NEW REPORT: The positive effect of digital payments on entrepreneurs

A new IZA World of Labor report finds that the switch to digital payments often increases an entrepreneur’s profitability by making financial transactions with customers, suppliers, and the government more convenient, safer, and cheaper.

Entrepreneurship, both formal and informal, is a critical source of labor force participation and income: 11% of adults in high-income countries are self-reported entrepreneurs versus 34% of adults in developing countries. Entrepreneurship also creates new wage employment and contributes to increased labor force participation. The economist Leora Klapper of the World Bank shows in her report that moving from cash to digital payments can increase an entrepreneur’s profitability by reducing operating costs and making it easier to manage trade contracts, delivery records, and accounts receivables.

Digital payments can also increase an entrepreneur’s access to formal financial services including credit. According to the World Bank Enterprise Surveys, half of all firms around the world need a loan, but only 35% have a bank loan or line of credit. Data analytics such as electronic payments from an account for utility and rent payments, can help create a qualifying credit score for an entrepreneur to start or grow their business. For example, in the US, the inclusion of utility and telecom payment histories reduced the share of adults who were financially “unscorable” from about 12% to 2% and reduced the estimated loan default rate.

For larger-scale entrepreneurs with employees, making the transition to digital forms of wage payments can save money and time. A study in Bangladesh found that the average factory reduced wage distribution costs by more than 50% within two years after it began paying workers directly via digital bank accounts. Traditionally, factory owners often spend considerable amounts of money bringing in cash-filled trucks to distribute wages to workers. Guards must be hired to safeguard the process and production time is lost when workers stand in line for their pay.

Furthermore, moving to digital wage payments can contribute to women’s economic empowerment. Socio-cultural issues and other factors might prevent women from controlling their own money and assets. Unlike cash payments, the arrival of a digital payment is typically private information. This allows the recipient to conceal the payment, at least temporarily, from other household members or friends who may demand money that would otherwise benefit the entire household. Evidence suggests that income in the hands of women, compared with men, is associated with more spending on nutritious food, health, and housing.

The author concludes: “Entrepreneurial opportunities supported by well-functioning digital payment systems can play a key role in encouraging labor force participation in developing countries. Governments and financial service providers both have to improve access and encourage the adoption of digital payments by entrepreneurs as well as their customers and employees. It is critical that governments ensure safe and reliable digital payments.”

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