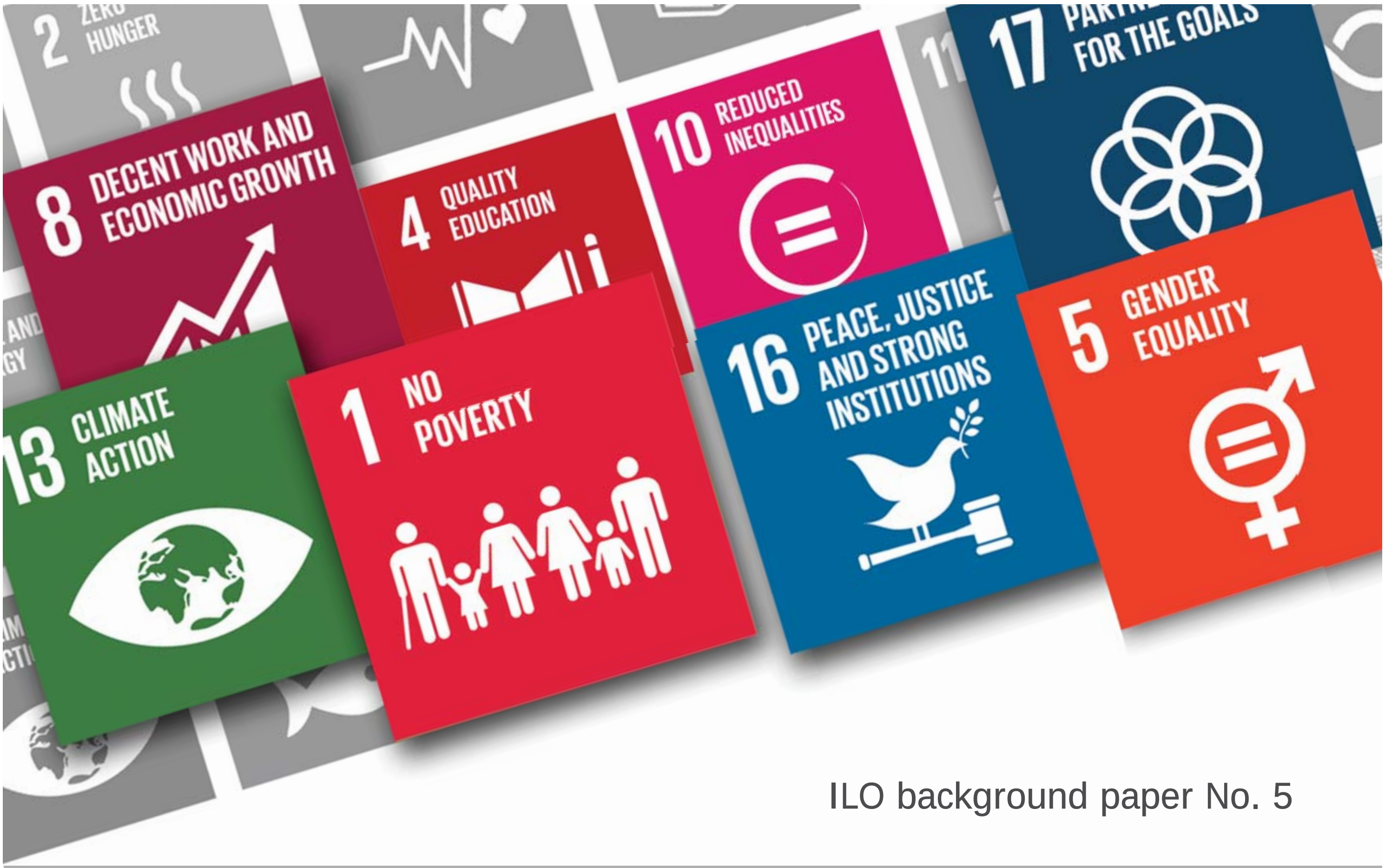

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Improving productivity and competitiveness: The role of labour management relations and transitioning to formality

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Introduction

Productivity is a crucial determinant of economic growth, and a vehicle towards prosperity and higher standards of living. Large and persisting differences in productivity levels between countries, between sectors, and between firms of different sizes have become an important concern for policy-makers. This paper is intended to address the issue of productivity and competitiveness in informal and formal firms and the role of labour-management relations in improving productivity. The paper recommends several policy responses that can help address formal and informal firm capability gaps to support improvements in productivity. Section I looks at productivity, barriers and drivers; Section II addresses working conditions and the link to productivity in informal and formal firms; Section III speaks to social dialogue and productivity while Section IV addresses productivity in SMEs. Section V highlights measures to build firm capability and section VI provides some insights from some ILO capability programmes.

I. Productivity, barriers and drivers

Productivity is a crucial determinant of economic growth, and a vehicle towards prosperity and higher standards of living. There are large and persisting differences in productivity levels between countries, between sectors within the same countries, between firms in the same sectors, and between firms of different sizes. Many countries have also witnessed a slowdown in productivity growth in recent years. In Latin America and the Caribbean, the phenomenon of the 'missing middle' is particularly acute, and refers to a situation where there is a large number of micro enterprises with very low productivity levels and some well-performing large enterprises, but far fewer formal SMEs. This is seen as a root problem of sluggish productivity increases and low growth rates in the regions.

Understanding and addressing constraints and enabling factors behind productivity differences and trends is therefore a key concern for policy-makers.

Aggregate productivity growth is driven by interconnected processes that lead to structural transformation of economies (i.e. the development of higher value-added sectors and activities), and firm level dynamics (growth, entry and exit, efficiency improvements). Productivity improvements within firms, i.e. 'firms becoming better at what they do' is a key mechanism of aggregate productivity growth in many countries.

The external business environment greatly impacts productivity growth. However firm internal capabilities also play an important role in fostering or hindering productivity growth, and they interact with drivers in the external business environment. Firm capabilities affect the distribution of productivity levels across firms and are linked to large differences in productivity levels between firms. They are particularly important in cases where there are large numbers of firms with low productivity, which is the case in many developing countries. Firm capabilities include managers' and workers' skills, innovation and technology use, access to inputs, management practices, and contracting relationships. The role of management practices has been receiving increasing attention in recent years, as it has been shown to be a key internal driver of firm level productivity growth. There is correlation between good management practices (some of which are related to human resources) and firm productivity levels, and evidence, including field experiments, suggest a causal link -- firms that improve management practices secured significant productivity increases.

II. Working conditions and the links to productivity at the informal and formal firm

When looking at firm level performance, there is a widespread correspondence between low productivity and poor working conditions. This suggest a situation where firms take a 'low road' to competition, based on low labour costs rather than productivity improvements, quality and innovation.

In many countries in Latin America and the Caribbean, SME's frequently take this "low road" and operate informally (Estimated as high as 60 per cent in some countries). Most often, this is a means of survival. Remaining informal is considered to afford some flexibility and independence. Informality is also influenced by complex procedures, inadequate regulations and limited inspection. There is a vicious circle of low productivity, lack of skills and precarious working conditions in these informal SME. Hence, a gradual transition to formality is a critical strategy to address low productivity and poor working conditions in informal enterprise units. The ILO Recommendation No. 204 speaks to an integrated approach through a mix of policies that reduce cost, extend benefits and strengthen law enforcement. Programmes to promote productivity such as access to finance, markets and technology, can incentivize formalization.

At the more formal firm level, the relationships between productivity and working conditions are complex and run in both directions. On the one hand, productive firms are better able to pay higher wages and benefits to workers, and invest in safety and health measures and workplace improvements. However the translation of productivity gains into better wages and other aspects of working conditions is not automatic. It is dependent on broader conditions such as the structure of the economy, labour demand and supply, as well as firm-level dynamics such as the existence of gain-sharing mechanisms.

On the other hand, improvements in working conditions can affect productivity. This is apparent in the case of occupational health and safety -- lower rates of workplace accidents and illnesses limit disruptions to production schedules, absenteeism and underperformance due to illnesses. Other aspects of working conditions that have been found to have implications for productivity levels include overtime, with excessive overtime impacting negatively on productivity, especially over prolonged periods of time and when it is associated with low payment; bundles human resource practices, particularly those that include provision of training, performance management, reward systems, and worker engagement can also foster performance improvement and thus higher productivity. It should be noted, however, that human resources practices involving high performance work systems may also be associated with greater job strain. For standalone improvements in other aspects of working conditions, evidence on their impact on productivity is still scarce, especially in the case of SMEs.

III. Social dialogue and its impacts on working conditions and productivity

Different forms and mechanisms of social dialogue have an important role in affecting working conditions. For dialogue to be meaningful, workers must have a means of having their voice heard. Worker voice is commonly understood to bring advantages for workers and to allow greater influence over anything from work tasks to employment terms and practices. Collective bargaining, has been shown to lead to higher wages, shorter working hours, and in some cases, increases in training provision for those covered by the agreement. In addition, other forms of dialogue, such as information-sharing, consultation and different forms of workplace cooperation have also been increasingly recognized has playing a part in improving working conditions, for example, the value of well-functioning bipartite OSH committees and workers' consultations on occupational risks and preventive measures has been emphasised.

Social dialogue has also a role in productivity enhancement. Mechanisms of social dialogue, and particularly collective bargaining, help communication flows and provide an assurance to workers that the distribution of productivity gains will be subject of negotiation. This in turn can provide incentives to workers to cooperate when process and organizational changes for productivity improvements are to be implemented. In addition, mechanisms of consultation and information-sharing can help improve job satisfaction. Systems for direct worker engagement on productivity improvement, such as participation in joint problem-solving and suggestion schemes, have also been found to increase worker commitment as well as facilitate access to ideas and insights from the shop-floor.

IV. Small and medium enterprises

SMEs are a particularly important segment to consider when discussing productivity and working conditions. Even though extensive data on MSME in developing countries is limited, and one needs to bear in mind the heterogeneity of MSMEs, available evidence and studies suggest a negative relation between productivity level and firm size, and also between firm size and working conditions. This is particularly the case in informal MME's.

In terms of productivity constraints and enabling factors, SMEs are disproportionally impacted by the business environment. They also face significant capability barriers, i.e management and worker skills, technology use, access to inputs, lack of economies of scale are all elements against which SMEs tend to fare poorly when compared to larger enterprises. With regard to working conditions, MSMEs are also particularly affected by constraints at the institutional and structural level. For example, they tend to be less within the reach of labour inspectorates than their larger counterparts and they also suffer from capacity gaps, e.g. in terms of access to information, awareness, and poor management systems to address labour compliance issues. These are exactly the conditions seen in the informal sector.

V. What can be done for building firm capabilities?

The importance of comprehensive policies aimed at bringing about a structural transformation in economies towards labour-intensive higher-valued sectors and at fostering a conducive business environment cannot be overstated. In this respect EESE assessment provide a valuable tool for identifying framework constraints and relevant policy interventions.

At the same time, addressing gaps in terms of firms' internal capabilities is of key importance. In this respect there are several entry points for public policy interventions.

Facilitating and supporting clusters

Clustering can help the development and access to specialized skills, facilitate learning and technology diffusion and can allow SMEs to rely on economies of scale, especially where there are strong producer associations. In terms of public policy, support to clusters typically focuses on infrastructure and knowledge-based investment, facilitation of networking,

Supporting knowledge and technology development and diffusion

The Chilean Economic Development Agency (CORFO) promotes collaborative research by companies, researchers and PRIs in priority sectors (e.g. aquaculture, the food industry, and mining). It offers a number of incentives to improve technology transfer (e.g. support for IPRs and programmes to strengthen universities' transfer and licensing offices). Go to Market, a programme launched in 2011, aims to facilitate the commercialisation and export of the results of applied R&D carried out by enterprises and researchers.

(OECD)

market linkages and access to services. These measures can enhance the benefits of spatial clustering and productivity gains that derive from it.

Argentina: The Argentinian government, through the Ministry of Science, Technology and Productive Innovation has been devoting more attention to cluster policies. The main instruments are the Productive Clusters Integrated Projects Programme (PI-TEC), which promotes the creation of clusters, and the Strategic Areas Programme (PAE), which was established in 2006 to foster the creation of knowledge clusters in priority sectors with high potential for economic and social impact.

(OECD)

Facilitating market linkages and value chains

The role of foreign multinationals in building domestic firm capacity: Cases from the automotive sector

The automobile sector in India and China developed due to waves of investment in these countries since the late 1980s.

In the case of China and India, the transfer of good practices was driven by the arrival of international car makers, often operating as joint ventures with local partners. (…) From the early 1990s onwards, MNCs entered both markets and in each case were required to achieve a high level of domestic content. Domestic content rules typically require foreign investors to source a minimum amount of goods and labour from the local market. This led to switching from imported components to sourcing from local vendors, which led to the establishment of Tier 1 suppliers of international standards. The role of the 'lead firms' was critical to this process and determined the extent to which local capability developed. However following this initial stage, China and India followed different paths, and relied much more on domestically grown lead-firms.

The Indian automobile sector has grown differently from that of other developing countries, especially China. In contrast to China, India has relied more on home-grown lead firms to propel its industry. A disadvantage of this approach is that the absorption of global best practices has been slow. Also, Indian suppliers have been lagging Chinese suppliers in both productivity and quality.

(International Growth Centre)

Participation in global supply chains can help to improve domestic firms' capacities, especially where firms directly supply to advanced international firms. Access to such markets, however, typically relies on some existing minimum level of firm capacity in terms of quality, productivity, and timely delivery. Supply chain interventions typically focus on measures to facilitate trade and attract Foreign Direct Investment, on the strengthening of backward linkages to domestic industries, on business match-making and on supplier capacity-building. In order to reap the benefits from participation in global supply chains, broader framework conditions, such as infrastructure and skills, also need to be addressed. Participation in global supply chains can be associated with higher compliance with labour standards, especially through Multinational Enterprises' Codes of Conduct, and therefore support improvements on working conditions. At the same time, downward pressures on producer prices and certain sourcing practices can have a negative influence on working conditions. It is therefore essential to ensure that economic upgrading goes hand-in-hand with social upgrading.

Business development services (BDS)

BDS have a direct impact on firm capabilities and thus facilitate productivity growth. BDS can improve firm capabilities in various fields, from financial skills, to marketing, to management skills, credit, and technology. They can take the form of information services, training, consulting, and finance. The availability of well-functioning BDS plays an important role in building and upgrading firm capabilities across sectors and firm sizes. Ensuring that service provision is accessible to SMEs, and not only large enterprises, should be a key concern for policy-makers, and can require public policy interventions. The rationale for public policy interventions on BDS for SMEs are linked market failures. These can be associated with a lack of access to finance because of the inability of banks to assess the risks of lending to SMEs; lack of information among SMEs on the benefits of certain support services, such as training or consultancy; a lack of providers for certain services, or providers' unwillingness to scale down their services to meet the demand of smaller enterprises because of an unfavourable ratio of fixed costs to revenues; and enterprises' reluctance to invest in research and development because they fear free knowledge spill-overs to other enterprises. Under such circumstances, policy interventions aimed at supporting market demand, subsidising services, or providing tax incentives linked to education and training, can be valid strategies to help firms improve their capabilities.

In the design and implementation of public policies aimed at improvements of productivity and working conditions, dialogue and collaboration with social partners is essential; first because it allows a better understanding of the constraints faced by enterprises and their workers and inform relevant and responsive solutions to specific contexts, and secondly, because the employers' and workers' organizations can play an important part in providing information and training to their members and thus support firm capability development.

VI. From vicious to virtuous cycles: insights from capability building programmes

There are approaches that leverage the linkages between improvements in working conditions and productivity. In particular it has been shown that modern management practices, such as approaches based on Kaizen or Lean Manufacturing can bring double dividends. An econometric study on the impact a Lean Manufacturing supplier development programme by an international sports good manufacturer found positive changes in terms of compliance with labour standards that resulted from the initiative, and indicated a stronger impact than measures that solely focused on compliance monitoring.

The link between the adoption of Lean Manufacturing practices and working conditions can be explained by the fact that Lean Manufacturing involves changes in labour and human resource practices. In particular, Lean Manufacturing requires increased investment in worker training and higher level of discretionary efforts by workers. In Lean systems workers are expected to perform tasks that go beyond those required in standard mass production systems, e.g. workers engage in joint problem-solving and play a role in quality inspection at their work stations. The higher level of involvement expected from workers and the investment in employee training required, means that managers have an incentive in improving working conditions to motivate and retain skilled workers.

The SCORE Training: an integrated approach to enterprise improvement

The ILO SCORE Training is a training and consulting programme aimed at improving productivity and working conditions in SMEs. It takes an integrated approach to improvement by building the capacities of managers and workers around practices on workplace cooperation, Lean Manufacturing for quality and efficiency, Human Resources, Occupational Health and Safety.

The SCORE methodology is used in 15 countries by a range of public and private institutions. Governments often collaborate with private service providers to make the training accessible to SMEs. SCORE has reached over 1,000 enterprises, with more than 8000 managers and workers trained.

Enterprises report a range of improvements, including: productivity gains, cost saving, lower defect rates, lower staff turnover, lower accident rates, and improved communication

A review of available evidence on interventions for SMEs on working conditions support the argument for integrated approaches that place concerns for working conditions at the core of business systems and operations, as opposed to standalone interventions. This has been found to be case, for example on occupational health and safety, wherein effectiveness is greater when OSH measures are integrated into enterprise management systems that also concern quality and other aspects of business operations.

Productivity and informal firms

Firms operating in the informal economy tend to be characterised by low levels of productivity and poor working conditions. This is particularly apparent in informal microenterprises which are typically subsistence enterprises run by necessity entrepreneurs. They tend to have extremely low capabilities, in terms of skills, technology, and finance, among others.

Enterprises' informal status in itself can also limit opportunities for capability development: for example, it contributes to constraining their ability to supply to advanced firms and limits their access to BDS.

The potential for linking formalization to measures that enhance capabilities for higher productivity is dependent on the type of informal enterprises considered. Dynamic, growth-oriented enterprises are well placed to take advantage of gaining access to BDS and advanced markets. Subsistence enterprises are much less able to do so and therefore the scope for productivity increases is likely to be more limited. It should be noted there is still a lack of evidence on impacts of interventions that link formalisation measures and productivity improvement.

Some questions for discussion:

- What are the main constraints for productivity growth in Small Island Development states?
- Are mechanisms of workplace dialogue (e.g. bipartite committees) widespread? What issues do they typically address? Do they address productivity issues?
- What are the most significant capability gaps in the SME segment of your country that impact productivity? Are there programs to address them?
- Does your country have programs on BDS for SMEs? Can you share an example? What are the challenges and success factors?
  What role can the government play in improving access to SME training that can foster improvements in both productivity and working conditions at the workplace? What is the role of the private sector (e.g. employers' organisations)? What are opportunities for partnerships?

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