 1/3 of companies in 41 countries are unable to find the workers they need
- Combining classroom with on-the-job training increases the chances of success of programs by as much as 20 percent
- Working with the private sector to identify the skills gap is fundamental to ensure that training tackles that gap

Sources: World Bank (2012); ManPower Group (2012); Fares Puerto (2009).

Shortage of skills is a major constraint

The lack of adequate skills is a particularly pressing constraint for larger companies and for businesses located in higher-income countries.¹²⁰ Larger firms, which tend to be more concentrated in higher-income countries, often perceive the lack of an adequately trained labor force as their biggest obstacle. On average, 7.3 percent of small companies and 9.7 percent of medium-size businesses identify an inadequately educated workforce as their biggest obstacle, while this figure is 12 percent for large firms.

A study conducted in Poland in 2009 found that soft skills (for example, teamwork, motivation, and communication) can be as or even more important than general and technical skills (for example, literacy and problem solving).¹²¹ Companies and policy makers have started to recognize that technical skills are not everything;¹²² and that a strong focus on soft skills is needed in order to create the right skills for the workplace in the coming decades.¹²³

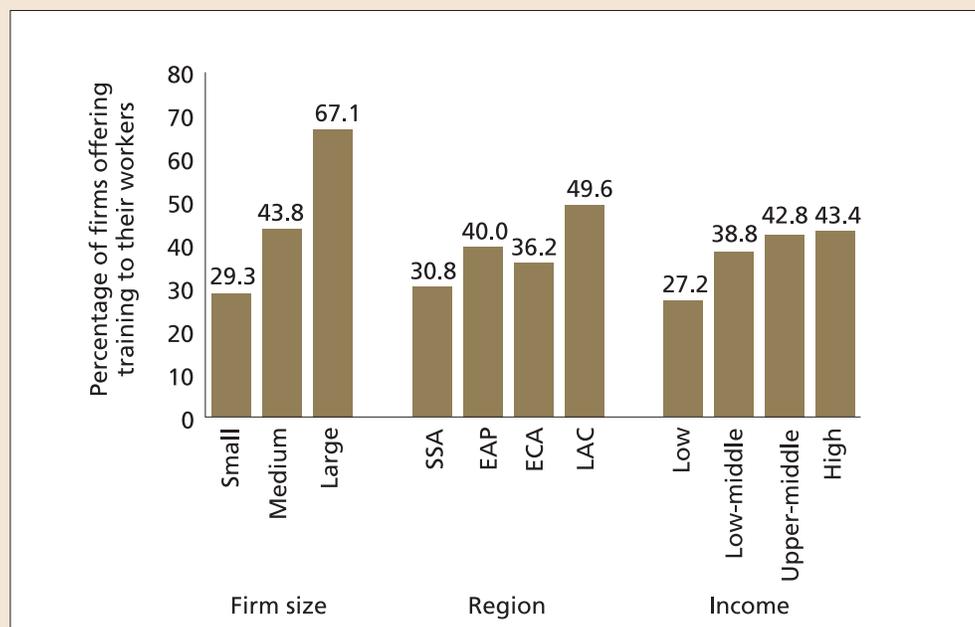
The lack of adequate skills particularly affects youth, who suffer from underemployment. For instance, youth in African countries can be underemployed rather than unemployed, 76 percent of workers in Sub-Saharan Africa are working in low-quality jobs that are characterized by a low level of skills and poor working conditions, and many of these workers are youth.¹²⁴

The skills gap matters most in higher-income regions

Income disparities across regions and technological advancement in countries markedly affect whether training and skills are a priority. For instance, in Latin America and the Caribbean, 12.5 percent of companies report that lack of training and skills is their biggest obstacle, while this percentage is only 3.2 in Sub-Saharan Africa.

China, despite significant investments in higher education, is expected to face a shortfall in workers with a tertiary education by 2020 as it moves to higher value-added activities, whereas India is expected to face shortfalls of people with a secondary education.¹²⁵ Given the size of these markets, this is likely to significantly affect the global search for skilled workers.

Figure 15: Larger companies and companies in higher-income countries are more likely to offer training



Source: Enterprise Surveys. Regions included are Sub-Saharan Africa (SSA), East Asia and the Pacific (EAP), Europe and Central Asia (ECA), and Latin America and the Caribbean (LAC). South Asia was omitted from the analysis because of the small number of observations.

Small companies, low-income countries invest less in training and innovation

The number of companies investing in their workers' education and in innovation varies by country income group and business size. The latest Enterprise Surveys conducted across 106 countries show that about 40 percent of firms offer training to their workers. About 29 percent of small enterprises, 44 percent of medium-size enterprises and 67 percent of large enterprises provide training.¹²⁶ In addition, about 27 percent of companies in low-income countries offer training, compared to around 43 percent in high-income countries (see figure 15).

Small and medium enterprises are much less likely than larger companies to invest in training. Among the reasons is that training and innovation can often be perceived as a cost rather than a benefit for businesses, especially for those with higher turnover of employees. In those cases, training employees constitutes a public good—the workers and other firms benefit, but the company providing the training may not reap the benefit. There is thus a public policy argument for supporting training for such businesses to avoid underinvestment in training. Providing information on the benefits of training and innovation programs can help, and given that young firms are often the ones with higher employment growth rates, it would be appropriate to support training programs for this group of companies.¹²⁷ Training also could be supported by working with larger businesses to improve their suppliers' skills, which ultimately benefit the larger firm as well; by supporting the production of training materials, (e.g. online training tools); or by providing vouchers for training. The cost of training can be fully or partially recovered by charging fees. IFC's FaST program does this, with the aim of developing a self-sustained market for management training services in emerging markets (see table 4).

Table 4: IFC's FaST projects create jobs in India and Yemen¹²⁸

India	Trained farmers have higher productivity increases
IFC developed a package of training materials for sugarcane farmers working with its investment client DCM Shriram Consolidated Limited. Training included seed management, soil improvement, water usage, planting techniques, micro-nutrients, and inter-cropping. In the first two years, trained farmers obtained productivity gains that were two to four times higher than productivity gains among the control group. The program expanded from 2,000 farmers to more than 12,000 in 2012. A total of 150,000 farmers are expected to be reached throughout the value chain. This program is expected to create around 3,000 jobs for youth at a tea plant.	
Yemen	Product Rejection rate reduced by 44 percent overall
In 2009, the Business Edge management training program targeted 16,000 people in a joint effort with Yemen Education for Employment Foundation. The program secured employment for more than 400 recent college graduates in the construction, oil, and tourism industries, a placement rate of 45 percent. In addition, hundreds of women started their own micro-businesses, for example sewing, farming, craft-work, and dentist's offices.	

Sources: SBA (forthcoming), "Creating Jobs in Yemen and Nigeria" and SBA (forthcoming) "Helping Business Flourish in a Fragile Environment"; IFC (2012), "The Sweet Taste of Success"; Khan, Ayesha (2012), Draft-unpublished document.

Training for informal sector workers can help them formalize

The informal sector also is a good candidate for training because it employs large numbers of people, including youth. Training for informal workers can help them become more productive and move from underemployed to full employment, perhaps in the formal sector. Apprenticeship programs could be used to give workers access to more efficient processes and new technology.¹²⁹ However, this training must be accompanied by incentives for employers to formalize, so that they can contribute to the economy's overall development. Governments could try to establish a market for private sector participation in such programs, rather than relying on the public sector to provide them.

Investing in training, innovation, and technology can stimulate job creation

The education level of workers matters. A higher percentage of workers who completed secondary education in a company is associated with a higher growth in sales.¹³⁰ Companies that offer training can boost their rate of job growth by between 4 and 5 percent. In addition, businesses that invest in innovation experience higher job growth rates, and growth tends to be higher for those firms with a larger proportion of unskilled workers and women.¹³¹ There also is a higher employment growth rate in companies that have an internationally recognized quality certification. Obtaining these certifications often requires the adoption of technology or of training and skills-development programs.¹³²

Most effective training and skill-building programs

We reviewed evaluations that have measured the impact of training and skills-development programs, dividing them into four groups: managerial and entrepreneurship training, vocational training, programs that help the unemployed find work (retraining programs), and cross-cutting issues (women, youth and quality of jobs). The results are:

- When these programs target business managers and business owners, they usually have a positive impact on companies' productivity but not necessarily on employment.
- In vocational training, combining classroom education with on-the-job experience had positive effects in multiple evaluations. This training was most beneficial for women and disadvantaged youth.
- Results are inconclusive about the impact of retraining programs on employment-related variables, but comprehensive programs (involving more than retraining component) yield positive results more frequently. Training for the unemployed seems to increase the probability of employment, but does not translate into higher earnings for participants.
- There is insufficient evidence to determine whether formal jobs created through training and skill-building programs are lasting jobs rather than short term only. In addition, effects from training interventions tend to be stronger for low-income youth and women.

Training that gets the job done

"When foreigners ask why youth unemployment is so low in Germany (just 8.2% compared with Spain's 50.5%), older Germans tout the dual system [that combines classroom with on-the-job training]."

Source: The Economist (2012).

In sum, programs offering training and skills have mixed results overall, but better results when education is combined with on-the-job training, and better results in the medium term than in the short term.

Comprehensive approach to tackle the mismatch of skills and unemployment

So far the report has focused on the effectiveness of stand-alone training and skills-building programs, but these are not sufficient to decrease unemployment or the mismatch of skills. A comprehensive approach is needed to address this mismatch and requires close collaboration with the private sector and other relevant stakeholders—such as educational institutions, training providers and organizations working with youth—in order to design and implement policies and curricula that more effectively address market needs.

Basic levels of general education should be reinforced, with special attention on secondary and post-secondary classroom education combined with on-the-job training. Collaboration across multiple levels of education is needed, and apprenticeship models—like those in Germany and Switzerland—appear particularly successful. Youth should be able to find an easy transition not only from technical and vocational education and training programs to the job market, but also from vocational education to tertiary or further education.¹³³ These programs should include both counseling on how to find a job and help with job placement. It is also important to incorporate technology training to give students a higher level of skills.

Clusters and other alternatives in training provision

It can be more cost-effective to provide specialized training for clusters of companies, such as in urban areas or special economic zones, or multiple suppliers or distributors linked to a large company. Because clusters increase the number of workers who could benefit from training, providers can focus on teaching more specialized skills to these groups with shared interests, and workers are able to apply these skills in more than one enterprise. There are well-known productivity spillover effects from such agglomeration or clustering.

Clusters also are an innovative way of building support for modifications to schooling programs and changes in regulations and standards. For example, some vocational training programs could be implemented if these programs are supported by groups of companies in a cluster.¹³⁴

The apprenticeship model of vocational training

Dual vocational training systems that combine classroom with on-the-job training work best, and Germany and Switzerland are among the most successful examples globally of how this approach can help tackle unemployment. This system closely connects employers, the public sector, and trade unions to ensure that it is properly regulated and funded.¹³⁵ Common standards are widely accepted and followed, there are qualified training providers and instructors, and there is research and development to keep training programs up-to-date.

The dual system provides learning on-the-job to develop soft skills such as teamwork, communication, and negotiation, while also teaching hard skills on the use of modern technology and equipment. The classroom training provides both general and specific training for an occupation, while the on-the-job training is specific to the occupation and employer. Businesses commonly hire their apprentices as workers once the training (also used as a screening process) finishes.

Many other countries have unsuccessfully tried to implement this system. Through decades of implementation, Germany's system has been accompanied by micro and macro policies (such as coordination among stakeholders) that make it easier to implement and therefore more difficult to replicate.

It also is fundamental to increase the recognition of vocational training programs as valid and prestigious. This can be done by building curricula that are recognized by employers—for example, through accreditation or by having employer associations administer final exams—so that students have real career prospects when they graduate, and by making it easy for students who graduate from these programs to transition to tertiary education if they wish.

The gender gap

Globally, education levels of women have increased, and educated women earn more than their uneducated peers. But the gender gap, the difference between the number of economically active women and men, persists. Women comprise 49.6 percent of the world's population but make up only 40.8 percent of the formal global labor market. This is untapped economic and productive potential, which matters because women's economic empowerment is good not only for women but also for society, companies, and the economy.

Educated and employed women help reduce poverty by helping their families and communities escape the cycle of poverty. Women influence the productivity and competitiveness of future generations by reinvesting 90 percent of their income into their families¹³⁶ and rearing children for success.¹³⁷ If women don't have the opportunity to contribute economically, the years of investment in their education also is wasted.

Gender diversity is good for companies

When women are able to fully participate in the labor market, companies benefit from increased business opportunities and access to new market segments. Productivity gains from women's inclusion in the labor market come from the variety of ways women bring added value to their workplaces, including their high education levels and alternative labor practices.

The global gender gap

Women: 49.6 percent of the population, 40.8 percent of the formal labor market

Firms owned or managed by women: 5 percent less likely to receive a loan than men-owned firms

Firms owned by women: interest rates 0.5 percentage points higher than men-owned firms

Sources: World Bank and IFC (2011); Muravyev, Talavera, and Schäfer (2009).

In the agricultural sector, increased access to productive resources for women (commensurate with levels for men) could have a productivity gain as large as 4 percent.¹³⁸ In male-dominated sectors and occupations, removing obstacles for women to enter could trigger productivity increases of as much as 13 percent to 25 percent.¹³⁹ A Brazilian engineering, construction, and chemicals group, Odebrecht, reported higher productivity after hiring women because the new gender mix resulted in the development of new ways to work.¹⁴⁰ For instance, at Odebrecht's hydro-electricity construction site in Santo Antonio, a female-led team with a majority of women workers performed electro-mechanical assembly tasks 35 percent faster than teams with a majority of male workers. In another example, more than one-third of all women recruited by the Ukrainian company Mriya in 2010 and 2011 were under 28 years old, a clear message that the company applies its anti-discrimination policy and supports the hiring of women of child-bearing age. During the same one-year period, Mriya jumped 39 places from 74 to 35 on Ernst & Young's annual survey of university graduates ranking Ukraine's best employers, showing that it managed to significantly improve its attractiveness as a place to work.

Gender diversity is good for the economy

Equality of employment opportunities for men and women is associated with reduced poverty and higher GDP levels. For example, barriers preventing women from fulfilling their economic potential are estimated to have cost the Asia-Pacific region somewhere between \$42 billion and \$46 billion in GDP losses.¹⁴¹

A study in Turkey simulated an increase in the relatively low participation of women in the labor force from 23 percent to 29 percent and found that it could help reduce poverty by 15 percent if women took full-time positions, or 8 percent if they had part-time jobs.¹⁴² In some developing countries—especially in the Middle East and North Africa—women's participation rates are lower than expected and notably lower than men's rates, considering the education and age levels of the population. Raising the labor participation rates to the expected level would boost household income by 25 percent.¹⁴³

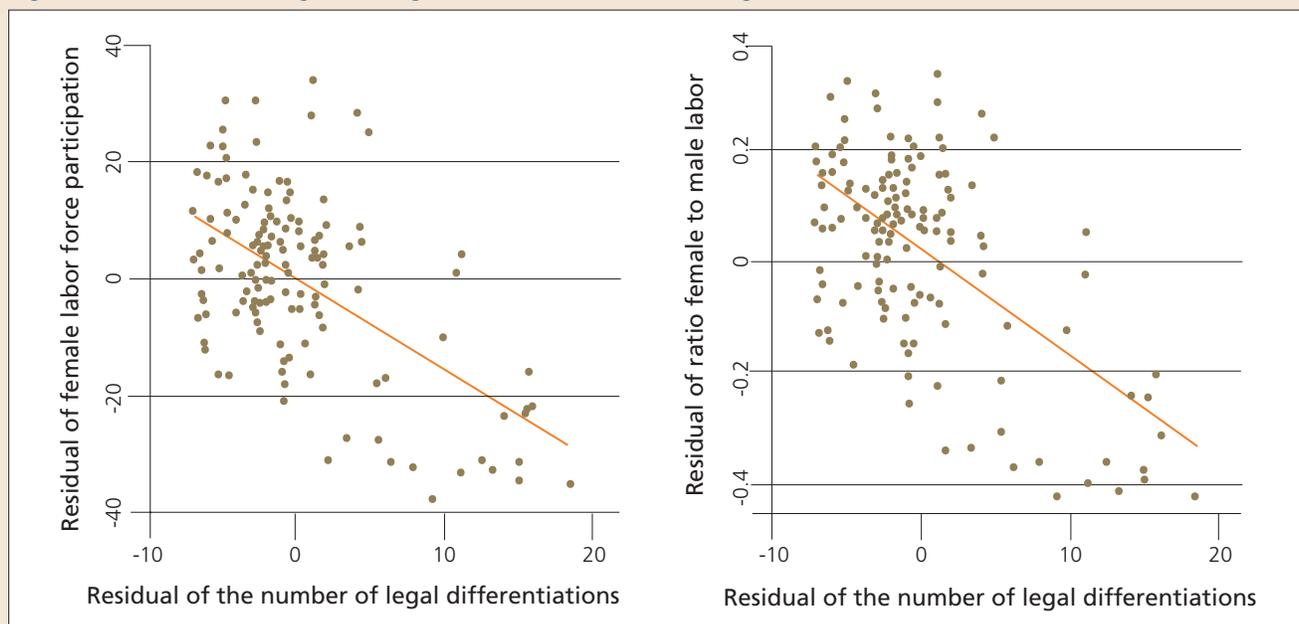
Barriers to women's full and productive participation in the workforce

Some widely cited reasons for the lack of gender parity in the labor market include limited access to education and training, the high cost of child care, household and family responsibilities, discrimination, regulatory constraints, and unsuitable working conditions. These constraints often are interconnected. For example, the unequal access to legal and property rights between men and women in many parts of the world is one reason women lack access to credit and financing. In order to get a bank loan to start a business, women sometimes need collateral that is under a male relative's name.

Legislative barriers: In many countries, laws regulating work in the formal sector treat men and women differently. The laws cover a variety of issues during a woman's work life cycle, including hours of work, taxation, parental benefits, and retirement. Some labor regulations may enhance a woman's incentives and abilities to get the job of her choice; others may inhibit her from doing so. In 102 out of 141 economies, there exists at least one legal difference that could hinder women's economic opportunities. In some cases, the intention may be to protect the women. But in countries where there are greater numbers of legal differentiations between men and women, fewer women work, own, or run businesses (see figure 16).¹⁴⁴

Cultural considerations and restrictions: Traditional views of a woman's role in society have the effect of reducing the number of women employed in the formal labor market and also increasing the wage gap between men and women.¹⁴⁵ In economies where women cannot get a job without permission from their husband or guardian, there are fewer women in the workforce than in economies where such restrictions do not exist.¹⁴⁶ This constraint is particularly binding during adolescence and after marriage.¹⁴⁷ This is in part due to the double burden that women face, with responsibilities at home and at work. Inadequate childcare in some parts of the world makes it difficult for women to simultaneously work and raise children. These care considerations are important even for highly educated and professional women who have access to childcare options¹⁴⁸ and have been cited as one of the reasons for unbalanced gender ratios on company boards.¹⁴⁹ There is a solid business case for the link between family-friendly policies and long-term business success. A German government study found that the average return on investment for policies friendly to women and families was 25 percent. In Vietnam,

Figure 16: When there is greater legal differentiation based on gender, fewer women work



Source: Women, Business and the Law database; World Development Indicators; Enterprise Surveys.

Note: The graphs present the partial correlations between the two variables identified after controlling for income per capita.

Nalt Enterprise garment factories saw a decrease of staff-turnover rates to the tune of 30 percent after the firm established a kindergarten for workers' children.¹⁵⁰

Lack of access to finance for women entrepreneurs: Lack of access to finance and financial services, such as commercial credit, is repeatedly identified as the major constraint for women entrepreneurs. Companies run by women are usually smaller than those operated by men in terms of number of employees, asset value, and annual turnover, besides being less profitable and productive.¹⁵¹ One reason for these differences: A study using 2005 data from 34 countries in Western Europe, Eastern Europe and Central Asia, and East Asia and the Pacific showed that businesses owned or managed by women were 5 percent less likely to receive a loan, and that women-owned firms had interest rates that were on average 0.5 percentage points higher than those for men-owned firms.¹⁵² In more developed countries, the probability of women obtaining loans was higher, and women had to provide less collateral on average.

Concentration of women in sectors with lower productivity

As a result of these barriers, women may seek other economic opportunities that tend to be less productive and are concentrated in sectors that are generally characterized by low pay, long hours, and often informal working arrangements.¹⁵³ Specific sectors that rely heavily on women workers include agribusiness, tourism, and textiles.¹⁵⁴ Women tend to be under-represented in industry and extractive sectors and other highly productive activities, working primarily in agriculture or services.

Entry points for the private sector

To equalize labor market opportunities between men and women, it is necessary to remove the various constraints discussed. Two main strategies have emerged to increase the number of women in the labor market: (i) support sectors or industries where there are already large numbers of female workers—and help women get to leadership positions in these areas; and (ii) encourage the participation of women in male-dominated sectors. Other targeted approaches that have been successful for women entrepreneurs or small business owners include connecting women entrepreneurs to global markets and providing finance to small and medium enterprises owned by women.

Quality of jobs matters

It is not just the number of jobs created that counts; quality matters. Quality jobs are effective in reducing poverty and maximizing companies' productivity and efficiency. Because jobs provide earnings, and often access to benefits including insurance, they can be the source of broader life satisfaction. Development in large part consists of increasing the positive direct effects of jobs on individuals.¹⁵⁵

It is through the creation of good jobs at the company level that positive macro-level transformation can take place within the society and economy (see table 5).

Table 5: Improved labor standards yield multiple benefits

China Chai Da/Ying Xie	Annual worker turnover decreased from 78 to 32 percent in three years
Cambodia ILO Better Factories program	Product Rejection rate reduced by 44 percent overall
Turkey Yesim	37 percent decrease in lost time from accidents and sickness
Turkey Topkapi	Receives 2.5 percent larger discount on insurance premiums for casualty and goods in transit
India Esstee	Worker turnover reduced from 75 percent to 35 percent

Source: IFC and Social Accountability International (2012).

The definition of a “good job” depends on whom you ask. The question is part of a large and growing debate about globalization and working conditions.¹⁵⁶ This report will use the definition elaborated in the IFC Performance Standard 2 on labor and working conditions: A job which guarantees workers' rights while paying them a decent wage. The requirements of this standard have in part been guided by core labor standards of ILO and key United Nations conventions.

The World Bank's World Development Report 2013 says jobs that promote development of countries are those that do more to support three fundamental aspects of society: social cohesion, living standards, and productivity.

Simply having a job does not guarantee high levels of life satisfaction. A study in Vietnam finds that workers with higher life satisfaction are more likely to perceive working conditions as good, are not concerned with verbal abuse, suffer only minor injuries in their workplace, and have received training in the last six months. Interestingly, there was no statistically significant finding related to the wage levels of these workers.¹⁵⁷ Other studies find that factors related to job security are more important than income levels, and that variability of earnings, job instability, or health and safety concerns affect a worker's well-being.¹⁵⁸

IFC Performance Standard 2 (PS-2)

PS-2 recognizes that the pursuit of economic growth through employment creation and income generation should be balanced with protection of basic rights for workers.

Objectives:

- To promote the fair treatment, non-discrimination, and equal opportunity for workers
- To establish, maintain, and improve the worker-management relationship
- To promote compliance with national employment and labor laws
- To protect workers, including vulnerable categories of workers such as children, migrant workers engaged by third parties, and workers in the client's supply chain
- To promote safe and healthy working conditions, and the health of workers
- To avoid the use of forced labor

The Equator Principles

The Equator Principles, which are based on IFC Performance Standards, are a credit risk management framework for determining, assessing, and managing environmental and social risk in project finance transactions that often are used to fund the development and construction of major infrastructure and industrial projects. Currently, 77 financial institutions in 32 countries have officially adopted the principles, covering more than 70 percent of international project-finance debt in emerging markets, which has made the principles a de facto global standard.

Successful use of Performance Standard 2 requirements: The case of Antea Cement

IFC provided €29.4 million in financing to Antea Cement in late 2008 to help the Greek company build and operate a blended-cement plant in Albania that resulted in the creation of 300 direct jobs and an additional 500 indirect jobs. CBMI, a member of the Chinese Sonoma Group, had the contract to design and build the plant and planned to hire 800 Chinese workers and build accommodations for them on site. Antea included specific Performance Standard 2 requirements in its agreements with CBMI and other contractors. After two years, Sonoma is presenting the Antea project as a case study of best practice. The benefits included on-time and on-budget completion of the project, zero accidents, best practices in contractor management, and improvement of labor and working conditions at Sonoma, which will create opportunities for the company to expand operations into European and North American markets.

Why the private sector should care about creating good jobs

Conventional wisdom tells us that companies sometimes consider compliance with labor standards costly. For example, businesses are often leery of revamped human resource practices. However, changes in such practices are viewed in the literature as another aspect of production technology,¹⁵⁹ similar to shop-floor production technologies, and may improve firms' productivity, performance, and survival rates.¹⁶⁰ This is just one example of the growing business case for improvements in compliance with labor standards.

Companies have noticeably shifted their focus in the past decade¹⁶¹ from questioning the desirability of various labor regulations to focusing on their effectiveness. Corporate social responsibility initiatives picked up speed in the late 1990s as a response to new challenges presented by economic globalization.¹⁶² Both businesses and governments have paid particular attention to monitoring complex global supply chains, where there was a perceived race to the bottom by unscrupulous employers who were taking advantage of workers in faraway low-income countries.¹⁶³ Global supply chains and distribution networks tend to be where most jobs are created, and therefore are very effective in reducing poverty.¹⁶⁴

This shift has been in part a response to demand-side pressures. Knowledgeable and socially conscious clients and customers increasingly consider the environmental and social practices of companies when conducting business or buying new products. Experiments conducted in a major retail store in New York City in 2005 found that sales rose for items labeled as being made under good labor standards, and demand for the labeled products even rose with price increases of 10 percent to 20 percent above unlabeled levels.¹⁶⁵

This demand-side pull eventually translates into greater understanding by suppliers that there are various benefits to providing good working conditions.¹⁶⁶ There is emerging evidence from a variety of industries in different countries that compliance with labor standards enhances productivity because it fosters collaborative team dynamics, increases worker loyalty, and reduces workplace accidents and injuries.¹⁶⁷ In addition, the ability to recruit and retain workers has been shown to have major payoffs for compliant companies. A study of the Lao garment industry found that it suffered from low productivity mainly because workers did not fully understand their contractual obligations, had difficulty transitioning from rural to urban areas where factories were located, and worked excessive overtime hours.¹⁶⁸ Further benefits of creating quality jobs are access both to new markets and to different forms of financing.

The most effective interventions to support compliance with labor standards are a combination of monitoring and tackling the root causes of poor working conditions. A root-cause intervention such as enabling suppliers to better schedule their work with the goal of improving quality and efficiency has been seen to improve working conditions considerably.¹⁶⁹ A forthcoming study from Vietnam finds that companies that pay as promised and that do not engage in verbal and physical abuse to elicit work effort earn higher profits than their peers that do not follow these rules.¹⁷⁰ It seems these two factors together lead workers to be more productive because they believe that their work adds value and that they will get a piece of the pie.¹⁷¹

How the private sector can improve labor conditions in distribution networks and global supply chains

It is trickier to track labor conditions in the distribution networks or supply chains associated with formal sector companies. But two examples, one at the company level (Mindanao Banana project) and the other at the industry level (ILO-IFC Better Work), show the potential to positively affect compliance in distribution networks and supply chains as well as in their respective industries. The Mindanao Banana project in the Philippines addressed systematic problems associated with banana farmers: low productivity, poor business management, and poor compliance with environmental and social standards. The project's outcome was improved income for the farmers and increased revenue for the lead company. Better Work, a partnership program between IFC and the ILO, aims to improve compliance with labor standards in seven countries. In the Better Factories Cambodia program, more than 90 percent of factories now pay correct wages and overtime rates. Cambodian apparel exports to the United States grew in value by 151 percent and more than 160,000 jobs were created between 2001, when the program started, and 2008.

Conclusions

According to the World Bank's Enterprise Surveys, the key obstacles for private enterprises in developing countries are a poor investment climate, inadequate infrastructure, lack of access to finance, and inadequate skills and training.

Perhaps the first and major contribution of this report is to provide evidence of the significant job-creation effects of removing these constraints, and to identify the specific conditions and activities necessary for the private sector to generate jobs:

- **Cumbersome and costly regulations are preventing companies from operating and growing in the formal sector.** Comprehensive investment climate reforms help create or improve jobs. Multi-reform programs are more effective than single reforms but require sufficient information and the ability of regulatory institutions to make sound policy decisions and coordinate among themselves. Certain stand-alone reforms—such as those affecting business entry, taxation, competition, and secured transactions—have demonstrated a positive impact on growth and jobs. A lower tax rate and investment promotion efforts both can help attract foreign direct investment. However, the effectiveness of lower tax rates in attracting this investment is weaker in countries with poorer investment climates. Many countries also use targeted investment climate tools, such as creating a special economic zone or improving regulations in a specific industry.
- **Lack of infrastructure**—especially a reliable power supply—is a big problem in lower-income countries. Many studies focus on direct jobs created during the construction phase, but indirect and induced effects often are larger. The most significant job effects often come from having improved services (like more reliable power), but it is difficult to estimate them. The private sector has increasingly invested in infrastructure, and going forward there will be a big need to improve the urban infrastructure, as more people move to cities. Infrastructure investments also can be very effective in reducing poverty and promoting more inclusive and equitable growth.
- **Lack of access to finance** is felt especially by micro, small, and medium enterprises and by women entrepreneurs. Firms operating in less developed countries also tend to face more financing constraints that prevent them from growing. Measures that can improve access include reform of financial sector regulations, policies that help financial institutions broaden their lending activities to underserved groups, increased competition in the financial sector, and enhancement and

development of financial infrastructure. Many different analyses indicate that facilitating access to finance can generate a significant number of jobs, especially for small enterprises. This happens, for example, when finance allows new companies to start operations or existing businesses to expand or invest in technology. However, strong public institutions that promote and effectively enforce regulations are necessary when credit is expanded in a country, in order to avoid misallocation of resources or over-indebtedness.

- **Technology and productivity trends are producing a shortage of high-skilled workers for larger companies in higher-income countries.** At the same time, the demand for low-skilled workers is decreasing, which increases the surplus of low-skilled workers both in developed and developing economies. Investing in education, training, technology, and innovation can boost job creation. While effects from training and skills programs seem to be mixed, combining classroom with on-the-job training seems to work best, focusing on disadvantaged groups appears to have greater impact, and employment effects from training programs seem to be more significant in the medium term than in the short term.

The report provides additional findings:

- First, focusing only on direct jobs can be misleading. The number of direct jobs created by IFC's client companies may be small, but there is large job creation in their supply and distribution chains (indirect jobs), which tend to benefit the unskilled and the poor. However, these indirect jobs, as well as second-order growth-related jobs from improved services (particularly relevant for infrastructure), are difficult to measure. Better data and comprehensive methodologies are needed to create a more complete picture of job generation resulting from specific activities and to clearly attribute the new jobs to these activities.
- Second, company size matters. When studying the effects of different programs and examining the literature, business size often has emerged as a determining factor. In general, small firms tend to have higher rates of job growth, but larger enterprises are more productive, invest more in training, and offer higher wages. Even though small firms have higher rates of job growth, most of them are unable to grow to their full potential because of multiple constraints that have been discussed earlier in this report.
- Third, there is evidence that higher labor productivity can be associated with faster employment growth. If the market is competitive enough, then higher productivity allows companies to produce more and thus makes it more attractive for them to hire workers. This effect outweighs job losses that can be associated with higher productivity. Furthermore, studies show that employment growth coupled with increased productivity is more likely to lead to reduced poverty.
- Fourth, women and youth face specific employment challenges. Women in many countries still face significant disadvantages—including legislative barriers, lack of access to finance, and cultural norms—that often force them to work in jobs that pay less and are more vulnerable. Providing better access to jobs for women is good for their families, their companies, and economies. Youth not only face higher unemployment than adults but also are more likely to work in informal jobs and be underemployed. A comprehensive strategy is necessary to address this multifaceted challenge.

Implications

For policymakers, it is important to consider the most important constraints for private enterprises in their specific country context. Removing these barriers will contribute significantly to job creation. While this study highlights the most important constraints globally and for countries at different income levels and different types of enterprises, more detailed analysis at the country and industry level will be needed for effective prioritization. Focusing on the most important constraints for private enterprises is a useful approach.

The World Bank Group, IFC, and development finance institutions oriented toward the private sector also have a role to play in helping to remove barriers to job creation. In fact, this report confirms that key elements of IFC's overall strategy (a focus on investment climate, infrastructure, access to finance, and training and skills) are crucial not only for private sector activity but also for job generation.

Using a “job lens” in country and regional strategies can help to identify key constraints to job creation. Typically, the more severe a constraint is, the bigger the job-creation effect by removing it. The jobs lens should consider—and attempt to strengthen—employment effects throughout supply chains and distribution networks.

Focusing only on direct jobs misses the point: This report has seen that the job effects are often much larger in supply chains and distribution networks, and that these jobs often provide opportunities for the poor. Helping to strengthen the link between client companies and their local suppliers and distributors is an effective way to reach the unskilled and reduce poverty. Another channel to attack poverty is to reduce obstacles that discourage businesses from becoming formal. Also, supporting financial institutions that serve micro, small, and medium enterprises has proven to be efficient in reaching underserved and unserved groups. Microfinance plays a critical role in helping unserved individuals and in offering opportunities for self-employment.

A comprehensive approach is needed to decrease the mismatch of skills and unemployment in general, and particularly for youth. Development finance institutions must collaborate with the private sector to identify its needs, as well as partner with other relevant stakeholders. Cooperation between different levels of educational institutions and collaboration across multiple economic sectors is also important, to ensure that youth can transition from one level of education to the next and later to the labor market. Clusters of companies or businesses in the same sector can help by making specialized training more affordable and relevant.

Training and skills programs can be part of this comprehensive approach, and vocational training systems, which combine classroom with on-the-job training show better results. SMEs appear to invest too little in training compared to larger companies, but training is important for them since it can help them move up the value chain to more productive activities and grow. Another important challenge is the lack of skills by managers and business owners, which also limits the potential for businesses to grow and create more jobs.

Ensuring high environmental and social standards helps companies improve productivity, reduce risks, and increase their likelihood of survival during difficult times. Development finance institutions can help ensure high standards, for example by applying the Equator Principles, and should raise awareness of the benefits of good working conditions among affected workers as well as among companies.

Focus on the quality of jobs in IFC’s clients as well as in supply chains. The most effective way to improve the quality of jobs is a combination of monitoring and tackling the root causes of poor working conditions. Interventions such as the ILO-IFC Better Work program target labor compliance in global apparel supply chains. This program leverages the interests of global apparel brands to protect their reputations by incentivizing factories to work on institutional change. The Equator Principles–based on IFC’s Performance Standard 2—also point to the importance of better management practices as a key entry point and driver for businesses to improve compliance with labor standards, including in supply chains.

Focus on creating opportunities for women and young people. Two main strategies have been identified to increase the economic participation of women and reduced the concentration of women in less productive sectors: (i) support industries that are already women-friendly, and (ii) encourage the participation of women in non-traditional fields. The private sector can play a major role in promoting women as valuable leaders, productive employees and dynamic entrepreneurs. A comprehensive strategy is necessary to address the multifaceted challenges facing youth. Training must integrate the needs of the private sector to give youth the skills they need for current and future jobs. There also must be sufficient job opportunities. Other pieces of the puzzle are investment climate reforms that facilitate entrepreneurship. Finally, policies to promote the information and telecommunications sector are of special relevance for youth. Not only can this sector help close the skills gap, but it also is an important direct provider of jobs for young workers.

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Statement by Members of the IFC Jobs Study Technical Advisory Panel

The Advisory Panel appreciates the opportunity to have engaged with the team writing this Report on three occasions during the preparation of the report. The team should be commended for the time spent soliciting comments and discussing the suggestions made.

The Advisory Panel itself represents a diverse set of backgrounds, from academia, multi-lateral institutions and the private sector – reflecting that the report itself aims to appeal to a wide audience. Getting the message right for any one subset is a challenge; pleasing all of them simultaneously is an almost impossible task. The team has put in a considerable effort to balance the presentation of findings to address the interests and concerns of these broad groups.

The panel members strongly support the central argument that the private sector is the key driver of job creation and it is appropriate to have this report focus on the role of the private sector coming out as a companion to the World Development Report 2013.

One of the key tasks the report seeks to accomplish is an analysis of the contribution that investments can make on job creation. The panel members support the qualitative discussion of the various channels that can affect the upgrading of existing jobs, the creation of new ones, and the possibility of reducing employment elsewhere in the economy. Being able to quantify these impacts is extremely challenging. Clearly assumptions are needed and the interpretation of any numbers given need to keep these assumptions in mind. The panel endorses the importance of providing the details and caveats of the methodology used, and looks forward to the report motivating a future research agenda to improve methods.

Expanding job opportunities is a critical issue for policy makers around the world. This report discusses the ways that policy reforms can strengthen the private sector's contribution to expand the number and productivity of jobs. We were all pleased to serve on this panel as we hope this report can help advance this important agenda.

JANUARY, 2013

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- Major Gen. (Retired) Amjad Khan Chowdhury, Founder and CEO, Pran-RFL Group
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