Regulatory dilemma in SMEs?
Some research questions on labour regulation for SMEs

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Introducing the on-going research project as part of the ILO Global Product concerning SMEs

How to assess the impacts of labour regulation on SMEs? What policy support/interventions? How?

Outline

- “Dynamic” nature of SMEs in contrast with “stable” large enterprises
- Labour regulation puzzle? → Identifying key elements of research
- ILO’s pilot research (life-cycle, dynamic approach)
Dynamic SMEs: Major source of job creation and destruction

Changes in employment (%, 2006-2010: 103 developing countries)
[Source: Adapted from Ayyagari et al. 2011: World Bank Enterprise Survey]
What roles of labour regulation?
“Obstacles” versus “Beneficial constraints”

- Often, labour regulation has been widely discredited as an obstacle to growth and job creation, particularly for SMEs (e.g., Doing Business Indicators)

- Others view labour regulation as having potentials of “beneficial constraints” (cf. W. Streeck)

- Our observations for policy research:
  - The proposed dichotomy is neither accurate nor helpful
  - Lack of theory and empirical evidence
  - Mainly driven by research on large enterprises
  - SME dynamics in developing countries remain relatively unknown
Labour regulation puzzle (I):
In reality, labour regulation is not the key concern

Firms perceptions about the biggest obstacle to their operation (all firms, % distribution)
[Source: World Bank Enterprise Survey]
Labour regulation puzzle (II): Even less concern for SMEs

Proportion of firms who perceived “labour regulation” as the biggest obstacles to their firms (%, selected developing countries)

[Source: World Bank Enterprise Survey]
Then, is all fine?
Perhaps NO. What is behind?

- The survey results (on firms’ perceptions) suggest that the negative impacts of labour regulations should NOT be overstated.

- However, great care is needed with interpretation (e.g., Middlesex University Report):
  - Labour regulation is not a “big deal” for SMEs simply because they don’t care: the issue of **compliance and enforcement**
  - “**Survival** effects”, given the relatively high risk of SME failures
  - The results do not necessarily suggest labour regulation as “beneficial constraints”. **Causality** may run in an opposite way (Better performances can afford labour regulation).
Insights from new studies
Evidence from Vietnam (1)

- SMEs account for more than 97% of total enterprises:
  - Employ more than 50% of the workforce
  - Contribute to around 50% of GDP

- The vast majority of SMEs are household firms and most of these operate in the informal sector (IS):
  - IS generates 25% of the total number of jobs
  - Accounts for about 20% of GDP

- Thus, in line with evidence from the WB enterprise surveys, Vietnamese SMEs are extremely dynamic and do not seem to be constrained by labour regulations

- Yet, despite their economic importance, knowledge of SMEs and especially IS firms remains limited due to measurement concerns and inadequate data
Insights from new studies
Evidence from Vietnam (2)

- Based on SME data covering the informal sector, Rand and Torm (2012) show that **formalization** results in:
  - Higher profits and investment, and increased credit access
  - Improved contract conditions for workers – due to regulations and adopting a longer term business approach

- Thus, encouraging formalization should be the first step towards ensuring regulatory coverage of SMEs

- Yet, lack of awareness among IS firms about registration requirements/procedures, and a general perception that registration costs outweigh the benefits of being formal

- Among larger SMEs: **compliance issue** e.g. > 50% of firms do not pay mandatory social insurance contributions
What to look at?
Some research questions

- **Dynamic** interaction between labour regulation and SMEs
  - Company-level changes
  - Over a sufficient long period of time

- **Causality**: Company performance $\leftrightarrow$ working conditions

- **Performance for SMEs?**: What to measure
  - Labour productivity and profitability
  - More importantly, **survival**

- **What labour regulation?**
  - Compliance
  - Company initiatives to go beyond it

- **What “supporting” policies?**: Two particularly important issues
  - “Shortermism”
  - “Negative learning”

- **When?**: Timing of policy intervention/support
A conceptual framework:

Life-cycle approach to labour regulation in dynamic SMEs

Source: Rosalia Vaquez-Alvarez (Concept note)
What are we going to do?

Research Plan (pilot phase)

- A series of empirical studies, based on the proposed conceptual framework
  - Pilot phase (2013)
  - Further elaboration (with revision) for the second phase research (2014-5)

- Data: enterprise micro panel data

- Focus: developing countries,
  - Including India, Vietnam and China (cf. data constraints)

- Research team: S. Lee, R. Vazquez-Alvarez, N. Torm, and M. Gerecke, with national experts