

International  
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# **Formalization of SMEs in supply chains in Latin America: what role for multinational enterprises?**

**Thematic Policy Brief – Enterprise Formalization**



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## Executive Summary

Small and medium-sized enterprises (SMEs)<sup>1</sup> play a major role in the world economy. It is estimated that formal SMEs contribute up to 45 percent of total employment and up to 33 percent of national income in emerging economies, and the numbers increase when informal SMEs are included.<sup>2</sup> SMEs are also key players in Latin American economies, particularly given their contribution to job creation. However, SMEs in the region are estimated to contribute little to production and tend to specialise in low value-added products. Moreover, many of them tend to operate in the informal economy, thus reducing their potential for growth and access to productive assets and limiting the benefits of social protection for their employees.

Conscious of this reality, governments in the region have developed public policies in support of SMEs, to reduce barriers to their formalization and improve their skills and productive capacities in order to strengthen their performance in national markets and enhance their access to international markets. Strategies have also sought to promote the establishment of business linkages between SMEs and large enterprises.

Recent experience in Latin America has shown that multinational enterprises (MNEs)<sup>3</sup> are increasingly undertaking initiatives to support SMEs in their value chains, as supplier or distributors of either goods or services. These initiatives are undertaken as part of their corporate social responsibility (CSR) and sustainability policies and focus on improving their managerial skills, product or service quality and use of technology. Such practices are promoted by the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policies (MNE Declaration), which aims to “encourage the positive contribution which multinational enterprises can make to economic and social progress and to minimize and resolve the difficulties to which their various operations may give rise” (MNE Declaration, para 2, pg.2).

1 Definitions of SMEs often vary by country and are usually based on the number of employees, the annual turnover or the value of assets of enterprises. Typically, micro- enterprises are defined as enterprises with up to ten employees, small enterprises as those that have ten to 100 employees, and medium-sized enterprises as those with 100 to 250 employees. According to definition used in ILO's report *Small and medium-sized enterprises and decent and productive employment creation*, SMEs are enterprise with fewer than 250 employees, thus including micro enterprises (ILO, 2015).

2 Estimates by the World Bank, available at: <http://www.worldbank.org/en/topic/financialsector/brief/smes-finance>

3 It is important to note that for the purpose of this thematic policy brief, the definition of “multinational enterprise” includes enterprises, of either public, mixed or private ownership, that own or control production, distribution, services or other facilities outside the country in which they are based. The term also includes parent companies or local entities, or both, or the organization as a whole.

**Box 1: About the MNE Declaration**

The MNE Declaration is the only ILO instrument that provides direct guidance to enterprises on social policy and inclusive, responsible and sustainable workplace practices. It is the only global instrument in this area that was elaborated and adopted by governments, employers and workers from around the world. Its principles are addressed to MNEs, governments, and employers' and workers' organizations and cover areas such as employment, training, conditions of work and life, and industrial relations as well as general policies. All principles build on international labour standards (ILO conventions and recommendations). The MNE Declaration facilitates outreach and understanding of the Decent Work Agenda in the private sector, as highlighted in the ILO Declaration on Social Justice for a Fair Globalization.

*Learn more about the MNE Declaration at:  
[www.ilo.org/mnedeclaration](http://www.ilo.org/mnedeclaration)*

Even if it is not their stated objective, initiatives undertaken by MNEs to support their providers can also play a positive role in promoting formalization among SMEs. With the objective of exploring precisely what role MNEs can play in this regard, the ILO commissioned a study with the purpose of analysing different initiatives undertaken by MNEs in four Latin American countries, namely: El Salvador, Costa Rica, Chile and Argentina. The case studies provide an overview of initiatives initiated by MNEs operating in diverse sectors in these countries. Based on the analysis, the study reflects on the role that employers' organizations can play in the promotion of formalization among SMEs and identifies a series of recommendations both directed to governments and MNEs.

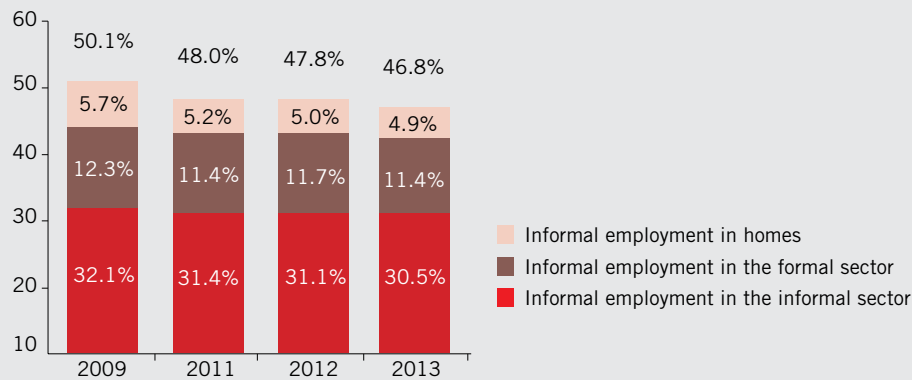
## I. Introduction

### The context of Latin America: persistent informality

Overall, the greatest labour market challenges remaining for Latin America, in its pursuit of economic growth and inclusive development, are amongst others to increase job creation, sustain a high labour force participation rate, and improve its labour quality. Job growth is slowing; for instance, urban employment-to-population ratio has fallen over the past two years and now stands at 56.2 per cent. Moreover, the region's labour participation rate, which reflects the size of the labour force, decreased to 59.9 per cent in 2014. Significantly, the region accounts for 130 million workers employed in informal conditions (ILO, 2014a). All of these are signs of the region's unequal access to quality education, weak social inclusion, low total factor productivity, and limited decent work conditions, among others.

Concerning informality, even though the rate has been declining, especially in recent years, it still persists and remains particularly high in the region. Figures suggest that a total of 46.8 per cent of jobs in 14 Latin American countries were considered informal in 2013, compared to 50.1 per cent in 2009, as demonstrated in figure 1 (ILO, 2014b).

**Figure 1: Latin America and the Caribbean (14 countries): rate of non-agricultural informal employment per component**



Source: ILO (2014b).

Informality in Latin America affects certain population groups and sectors more than others. Higher informality rates are observed amongst women (49.7 per cent versus 44.5 per cent for men) and youth aged 15 to 24 years old (55.7 per cent)<sup>4</sup> and activities with higher rates of informality are observed in construction (68.6 per cent) and commerce, restaurants and hotels (55.7 per cent) (ILO, 2014b).

## The challenge of informality for SMEs

It is estimated that there are 420 to 510 million SMEs worldwide, of which only 9 per cent are formal (excluding micro-enterprises) and 80 to 95 per cent are in low- and middle- income countries (ILO, 2015). SMEs are key players in Latin American economies, particularly given their contribution to job creation. It is estimated that SMEs contribute over 50 per cent of job creation, approximately one fourth of the GDP generated in the

region and 8 per cent of total exports (Cimoli, 2014).

Yet, despite the potential of SMEs to generate business linkages, innovation and economic growth, approximately 60 per cent of their workers are informally employed. In addition, the poorest segments of the population hold a high percentage of these jobs. The majority of the region's informal workers belong to the 20 per cent poorest segment of the population, which presents an informality rate of 72 per cent (ILO, 2014c).

<sup>4</sup> As the years of education increases, the likelihood of accessing formal employment also increases.



### **Box 2: How is informality defined?**

The informal sector refers to a group of economic units engaged in the production of goods or services, according to the definitions and classifications provided in the United Nations System of National Accounts, which are not registered under national legislation and which do not constitute a separate legal entity independent of the household owner or of its members that own them, and for which no complete sets of accounts (including balance sheets of assets and liabilities) are available. The sector is composed of a very heterogeneous group, including own-account workers employed in their own informal sector enterprises and employees holding informal jobs in informal sector enterprises.

Although one usually associates informality with jobs in informal sector enterprises, this concept also includes those jobs that do not comply with social and labor rights as defined by national law even when they are found in formal sector enterprises. Indeed, employees are considered to have informal jobs if their employment relationship is, in law or in practice, not subject to national labour legislation, income taxation, social protection or entitlement to certain employment benefits (advance notice of dismissal, severance pay, paid annual or sick leave, etc.). The main characteristic of informal employment is the lack of social protection- with no social security coverage - and whose workers are the most vulnerable.

The conceptualization and measurement of informality has evolved over time. It can both focus on production units i.e. enterprises, when referring to the informal sector, and jobs as observation units, when referring to informal employment. Thus the informal economy refers to both informal enterprises and informal employment.

It is important to recognize that the criteria for defining informal jobs are determined in accordance with national circumstances and data availability. Given the considerable diversity of informal employment situations, this poses limits to the extent to which statistics on informal employment can be gathered and harmonized across countries due to difficulties faced in measurement.

*Sources: Resolution concerning statistics of employment in the informal sector, adopted by the Fifteenth International Conference of Labour Statisticians (1993); Guidelines concerning a statistical definition of informal employment (2003); Van Elk, K. and De Kok, J. (2014).*

Often, it is thought that microenterprises operate completely outside the policies, laws and regulations in force. While it is true that microenterprises are characterized by informality, experiencing either partial or total failure of compliance with regulations, this does not mean that the regulatory environment is unimportant to them. Certainly, directly or indirectly, almost all enterprises, even small ones, are affected by regulatory frameworks. For example, a small entrepreneur who does not register his enterprise to avoid paying

taxes will see his business prospects limited by the same decision. For fear of being discovered, the enterprise cannot advertise its products, create business linkages with established companies that require a certain formality in commercial transactions or become a supplier in the public sector, and will face difficulties in accessing financing amongst others obstacles (Valenzuela et al., 2006).

However, country experiences indicate that formalizing and running a formal enterprise requires significant investment



of both time and financial resources. As a result, most SMEs comply only partially with the regulations or even prefer to stay out of the regulatory framework. Latin America is no exception and the complexity of the regulatory framework is observed in several countries in the region (Valenzuela et al., 2006).

Studies show that enterprises that meet most of the legal requirements create more jobs than others of similar size with lower compliance. Moreover, in more formal enterprises, employment is of better quality. A high incidence of enterprise informality is indeed associated with several negative developments, such as low productivity, a poor tax base, precarious working conditions and unfair competition. Overall, the informality of SMEs not only limits the economic benefits and social protection of workers (minimum wages, health coverage, pensions, working hours, amongst other labour rights), but it importantly also inhibits enterprises from participating in activities with higher productivity and profitability (ILO, 2015; ILO, 2014c; Valenzuela et al., 2006).

### ***Box 3: What are the benefits of formalization?***

- Increased possibilities of greater market positioning without legal problems.
- Options to associate with other people or enterprises to become more competitive.
- Increased credibility and trust of customers.
- Greater opportunities to access new markets and expand into international markets through exports.
- Access to loans from different financial institutions both public and private.
- Possibility to pay with invoice and access tax credit.
- Participation in public tenders and become a client of the state. Also possible to be included in the list of suppliers of large companies.
- Contribute to social and economic development given tax payment.

Faced with the reality of high SME informality, many countries in Latin America have developed specific measures and policies to facilitate their transition to formality. Typically, these interventions have focused on simplifying the process for registering informal enterprises and on extending the benefits of formalizing employment. They 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 (ILO, 2014c). Other public policy measures, such as investments in education, infrastructure, productivity, public transport and social

protection systems are also likely to have significant positive effects on the reduction of informality.

## What role can MNEs play in promoting formalization among SMEs?

Multinational Enterprises (MNEs) have shown sustained growth in Latin America, which is reflected in their sales and share of national markets. For instance, in the mid 2000s, in the retail sector, more than two-thirds of total supermarket sales of ten countries was concentrated within five chains of stores, in which MNEs represented a share of around 70 per cent (Readon and Berdegué, 2002).

Integrating into the value chains of MNEs and gaining market access can be a crucial motivation for SMEs to formalize. In addition to being a frequent requirement to access these business channels with high domestic market participation, the formalization and the subsequent establishment of economic relations with an MNE allows SMEs to: (i) be part of the MNE strategies for market positioning, both nationally and regionally; (ii) increase the added value of their products through technologies often transferred by MNEs and consequently access better prices as well as information, technology and innovation developed by the MNE; and (iii) adopt administrative controls and techniques that allow them to have better enterprise management.

In the context of high informality, large private enterprises have implemented their own initiatives to support SMEs. These initiatives often focus on improving their managerial skills, product or service

quality and use of technology. However, even if it is not their stated objective, these initiatives can also play a positive role in promoting formalization among these SMEs, as a pull factor for them to gain access to these support programmes and increased business opportunities.

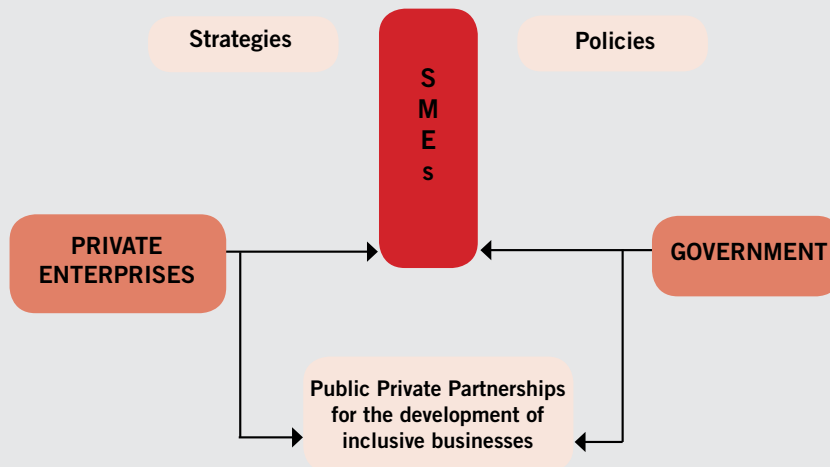
The strategies developed by MNEs here presented have been diverse in scope and results have also varied, as will be illustrated in section 2 of this brief. These initiatives are undertaken within the scope of their corporate social responsibility (CSR) and sustainability policies and directly linked to their core business, with a strong focus on promoting inclusive business.

Indeed, in the last decades, enterprises operating in Latin America have experienced a change of paradigm towards responsible business practices, leaving behind more traditional corporate philanthropy approaches. Large enterprises have taken advantage of these opportunities to create social and economic value by promoting inclusive business and contributing in diverse ways to national development priorities.

MNEs have and can align their strategies with government policies to help foster public-private partnerships (PPPs) notably in the development of joint projects to establish business linkages with SMEs and enhance their productive capacities in the integration of value chains. PPPs promote collaboration with public and private organizations and can be effective and efficient for the development of inclusive businesses and thus promoting formalization, as shown in figure 2.



**Figure 2: Public Private Partnerships in the implementation of CSR**



## Research methodology

With the objective to identify and systematize the experiences of four Latin American countries, the policies and strategies implemented by governments and MNEs to promote the formalization of SMEs were analysed by a study conducted by FUNDES<sup>5</sup> from April to June 2015.

For the selection of the case studies, two fundamental conditions had to be met. The first being that a value chain had to be led by a large enterprise, which established business relationships with SMEs as part of its core business, and the second condition, that there was a specific need to guarantee or comply with standards imposed by policies or the system in which the value chain operates.

With these criteria in mind, the researched identified a range of potential cases and focused on four of them, taking place

in different countries and in a variety of economic sectors, to illustrate the variety of approaches that can be developed to promote formalization. The analysis of the cases first takes stock of existing public policies and frameworks to reduce informality and then looks into specific programmes developed by companies with the objective of providing support to their suppliers.

<sup>5</sup> FUNDES is a consultancy company that specializes in developing corporate and government programs that seek to generate efficiencies, profitability, welfare and innovation throughout value chains, economic sectors and every other domain that affects micro, small and medium businesses in Latin America: <http://www.fundes.org/> The original study included five cases, but four are presented in the brief.

## II. Approaches and Results

### 1. El Salvador: Building skill capacities for sustainable business development

According to the Ministry of Economy of El Salvador, 50 per cent of the economically active population works under informal conditions. Government efforts have aimed at increasing the formality and quality of employment by strengthening the productivity of enterprises and local services that foster job creation. In addition, the government has implemented target programmes to strengthen SMEs and is considering public-private partnerships to foster productive business linkages with MNEs.

A key private undertaking is the “*4e Camino al Progreso*” initiative developed by a multinational beverage company which seeks to promote the competitiveness of SMEs and their business relations with large companies, mainly based on CSR strategies.

Over the past 20 years, small retailers, grocery or supplier stores in Latin America have been losing their share of the total food market mainly due to the rise of large convenience stores.

Against this background, the company implemented a project to develop the business and leadership skills of owners of its traditional market channels that merchandise its products (beverages, soft drinks and beer), especially small and medium-sized retailers. This project, which was initiated more than a decade ago in El Salvador is now a Latin American wide programme implemented in 5 additional countries of the region,

namely: Peru, Colombia, Ecuador, Panama and Honduras.

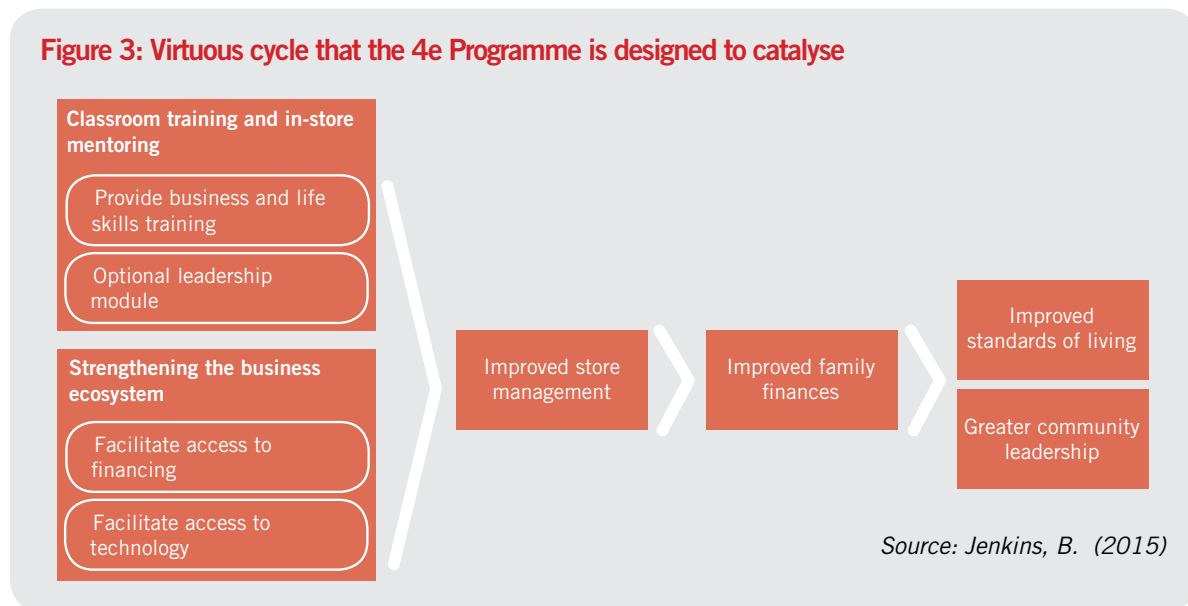
As illustrated in figure 3, the programme “*4e Camino al Progreso*” is an initiative that seeks to promote social change by providing capacity building and support services to small retailers to develop their entrepreneurial skills, strengthen the sustainability of their business and help implement community development ideas. Participants receive training and have access to personalized in-store mentoring, focusing broadly on life, family, community and business leadership skills.

In El Salvador, the programme was coordinated by Industrias La Constancia<sup>6</sup> to incorporate all small-scale retailers and even restaurants. It has focused on those small enterprises that demonstrate leadership and an interest to improve their environment, especially those located in low-income areas and where women shopkeepers are heads of households, representing 70 per cent of the owners of local supplier stores (according to the Department of Communications and Sustainable Development of the MNE).

The classroom training courses consist of several modules, each lasting four weeks, and provide an incentive to formalization. While the multinational beverage company devised the project, since 2013, FUNDES has been the agent commissioned to develop the training methodology targeted to these enterprises.

<sup>6</sup> Industrias La Constancia (ILC) is El Salvador's largest beverage company, with a 41 per cent share of the market for alcoholic beverages and a 50 per cent share of the market for non-alcoholic beverages. It is a subsidiary of the multinational beverage company.

**Figure 3: Virtuous cycle that the 4e Programme is designed to catalyse**



This project has included the participation of multilateral and private actors who have promoted synergies for the transfer of knowledge, technology and financial resources in support of the project. These include the Inter-American Development Bank (IDB) and the Multilateral Investment Fund (MIF), which help generate new funding opportunities through micro-credit opportunities; and the Banco Agrícola which is involved in developing administration skills for small retailers through capacity building in finance and new technologies.

After several years of this initiative's implementation, the owners of those targeted businesses have observed benefits from joining the project. The formalization of their activities is one of the tangible benefits, as well as the empowerment of women owners, and increased sales, which are estimated at 11 per cent (Industrias La Constancia, 2014).

In El Salvador, both SMEs and the government have benefited from this MNE initiative. Indeed, this has not only facilitated tax collection, thanks to the visibility of the enterprises following their

formalization, but has left these enterprises both strengthened and empowered.

## 2. Costa Rica: Strengthening distributors through franchise development

According to the Ministry of Economy, Industry and Trade of Costa Rica, SMEs accounted for 95 per cent of all enterprises in the country, generating 46 per cent of total employment and contributing to 30 per cent of GDP in 2012.

FUNDES estimated that about 78 per cent of MSMEs are not totally legal in nature, with the non-payment of dues to the Costa Rican Social Security Fund being the main reason for non-compliance with regulations.

The government in Costa Rica has undertaken numerous efforts and strategies to support SMEs and develop entrepreneurship. In addition, as part of its goals for attracting foreign direct investment, Costa Rica has for several decades developed programmes aimed

at promoting business linkages between SMEs and large multinational enterprises.

A leading manufacturer and supplier of cement-related materials in Costa Rica initiated in 2004 the project “*Construred*”, which aims to strengthen the distribution channels of its products through the creation of franchise hardware stores and warehouses of materials.

To achieve this initiative with the aim of consolidating business linkages and expanding its services and sales, the cement company supports building capacities and management skills of small and medium-sized businesses in its value chain specialized in construction materials. This called on project managers to understand the situation of each MSME and their specific needs to develop a thorough proposal in accordance with the realities of the sector.

The services provided to MSMEs include training for the staff and owners of enterprises on topics ranging from accounting, finance, inventory, management and marketing to investment in technology and physical renovation of the premises. In addition, “*Construred*” expanded its offer to ensure that banks relax credit conditions to improve investment options for MSMEs in accordance with their established business plans. This aspect of the project is particularly important given the difficulties many face to access formal credit channels.

While the formalization of enterprises is not the explicit goal of the project’s strategy, it has nevertheless contributed to this process. One of the company’s managers involved in the initiative interviewed for the research stated that

*“Even though it is not requested as an entry condition that they be formal enterprises, it is, however, considered as a fundamental basis for healthy economic growth because it is difficult to consolidate business growth and prosperity if it (the MSME) does not comply with the laws and does not exercise sound business practices”.* Indeed, it was defined that distributors had to fulfil with tax regulations, the Costa Rican Social Security Fund (CCSS) and other general laws to operate in the franchise.

These small hardware stores and warehouses have as a result achieved greater participation in the market for construction materials through the consolidation of volumes and shared services, as well due to improved rules and processes. Notably they have been able to increase their market access with the project’s commercial partners, which include other large enterprises related to the construction sector.

This project is solely funded by the company, spending between forty and fifty thousand dollars yearly, and has already had significant impact. While the company has increased the efficiency of those participating in its market channels by notably increasing the sales of its products, MSMEs have also experienced positive results in terms of improved business management, increased sales and profit margins. One of the main benefits for franchise hardware stores and warehouses has been the ability to achieve better control of their internal finances as well as improvements in their duty cycle and inventory system. Concerning this latter point, the programme has enabled an increase of 78 per cent in the

reliability of inventories, thus reducing the cost for losses.

### **3. Chile: Leveraging government efforts to reinforce business linkages amongst suppliers**

Chile has a significant tradition in policies and public-private strategies in support of SMEs. In 2005, Chile accounted for 125 mechanisms to promote production, of which 99 were directed to SMEs and micro enterprises, own-account workers or community-based social groups.

Although Chile does not have a single entity that centralizes efforts in the formulation and implementation of public policies and regulations aimed at SMEs, most of these lie under the Chilean Economic Development Agency (CORFO- Corporación de Fomento de la Producción). It coordinates more than 20 public institutions to develop programmes in accordance with the needs of SMEs.

The Supplier Development Programme, part of the tools provided by CORFO, is the main public effort in support of promoting business linkages with SMEs. This programme aims to strengthen the diagnosis and development of both public and private business projects to improve the quality and productivity of suppliers. Through the creation and consolidation of stable subcontracting relationships between an enterprise and its suppliers, it helps generate reciprocal business linkages.

A leading multinational company producer of long steel in the Americas and one of the largest recyclers in Latin America has been present in Chile since 1992 and has focused its activities on the production

of steel and wire products, essential for key sectors such as civil construction, metalworking, mining and agribusiness.

Leveraging efforts of the Supplier Development Programme, the company has established a programme that aims to increase the competitiveness of selected SMEs through a process of professionalization as a way to become suppliers of scrap in the company's value chain.

Funded 50 per cent by the Supplier Development Programme, the initiative is aimed at reinforcing business linkages and had a duration of three years during which SMEs were accompanied by capacity building opportunities to increase their management skills, entrepreneurship, accounting, IT and software, inventories, and sales, among others. The initiative had three distinct phases: i) Mapping, analysis of economic feasibility and training of SME suppliers of recycled scrap on safety, 5S<sup>7</sup> and administration; ii) Direct assistance provided to the SMEs for the implementation of business plans and improvement in entrepreneurship, communication and decision-making skills; and iii) Monitoring of the selected SMEs.

The inclusion of new small scrap suppliers in the company's value chain demanded more capabilities with respect to product quality, speed of response to consumer demands, continuous diversification, customer service and the flexibility of the production process.

7 5S is the name of a workplace organization method that uses a list of five Japanese words: seiri, seiton, seiso, seiketsu, and shitsuke. They can be translated from the Japanese as "sort", "straighten", "shine", "standardise", and "sustain".



In order to achieve greater economic and social impacts, the requirements for SMEs to be selected to take part in this initiative included that they have at least a 60 per cent purchase relationship with the transnational company and be a family businesses not exceeding US\$ 300,000 in annual sales.

In the first year of the initiative's implementation, the company observed that the level of compliance among participating SMEs was approximately 25 per cent on average. This further increased to 56 per cent and finally culminating in 70 per cent, demonstrating increased positive impacts regarding the process of formalization.

Unlike previous examples, in this case the Chilean government played a fundamental role as it financed 50 per cent of the project with resources from the Supplier Development Programme. The remaining 50 per cent was financed by the MNE itself, which managed to increase both its sales as well as those of its supplier SMEs. Even if the business linkages were positive for both parties, smaller firms were the major beneficiaries in becoming suppliers as it guaranteed a large client and the availability of prepayments.

#### **4. Argentina: Enhancing the professionalization and formalization of small entrepreneurs**

Apart from national policies fostering the formalization of SMEs, improving their entrepreneurship, innovation and access to productive assets, the Argentinean government has also developed programmes aimed to enhance suppliers within value

chains. For instance, the Ministry of Industry has developed a strategic initiative on the substitution of industrial imports with the aim of promoting the development of value chains, structural changes to enhance national and regional productive capacity, and strengthen the balance of payments situation in coordination with other state agencies.

It is within this framework that an Argentinean private financial institution with a broad portfolio of clients ranging from SMEs to MNEs, initiated in 2007 the programme *"From entrepreneurship to SMEs"*. The programme aims to equip entrepreneurs with new concepts, tools and skills to increase the competitiveness, growth and sustainability of their enterprises.

The programme gives entrepreneurs the opportunity to build their capacity on issues related to business management, thereby contributing to the professionalization of enterprises and the process of formalization. The programme consists of 4 phases, which have a total duration of two years.

In the first phase, monthly gatherings focus on building capacity related to: human resources, trade, legal and tax aspects, accounting and finance, business planning, digital communication tools, interpersonal relationships, leadership and delegation of work. The second phase, based on a total of 20 hours of virtual mentoring, provides support to participants to develop a strategic business plan. In the third phase, the business plan is submitted and approved. Advice is also offered to those ventures who are not formalized and entrepreneurs interested in the starting the process of formalization to comply with the law. In the fourth and final phase, all



those SMEs that have been formalized due to their participation in the programme are given the opportunity to apply for credit under special conditions, such as subsidized rates.

Unlike other programmes promoting business linkages and empowering suppliers within value chains, this initiative enables informal enterprises to participate provided they have one year of establishment and have billed less than US\$ 50,000. Through the programme, informal enterprises can have more information about how to formalize and access credit once the formalization process has concluded. Also, the programme is open to SMEs which may not be customers of the bank and thus is broader in scope than other of the programmes analyzed.

The bank not only finances 100 per cent of the project but is also in charge of all the logistics related to its implementation jointly with other strategic partners. In terms of results, while the SMEs benefit from professionalizing their businesses and increasing their competitiveness through new learned tools that enhance their sustainability.

### III. Conclusions and recommendations

First and foremost, adequate national legislation and enforcement, as well as a smart mix of public policies are needed to address the various and complex causes of informality. However, the evidence presented has demonstrated the positive role that MNEs can play in the formalization of SMEs in Latin America, by acting as a vehicle to promote and deliver good practices to companies in their value chains. Even though in the cases analysed SME formalization was not a goal in itself, initiatives that seek to provide support to SMEs on their management practices and business processes proved to have a positive impact on formalization.

The experiences analysed also show that, while it is not often the case, where there is collaboration between the public and private sectors, such initiatives have better chances of succeeding and having a greater impact. When there are public policies and frameworks in place to promote and ease formalization, MNEs can seek ways to collaborate and contribute. Thus, there is significant potential for strengthened collaboration on the topic between the public and private sectors, each with the realm of their respective roles and responsibilities.

Employers' organizations have a key role to play in such efforts. Employers' organizations, for example, can develop and deliver training modules that include information on formalization processes, targeted at large companies' suppliers. They can also play a crucial role in informing governments of the challenges

faced by SMEs in the formalization process and the requirements of MNEs, and take part in the assessment of formalization policies. Employers' organizations can also advise MNEs on how to develop new approaches to support SMEs in their value chains. Thus, they can be valuable partners in both the design, implementation and evaluation of public policies to reduce informality and with respect to programmes that enterprises undertake to support their providers.

A series of recommendations directed at governments and MNEs follow, in order to enhance their contribution in the process of SME formalization.

## 1. Recommendations for governments

- ***The need for integrated and comprehensive approaches to create the right enabling environment:***

In order to advance towards SME formalization, integrated strategies are required that simultaneously address the multiple and complex causes of informality, incorporating issues related to administrative, tax and labour regulations, access to social security and private sector development strategies, in addition to improvements in public infrastructure and transport systems. Policies should include strategies to increase productivity, improve norms and regulations, generate incentives for formalization and enhance government's capacity to enforce compliance. Approaches should address different determinants

of informality and thus be comprehensive in nature. To illustrate, reducing the administrative burden in terms of cost and length of procedures may not be effective if it is not combined with continuous efforts to improve the competitiveness of small enterprises through effective enterprises development policies. At the same time, it is necessary to create the right incentives for formalization, taking into account the needs and interests of small enterprises and their workers. These efforts need to be further complemented by policies to improve inspection and raise awareness amongst employers and workers on the obligations and benefits of formalization. Tackling this multi-faceted process requires a balance between incentives and sanctions. The challenge for policymakers is to find the right mix of instruments for each context, ensuring that formalization is an attractive option both for enterprises and their workers (ILO, 2014c; ILO, 2014d; Van Elk, K. and De Kok, J, 2014).

- ***Complement national policies with subnational strategies:***

While in most cases policies to simplify the formalization process are designed at the national level, local governments are often at the forefront of their implementation. Local governments often have better knowledge of the socio-economic challenges and opportunities in their territories and the public policy needs of their populations. The success of measures will be greater in those cases where local governments have been

involved in the design of such policies, have strengthened implementation capacity, and sufficient room to adapt them to the local context when required.

- ***Implementation of impact assessment methodologies:***

It is important that policies in support of SMEs are designed under logical frameworks, which have clear and specific indicators. With the aim of increasing the efficient use of resources and efforts in the professionalization and formalization of SMEs, it is essential that policies be monitored, evaluated and reviewed on the basis of results achieved. Only then will it be possible to determine good practices in the future.

- ***Improved understanding of SME conditions and the requirements of MNEs:***

Policies to promote business linkages can provide a strong incentive for SMEs to become formal, in order to access new business opportunities and markets. These policies, however, need to be based on a thorough understanding of the requirements of MNEs on the one hand, and the difficulties than SMEs may have in complying with such requirements on the other. Policies can then provide tailored support to SMEs for them to overcome challenges encountered in the process of integrating into local, national or international value chains.

- ***Encourage the participation of large enterprises in the provision of services for SMEs in their value chains:***

Some countries have made positive impacts with the greater participation of large enterprises in the provision of funding, training and innovation services needed by SMEs, particularly in those cases where SMEs integrate into the value chains. These can not only have beneficial impacts in terms of the sharing resources, but importantly these models can allow SMEs to access larger and more efficient markets for accompanying services. Other benefits of public-private partnerships to promote formalization can include transfer of know-how and technology, skills upgrading and access to finance. Large companies can benefit from developing long lasting relations with their suppliers and from an increased reliability.

## 2. Recommendations for MNEs

- ***There is no one size fits all approach for managing MNE policies aimed at supporting SMEs in their provision and distribution value chains:***

The case studies presented show that each MNE defines the approach that best fits its needs. While in some cases the success factor was determined by the leadership that the MNE exercised throughout the process of project development and implementation, in others it was the involvement of external support organizations to facilitate and manage the day-to-

day operations of the project. It is essential that in the process of project development and management, MNEs not only recognize the role that they can play, but also the specific needs of SMEs in their value chain and the existence of national frameworks with similar goals. Whatever the project approach, in order to be successful the needs of SMEs should be central to any provider support project developed by an MNE.

- ***Leveraging and complementing government efforts is essential:***

The development and implementation of strategies and programmes to promote the competitiveness of SMEs and their integration into value chains must consider and leverage existing government efforts. Not doing so would imply duplication and fragmentation of responsibilities and efforts. It is important that new efforts by large companies begin by reviewing existing government measures in place to complement initiatives.

## End notes

This thematic policy brief was prepared as part of a policy brief package on enterprise formalization which includes a series of regional and thematic briefs. It highlights the main findings of a study exploring how multinational enterprises are promoting formalization among their providers, in the framework of their corporate social responsibility policies. The study was conducted by FUNDES, and was summarized by Ms. Anna-Maria Fyfe. The findings of this and other similar policy briefs are synthesized in an Introductory Brief, which presents key findings in an easy to digest summary of the main issues and approaches.

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40	77,85	1,10%	81,05
	1,20%		132,05
5	0,5		15,10