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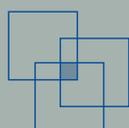
PROGRAMME FOR THE PROMOTION OF FORMALIZATION  
IN LATIN AMERICA AND THE CARIBBEAN



International  
Labour  
Organization

## NOTES ON POLICIES FOR THE FORMALIZATION OF MICRO AND SMALL ENTERPRISES

# Policies for the formalization of micro and small enterprises in Colombia



Regional Office for Latin America and the Caribbean

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## Foreword

One of the major challenges in reducing informal employment in Latin America and the Caribbean is to facilitate the transition to formality of micro and small enterprises, which are the main generators of employment in our region.

This is a complex challenge as informality is a multidimensional phenomenon and as the reality of MSEs is highly heterogeneous. Available data indicate that informality in micro and small enterprises constitutes a major obstacle for countries in the region to advance in their social and economic development, which is why it is crucial to find solutions.

Over the last decade, Latin American and the Caribbean registered a period of sustained growth that even resisted reasonably well the international financial crisis. Urban open unemployment fell to 6.2% in 2013, the lowest figure since ILO started recording. Informality, although it was reduced over time, is persistent and still affected 47.7% of urban employment in 2012. According to ILO estimations, 60% of the workers in MSEs are informally employed.

The majority of the region's informal workers belong to the 20% poorest segment of the population, which presents an informality rate of 72%, more than double the rate registered for the richest 20% of the population where informality is around 31%. These figures show a clear link between informality and income inequality.

How to address informality in MSEs? There is no standard recipe and that is precisely why this new series of ILO FORLAC Focus Notes seeks to encourage debate on this topic and generate discussion on different policy options to reduce informality.

The design of MSE policies needs to take into account that there is a difference between formalizing small enterprises and formalizing employment in these firms. The reality is that undeclared work also exists in an important share of registered MSEs. Therefore special attention should be paid to strategies for the creation of formal jobs in this segment of enterprises.

In order to advance towards MSE formalization, integrated and long term strategies are required that simultaneously address the multiple causes of informality, incorporating issues related to administrative, tax and labour regulations, access to social security and private sector development strategies. Policies to promote the formalization of MSEs should include strategies to increase productivity, improve norms and regulations, generate incentives for formalization and enhance government's capacity to enforce compliance.

Key aspects include the simplification of administrative procedures for business registration, the development of adequate taxation regulations, the creation of incentives related to social security and the strengthening of information and inspection systems. For enterprises, it is important that the transition to formality makes good business sense. And for countries it is critical to take advantage of the potential of the MSE sector and its workers in order to boost sustainable economic growth.

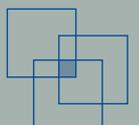
This series of focus notes reveal that notwithstanding the complexity of the issue, positive experiences exist in several countries in Latin America and the Caribbean, which are worth reviewing and sharing with policy makers. The experiences presented in this series of focus notes also show that countries are concerned about the fact that youth and women are overrepresented in informal MSEs, either as workers or entrepreneurs.

The dissemination of these focus notes form part of the Programme for the Promotion of Formalization in Latin America and the Caribbean (FORLAC), launched by this Office in 2013. We hope that this series of notes helps in the design of policies that can give a new impulse to a topic that needs to be at the centre of the Latin American and Caribbean policy agenda.

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## NOTES ON POLICIES FOR THE FORMALIZATION OF MICRO AND SMALL ENTERPRISES

### 1. Introduction

The micro and small enterprise sector (MSE) in Colombia is characterized by high levels of informality. In 2010, six out of every ten microenterprises was operating informally. In the same year, one out of two workers in Colombia was informally employed. A clear link exists between the size of the production unit, informality and job quality, with microbusinesses registering the highest levels of vulnerability.

Formalizing businesses and employment has been a central policy objective of the Colombian Government in recent years. A series of legislative initiatives have sought to simplify procedures for registering companies and to reduce the costs of operating formally and hiring employees. Public enterprise development agencies designed new programmes and instruments to support the development of a competitive micro and small enterprise sector, able to operate formally and comply with laws and regulations. Chambers of commerce in Colombia worked closely with the national and local authorities in the design and implementation of a series of programmes designed to encourage formalization.

This focus note summarizes policies and strategies applied in Colombia to promote the formalization of micro and small enterprises, both in terms of their registration with the relevant authorities as well as in terms of the formalization of employment in these firms. Without pretending to be exhaustive, this document presents the main efforts undertaken in the areas of enterprise development, streamlining of administrative procedures, and efforts to support businesses to formalize.

### 2. Recent trends in informality

According to the most recent national census,<sup>1</sup> microenterprises in Colombia, defined as units with up to 10 employees, represent 96% of the country's economic units. Small enterprises with 11-50 employees account for 3% of the total, while medium and large enterprises represent 0.5% and 0.1% respectively.

According to Colombia's main household survey (*Gran Encuesta Integrada de Hogares*), in 2012, 60% of people employed in the 13 largest cities worked either in microenterprises or as own-account workers. Small enterprises accounted for 10.3% of total employment. Medium-sized and large firms accounted for 3.2% and 26.5% of jobs in these urban areas respectively.

The 2012 microenterprise survey (*Encuesta de Microestablecimientos*)<sup>2</sup> found that in that year 69.7% of Colombian microenterprises were registered with the local chamber of commerce (*registro mercantil*) while 77.3% maintained some kind of accounting system. These figures show that there has been substantial progress towards the formalization of microenterprises since 2008, when just 44% were registered and just 55% maintained some kind of bookkeeping.

A useful indicator of the level of informal employment in microenterprises is the percentage of employees in these units covered by social security. According to the ILO, in 2012, 34.6% of the urban employed in establishments with up to five employees were covered by health insurance and/or pension schemes, well below the weighted average of countries in Latin America. In the year 2000 the same figure stood at 32.0%, which shows that progress in this area over the past decade has been modest.

Figure 1 shows the trend toward microenterprise formalization over the past five years, in terms of the percentage of units registered and maintaining some kind of accounting system. The same

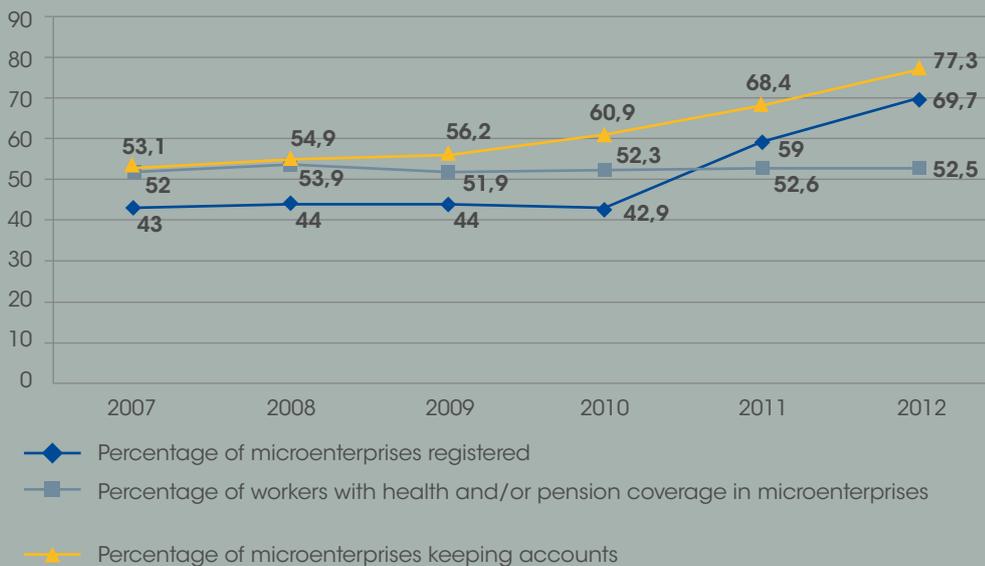
The ILO Regional Office for Latin American and the Caribbean would like to thank Jairo Guillermo Isaza, who prepared the document that formed the basis for this Focus Note, and Linda Deelen, for her technical coordination.

<sup>1</sup> Departamento Administrativo Nacional de Estadística, 2005

<sup>2</sup> For the purpose of this survey, the national statistics bureau (*Departamento Administrativo Nacional de Estadística*) defines micro-business as the unit carrying out economic activities, involving nine or fewer employees, with no more than three locations, including the main office.

graph shows the trend in informal employment in microenterprises, measured as the percentage of urban employees in units of up to five people with health and or pension coverage. Clearly business registration has advanced over this period, but as yet this progress is not reflected in a rise in formal employment.

**Figure 1: Trends in microenterprise formalization, 2007-2012**



Source: Authors based on data from DANE and ILO.

### 3. Formalization schemes and policies for micro and small enterprises

#### Institutional framework for MSME development

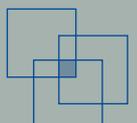
Public policies supporting micro and small enterprise development in Colombia derive from Law 590 promulgated in 2000, also known as the Micro, Small and Medium Enterprise Law (*MSME Law or Ley MIPYME*). Over time, this Law underwent several amendments, which were formulate first of all in Law 905 of the year 2004, followed by later modifications as described in the national development plans of 2006-2010<sup>3</sup> and 2010-2014<sup>4</sup>. Another legal instrument worth mentioning is the 2010 Law on the Formalization and Generation of Employment (*Ley de Formalización y Generación de Empleo*<sup>5</sup>). In general terms, this regulatory framework distributes responsibilities among different public entities, which are given the mandate to implement a set of policy instruments for the promotion of micro, small and medium-sized enterprises.

Law 590 of the year 2000 in many regards can be considered a pioneer initiative as it established the foundations for MSME policy development, creating a high-level advisory council for microenterprise development (*Consejo Superior de la Microempresa*), another high-level advisory council for small and medium (SME) enterprise development (*Consejo Superior de la Pequeña y Mediana Empresa*) and an MSME Fund (*Fondo MIPYME*). The Law also establishes the legal basis for incentives to the development of microcredit through financial institutions and non-governmental organizations specialized in this area.

<sup>3</sup> Law 1,151, 2007.

<sup>4</sup> Law 1,450, 2011.

<sup>5</sup> Law 1,429, 2010.



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Law 590 also establishes the legal basis for fiscal incentives for the creation of new firms, as well for the formalization of existing companies through a special tax regime that contemplates periods of tax exemption and size-related special tax rates. Particularly important was the reduction of parafiscal taxes paid by employers together with their social security contributions. Newly registered enterprises pay the reduced rate during the first three years of operation.<sup>6</sup>

To determine which types of firms would be eligible for certain fiscal incentives as well as for participation in certain enterprise development programmes, the Law defined micro, small and medium enterprises, as indicated in Table 1.

**Table 1: Classification of micro, small and medium enterprise in Colombia (Law 590, 2000)**

Classification	No. of employees	Total assets
Microenterprise	Up to 10	Up to 501 LMW <sup>1</sup>
Small enterprise	11 to 50	501 to 5,001 LMW
Medium enterprise	51 to 200	5,001 to 15,000 LMW

1: Legal minimum wage (Salarios Mínimos Mensuales Legales Vigentes).

Source: Authors, based on Article 2, Law 590 (2000).

In 2004, Law 905, also known as the Micro, Small and Medium Enterprise Development Law (*Ley de Promoción del Desarrollo de la Micro, Pequeña y Mediana Empresa*) proposed changes to the definitions presented in Table 1. As the law's regulatory decree was never passed, however, the previous definitions remain in effect. Law 905 created the National MSME System (*Sistema Nacional de MIPYMEs*), formed by the respective high-level councils for micro, small and medium enterprise development, and their regional councils.<sup>7</sup>

Article 12 of Law 905 establishes MSME's preferential access to public procurement, while Article 17 created a fund to support the modernization and technological development of MSMEs (*Fondo Colombiano de Modernización y Desarrollo Tecnológico de la Empresas Micros, Pequeñas y Medianas, FoMSME*),<sup>8</sup> which finances projects, programmes and other initiatives this area. Similarly, the Law facilitated MSME access to credit through the Industrial Development Institute (*Instituto de Fomento Industrial, IFI*) and the National Guarantee Fund for Financial Institutions (*Fondo Nacional de Garantías de Instituciones Financieras, Fogafin*).

In order to promote business registration, Law 905 laid the basis for joint cooperation between the Government and the regional Chambers of Commerce, of which the technical details were later defined in Decree 3,820 of 2008. In the area of taxation, the Law opens the possibility for local and regional government to establish tax regimes that would encourage the creation and formalization of MSMEs.<sup>9</sup>

### Business Support Centres

In 2001, according to the National Confederation of Chambers of Commerce (Confecámaras), creating a company in Colombia involved 17 administrative procedures to be processed by 10 different entities, 35 visits to these entities, 45 documents and at least 55 days to complete the necessary procedures.

<sup>6</sup> Parafiscal contributions are taxes that companies pay as a percentage of total payroll. They finance the National Training Service (*Servicio Nacional de Aprendizaje, SENA*), the Colombian Institute for Family Welfare and Family Benefits (*Cajas de Compensación Familiar*). The reductions established by Article 43 of Law 590 resulted in the following percentages: 75% during the first year, 50% during the second, and 25% during the third year of operation.

<sup>7</sup> In compliance with Article 3 of Law 905 (2004), Resolution 3.205 (2008) issued by the Ministry of Trade, Manufacturing and Tourism (*Ministerio de Comercio, Industria y Turismo*) regulates the functioning of the regional MSME councils. The councils are mandated to design and propose public policies for the promotion and development of MSMEs at the regional level.

<sup>8</sup> Law 1,450 (2011) established the Fund for Modernization and Innovation of Micro, Small and Medium Enterprises, called "INNPulsa MIPYMEs", which replaced FoMSME.

<sup>9</sup> There is no evidence so far that this decree has led to the creation of special tax regimes at the local level.

In response to this situation, in 2001 Confecámaras created a series of business support centres (*Centros de Atención Empresarial, CAE*). These centres provide information and assistance on business registration, in order to streamline procedures and reduce associated costs. The main goal of these centres is to “create firms in one day, through one step, at one place, with one contact point, one requirement and at minimum cost.”

The first phase of the programme (2001-2004) was financed by the Inter-American Development Bank, while funds for the second phase (2006-2008) were provided by the Royal Government of the Netherlands. By 2013, the regional Chambers of Commerce had established business support centres in 30 cities.

According to an evaluation undertaken by Cárdenas and Rozo in 2007<sup>10</sup> in cities where business support centres had been established, all other things being equal, the registration rate amongst companies had augmented by 5%, as compared to cities without support centre. The difference was largest in Bogota, Medellin and Bucaramanga, while there was no significant increase in the registration rate in Cartagena, Cali and Barranquilla.

According to Confecámaras, by 2013 the number of procedures for registering a business in the centres had fallen from 17 to 2, while the number of agencies to be contacted has been reduced from 10 to 2, thereby cutting costs by 76% for microenterprises and 45% for SMEs.

### National Competitiveness Policy Framework

The 2008 National Competitiveness Policy Framework (*Política Nacional de Competitividad*),<sup>11</sup> endorsed by the National Competitiveness Commission (*Comisión Nacional de Competitividad*) establishes five pillars, one of them pertaining to the formalization of businesses and employment.<sup>12</sup> The proposals to promote business formalization comprise improved business regulations, the integration of the business support centres into other support programmes, simplified tax regimes for MSMEs, temporary exemptions from parafiscal taxes, clarification of certain ambiguities regarding state regulations and functions, information campaigns, and information sharing between public agencies to better control informality.

The chapter on informal employment proposes several areas of improvement, among them, strengthening the labour inspection and reducing evasion of social security obligations. To combat informal employment, the Commission also proposes entrepreneurship promotion as a measure to include vulnerable groups into the labour market, based on the ILO Decent Work principles.

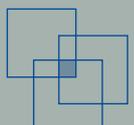
As described in the following sections, there has been significant progress in the implementation of some of these policies, for instance those related to reducing the fiscal and parafiscal burden on firms, and in reducing red tape. Within the framework of the National Competitiveness Policy Framework a series of regulatory reforms took place, which reduced the time and cost incurred by firms in complying with their legal obligations.

Amongst some of the important reforms, Decree 1,879 of 2008 should be mentioned, which prohibits district and municipal governments from asking firms to present licenses, permits, patents or other kinds of certifications beyond the standard business license (*matrícula mercantil*) or, in the case of enterprises in the tourism sector, their tourism registration document. Although the Decree does not exempt companies from meeting certain sanitary and land use requirements, no business can be sanctioned by officials in charge of inspecting commercial activities, or by the national police for not presenting these papers.

10 Cárdenas, Mauricio and Rozo, Sandra, La informalidad empresarial y sus consecuencias: ¿son los CAE una solución? Working Paper Series No. 38. Bogotá: Fedesarrollo, 2008.

11 Documento COMPES 3527, Consejo Nacional de Política Económica y Social de la República de Colombia, Departamento Nacional de Planeación, 2008.

12 The five pillars of the overall policy are: (1) the development of world-class sectors or clusters, (2) a leap in productivity and employment, (3) business and labour formalization, (4) scientific, technological and innovation-related development, and (5) cross-cutting strategies to promote competition and investment.



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Another significant step forward was the creation of a National Business Creation Portal (*Portal Nacional de Creación de Empresas*)<sup>13</sup> in 2008. This portal simplifies registration procedures to the point where companies only need to go to the local Chamber of Commerce to sign and pay their registration fees. That same year, the Bogota Chamber of Commerce informed that 67% of newly created firms had used the portal. This project, led by the Bogota Chamber of Commerce, Confecámaras and the International Finance Corporation (IFC) has been replicated in over 20 cities.

### The Anti-Red Tape Decree

The Anti-Red Tape Decree No. 19 (*Decreto Anti-trámites*) was passed in 2012 in order to rationalize the different administrative procedures that citizens and businesses are required to comply with. The decree is based on the principals laid out in the National Competitiveness Policy with regards to the simplification, standardization and automation of administrative procedures, thereby avoiding unjustified or unnecessary requirements to individuals and firms.

The law responds to citizens' and businesses' need for a more effective and transparent government, establishing the obligation of public entities to provide the necessary information on their administrative procedures, promote the use of information technologies, streamline responses, and apply principles of good faith and excellence in service provision.

Beyond these general provisions, the anti-red tape decree eliminated or streamlined a great number of procedures, thereby directly reducing the costs and the time needed for formalizing a company. For example, the Decree eliminates the requirement to register accounting ledgers and board of directors minutes with the Chamber of Commerce, a procedure that used to cost around COP 8,000 per ledger. The Decree also reduced the time required to sign up with the family welfare fund (*Caja de Compensación Familiar*) from ten to three days.

During the same time that the Anti-Red Tape Decree was implemented, companies also saw several administrative procedures simplified and/or digitalized, resulting in a significant reduction in the time spent by entrepreneurs and their accountants on these procedures. As of 2008, the declaration and payment of the main national taxes can be done on-line, using a single format (*Modelo Único de Ingresos y Servicios de Control Automatizado*, MUISCA).

Similarly, social security and parafiscal contributions can now be declared and paid on-line, using the Integrated Social Security Contribution Form (*Planilla Integrada de Liquidación de Aportes*). Registering employees with pension schemes and with the obligatory health care programmes is now much more efficient than five years ago.<sup>14</sup>

### Law For The Formalization And Creation Of Employment

One of the main achievements in terms of formalizing employment in MSMEs was Law 1,429 on the Formalization and Creation of Employment (*Ley de Formalización y Generación de Empleo*, 2010), whose main objectives were to formalize informal jobs and businesses, to create more jobs in the formal economy and to strengthen the income generating capacities of people operating in the informal economy, the unemployed, and small entrepreneurs.

This law covers six main areas related to formalization:

1. Business development programmes,
2. Temporary reductions of small firms' regulatory burden,
3. Incentives to jobs creation for groups facing certain barriers to employment,
4. Regulations on worker cooperatives,

<sup>13</sup> [www.crearempresa.com.co](http://www.crearempresa.com.co)

<sup>14</sup> World Bank and International Finance Corporation, *Doing Business in Colombia 2013*. Washington DC: World Bank and International Finance Corporation, 2013.

5. Streamlining of procedures,

6. National observatory on employment demand.

In terms of business development programs, the Government committed itself to reviewing existing programmes and designing new instruments, should these be necessary, in order to create a package of benefits for companies that formalize their operations. The design and implementation of business development programmes is coordinated by the Ministry of Trade, Manufacturing and Tourism (*Ministerio de Comercio, Industria y Turismo*).

The government also agreed to expedite a special regulation that would enable businesses created by professionally or technically trained youth (under 28 years of age) to have their bank loans guaranteed up to 80% by the National Guarantees Fund (*Fondo Nacional de Garantías*). In addition to this, Decree 489 of 2013, which fine-tunes several aspects of the country's different business development programmes, establishes a discount of 20% or more on the commissions on guarantees provided by *Fogafín* to enterprises owned by youth under 28 years of age.

In order to reduce the regulatory burden of small firms employing up to 50 employees and with total assets worth no more than 5,000 minimum wages, the Law introduces size-related contribution rates and exemptions from income taxes, parafiscal contributions, business registration fees (*matrícula mercantil*), and contributions to the Solidarity and Guarantee Fund (*Fondo de Solidaridad y Garantía, FOSYGA*).

These reductions decrease over time until the sixth year of operation, as detailed in Table 2. The provisions on taxation have an indefinite character, while lower payroll taxes and reductions in the fee for commercial registration may only be used by companies benefiting from the Law until the end of 2014.

**Table 2: Reduced obligations business registration, income tax and parafiscal contributions as per Law 1,429 (2010)**

Year	Chamber of Commerce	Income tax	Parafiscal and FOSYGA
1	0%	0%	0%
2	50%	0%	0%
3	75%	25%	25%
4	100%	50%	50%
5		75%	75%
6		100%	100%

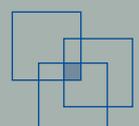
**Source:** Authors on the basis of Law 1,429 (2010).

**Note:** In the regions of Amazonas, Guainía and Vaupés, exemptions from income tax and parafiscal contributions have a duration of six years.

The law also provides incentives for local government to introduce size-related reductions to the manufacturing and trade tax, and to integrate these taxes, on a voluntary basis, with the national tax system. Similarly, the law encourages municipal councils, mayors and regional assemblies to eliminate fees presently charged when new businesses get registered.

Law 1,429 also reduced the costs of hiring staff that belongs to certain vulnerable groups, particularly youth under 28 years of age, those displaced by violence or seeking reintegration after participation in armed conflict, women that have been unemployed for more than one year, and heads of households classified as vulnerable.<sup>15</sup> The law allows the deduction of parafiscal taxes on new employees belonging to one of these groups from income tax, provided that the

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<sup>15</sup> These vulnerable persons are classified as level 1 or 2 under the national social benefits system (*Sistema de Identificación y Clasificación de Potenciales Beneficiarios para los Programas Sociales SISBEN*) administered by the Colombian government.

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value of payroll as well as the total number of employees has increased as compared to the previous fiscal year.

In relation to workers cooperatives, the law ratifies the prohibition<sup>16</sup> to undertake labour intermediation activities or to provide staff on a temporary basis for activities or services directly related to the company's core business.

In order to facilitate formalization, Law 1,429 streamlines certain labour, commercial and administrative procedures. The law eliminates a series of registration requirements formerly administered by the Ministry of Social Protection and removes the employers' obligation to requests authorization from the labour inspection for certain types of agreements between employer and employees. The Law also eliminates certain procedures and obligations related to the dissolution, reactivation or reorganizing of companies.

Another important incentive to formalization is the Law's provision that beneficiaries of the System for the Selection of Beneficiaries of Social Programmes (*Sistema de Identificación de Beneficiarios de Subsidios Sociales*, SISBEN), continue to receive benefits during one year after being hired and keep their registration number with the system during two years. This rule addresses a disincentive that existed amongst workers to sign a formal labour contract for fear of losing certain social benefits.

According to a study by the National Tax and Customs Agency (*Dirección de Impuestos y Aduanas Nacionales*, DIAN), the number of small firms that got registered as a result of Law 1,429 had reached 7,345 by March 2013, 99% of which were newly created firms, versus 1% existing companies. This number equals 3.1% of the total number of firms created annually in Colombia, according to the same report.

### The 2013 Tax Reform

In 2013, Law 1,607 introduced tax reforms, which brought major changes to the Colombian system. The reform, whose central purpose was to create jobs and reduce inequality, also promotes formal employment as it reduces the direct cost of hiring workers.

The 2013 tax reform eliminated parafiscal contributions to the National Training Service (*Servicio Nacional de Aprendizaje*, SENA) and the Family Welfare Institute (*Instituto Colombiano de Bienestar Familiar*, ICBF) as well as part of the employer's contribution to social security, in the case of employees receiving salaries below ten minimum wages. This modification implied a reduction in employers' social contributions of 13.5%. Other employers' contributions to pension schemes, occupational health and safety insurance, and family welfare funds (*Cajas de compensación*) remained the same. Nor were there any changes to the employees' contributions to pension schemes and health care.

To offset the decline in revenues caused by these modifications, a CREE tax was introduced, consisting of a 9% tax rate on corporate profits until 2015, followed by an 8% rate from 2016 on. This decreased the fiscal burden on employment while increasing the fiscal burden on business revenue, which is supposed to be beneficial –in general terms– for micro and small enterprises, as these entities are normally labour-intensive. The tax reform significantly changed the Colombian social security model, as health care is now primarily financed through general taxes.

### "Colombia Goes Formal"

"Colombia Goes Formal" (*Colombia se Formaliza*) is a programme led by the Ministry of Trade, Manufacturing and Tourism (MinCIT) that aims to formalize existing companies, thereby creating more formal and better quality jobs, with higher levels of income both for vulnerable groups operating in the informal economy as well as for small entrepreneurs.

<sup>16</sup> Decree 4,588 (2006), Article 17, expressly prohibits worker cooperatives from acting as labour intermediation businesses or as temporary service firms providing employees to a user or third party in the system. This prohibition was repeated in Article 7, Law 1,233 (2008), so that no labour cooperative can act as an intermediary or provide labour to meet the temporary needs of third parties.

The programme puts into practice some of the approaches proposed by Law 1,429 on the formalization and creation of employment, and by Decree 545 (2011), that regulates some of its provisions. The programme disseminates information on the Law's provisions and offers benefits to small firms that wish to formalize their operations through Bancoldex credit lines, grants from the iNNpulsa Micro, Small and Medium Sized Enterprise Fund and from the Entrepreneurship Fund (*Fondo Emprender*), among others.

In practice, the programme takes the form of formalization workshop (*Ruedas de Formalización*) and brigades (*Brigadas de Formalización*). The former are events to which informal entrepreneurs are invited, so that they can find out about the services offered by private and public entities during the registration of their businesses. MCIT figures reveal that between 2011 and 2013 a total number of 47 workshops was organized, attended by 5,411 entrepreneurs.

The formalization brigades are efforts to raise awareness and offer personal assistance to entrepreneurs who are ready to formalize their business operations, implemented through an agreement between the MinCIT and Confecámaras. The brigades reach out to entrepreneurs in their place of work, offering a package of services provided by different public agencies. Official figures indicate that in 2012, the programme contacted 77,615 entrepreneurs in 324 municipalities, of which 32.9% opted for formalization, while in 2013 the programme contacted 81,292 entrepreneurs, of which 39.6% formalized their business.

## MSME Access To Public Procurement

As mentioned earlier, Law 905 of the year 2004, known as the Micro, Small and Medium Enterprise Development Law (*Ley de Promoción del Desarrollo de la Micro, Pequeña y Mediana Empresa*) lays the foundation for MSME preferential access to public procurement. In the same spirit, the 2010-2014 National Development Plan<sup>17</sup> allows public agencies to carry out tender procedures with direct invitation to MSMEs.

Based on the provisions of the National Development Plan, Decree 1,510 (2013)<sup>18</sup> regulates these invitations to tender, extended to micro, small and medium firms interested in supplying the government with goods and services, specifying the following conditions: (i) the amount involved must be less than US \$125,000; (ii) there must be at least three expressions of interest from MSMEs, (iii) the firms interested must demonstrate they have existed for at least one year. The decree also establishes that in the event of a tie in a public tender, MSMEs will be given preference, particularly in the case of companies offering domestically manufactured goods.

To provide micro, small and medium firms with genuine access to public procurement, the MinCIT has made important efforts to disseminate existing regulations and support businesses in selling goods and services to the Government. The Ministry has developed a public procurement handbook for micro, small and medium firms and organizes workshops and public events throughout the country.

## The National MSME System and its Instruments

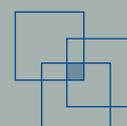
In 2004 Law 905 created the National MSME System (*Sistema Nacional de MIPYMEs*), led by the Vice Minister for Enterprise Development in the MinCIT and composed of the High-level Advisory Council for small and medium enterprise development, the High-level Council for Microenterprise Development<sup>19</sup> and the regional MSME councils<sup>20</sup>.

<sup>17</sup> Law 1,450 (2011).

<sup>18</sup> This decree changes some of the rules established in Decree 734 (2012) on closed invitations to MSMEs. Decree 1,510 (2013) eliminates the distinction between tenders open to MSEs versus MSMEs as established by Decree 734.

<sup>19</sup> The function of both public-private councils is to formulate and adopt general, cross-cutting, sectoral and regional policies for the development of micro, small and medium firms, particularly to create jobs and generate sustained economic growth.

<sup>20</sup> Regional MSME councils are public-private bodies at the regional level, whose goals include: (i) encouraging market research and export plans for the entrepreneurs operating in the region, (ii) promoting the creation of information systems and access to capital, (iii) promoting technological and knowledge development among MSMEs, and (iv) providing assistance to MSMEs.



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This National MSME system comprises of several financial and non-financial enterprise development instruments that offer strong incentives to business formalization. According to official data from the MinCIT, the resources available through this system increased by 44.7% in real terms, from COP 10.2 trillion in 2008 to COP 14.7 trillion in 2011. Despite this increase, the resources of which the system disposes have dropped as a percentage of Gross Domestic Product, from 3.1% in 2008 to 2.4% in 2011.

The main programmes and instruments are:

### Credit Guarantees

Since 1981, the National Guarantee Fund (*Fondo Nacional de Garantías*, FNG) facilitates access to formal credit for micro, small and medium firms, by offering guarantees covering 50%, 70% or 80% of the loan amount, depending on the type of credit and client. The capital injections to the fund which took place in the framework of the National Development Plan 2010-2014, implied increased capacity by the Government to support credit and leasing operations to MSMEs by private banks and institutions specialized in microcredits. In 2011, reimbursable funds for MSMEs handled by the FNG totalled COP 7.22 trillion, assisting more than 112,000 small and medium firms and 372,000 microenterprises.

### Bancoldex lines of credit

Colombia's foreign trade bank (*Banco de Comercio Exterior de Colombia*) operates as a second-tier financial institution through a network of financial intermediaries (banks, finance companies, leasing companies, cooperatives, microfinance institutions, workers funds and family welfare funds). As its name suggests, the bank focuses on exporting firms, but also prioritizes credit for micro, small and medium-sized enterprises, whether these are exporters or not. In many cases these credits are covered by FNG guarantees. In 2011, Bancorex provided 7,222 MSEs with loans worth COP 1.13 trillion. That same year, it provided microcredit to almost 135,000 firms, worth a total of COP 552.7 billion.

### Banca de Oportunidades

Bancorex's "Banca de Oportunidades" programme<sup>21</sup> targets low income families, micro and small enterprises that have no access to traditional financial services. It works through a network of non-banking agents in order to expand formal financial service provision to localities not covered by banks. In late 2013, this network comprised almost 50,000 service points in pharmacies, post offices, supermarkets and stores, among others. Between August 2010 and January 2013, the programme placed 5.4 million credits with microbusinesses, worth COP 16 trillion. In 2012, the network handled 2.29 million operations, worth COP 7.04 trillion.<sup>22</sup>

### Entrepreneurship fund (*Fondo Emprender*)

This seed capital fund, which forms part of the National Training Service (*Servicio Nacional de Aprendizaje*, SENA) is intended to finance business initiatives developed by students who have completed national training programmes run by SENA and those who are finishing higher education. The only requirement is a viable business plan. While application procedures can be carried out online, special calls exist for proposals from specific regions. Business incubators play an important role in the identification of viable projects. In 2013, through this fund SENA invested COP 49.845 million in 651 different projects.

### INNpulsA MIPYME

This MSME modernization and innovation fund (*Fondo de Modernización e Innovación para las MIPYMEs*) run by Bancoldex offers co-funding through grants to promote innovation and

<sup>21</sup> Created by Decree 3.078 (2006).

<sup>22</sup> Bancorex, Informe de Gestión y Resultados, Informe Programa de Inversión Banca de Oportunidades Enero-Diciembre de 2012. Bogotá, 2013.

competitiveness through new products or services, modernization of suppliers, distributors and clusters of MSMEs that have operated for more than two years. Resources are allocated through calls for participation by enterprises operating in different economic sector with the exception of the primary sector. The programme is handled through local entities that can be either associations supporting MSMEs, chambers of commerce or other business associations. From its creation in 2012 to January 2014, the iNNpulsa MIPYMEs programme has provided COP 80.6 million to 24,278 firms, funding 251 projects throughout Colombia.

### Finagro

Created in 1990, this Agro-business Fund (*Fondo para el Financiamiento del Sector Agropecuario*) operates as a second-tier financial institution, facilitating projects focused on the modernization of rural MSME production systems, and providing credits for any kind of investment required agricultural production. This fund provided COP 5.6 trillion in credits to MSME farming and agri-industrial projects, developed by 450,000 different productive entities.

## 4. Conclusions

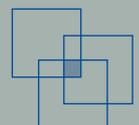
Colombia over the years promulgated a wide range of legislative initiatives for the promotion of MSMEs. This focus note describes some of these initiatives, such as the MSME Law (2000), the Law for the Formalization and Creation of Employment (2010), as well as several decrees that play a role in the formalization of micro and small enterprises businesses. On several occasions these legislative initiatives changed the criteria for resource allocation to this sector, merged or created new public entities responsible for the implementation of certain programmes, and created or improved incentives for formalization.

The National MSME System encompasses a good number of MSME development instruments, which are coordinated by national High-level Advisory Councils for Micro, Small and Medium Enterprise Development as well as by regional councils. Technical and operating support to these councils is provided by the Ministry of Commerce, Industry and Trade, through its Directorate for Enterprise Support (*Dirección de Apoyo Empresarial*). This Directorate, together with the Technical Secretariat of the National MSME System, is responsible for developing Colombia's MSME sector. This System is supposed to guarantee effective coordination of the different policy instruments operated by different national and regional public entities, in close cooperation with business associations and Chambers of Commerce in the different localities.

The initiatives coordinated by the MinCIT go beyond streamlining procedures and implementing traditional enterprise development programmes, and include innovative approaches to foster a genuine culture of formalization amongst entrepreneurs. The efforts of the MinCIT and the Chambers of Commerce to raise awareness among entrepreneurs and to support them in formalizing their businesses seem to have had a rapid and direct impact on the number of micro and small businesses registered. Beyond these numbers, promotional activities directly targeting entrepreneurs have helped to change perceptions that informality is and should be normal.

The 2013 tax reform decreased the cost of hiring workers beyond what was earlier foreseen in the Law on the Formalization and Creation of Employment (*Ley de Formalización y Generación de Empleo*, 2010). Through the reform the fiscal burden on employment was decreased and replaced with an increased fiscal burden on business revenue. The final impact of this change will vary according to the type of company, as it depends on many factors. In general terms, however, the tax reform is likely to positively affect job creation, formalization and the development of small employment-intensive businesses.

Figures presented in the focus note reveal that the challenge of formalizing micro and small enterprises in Colombia remains enormous. Among the pending issues are regional and municipal taxes. While national taxes can be declared and paid online through a unified system,



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at the municipal level a range of other taxes are collected. Whereas some local governments offer on-line collection systems, others do not, which means that businesses must prepare and present several declarations, often in person. Advancing toward greater unification and efficiency in local tax collection is therefore essential.

In terms of the National MSME System, it is worth noting the limited role of research and technology development bodies in the support network for micro and small enterprises. Similarly, in the design of the different enterprise development instruments, programmes to enhance collaboration with public and private universities to encourage innovation and technological development in small production units are lacking. Rather than a design flaw, this may reflect a national production system with little focus on innovation and technology overall.

Information gaps related to the exact number of MSMEs in Colombia make it difficult to measure the impact of government policies to encourage the formalization of micro and small enterprises. Similarly, the lack of evaluations of small business development programmes is a barrier to determining to what extent these policies meet their objectives. A first step towards the design of better policy instruments should therefore be the evaluation of existing programmes, using rigorous methods and experimental designs with control groups, monitored over sufficiently long periods of time.

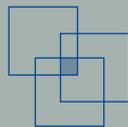




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# FORLAC

PROGRAMME FOR THE PROMOTION OF FORMALIZATION  
IN LATIN AMERICA AND THE CARIBBEAN



**NOTES ON POLICIES FOR THE FORMALIZATION  
OF MICRO AND SMALL ENTERPRISES**

Regional Office for Latin America and the Caribbean