

NOTES ON POLICIES FOR THE FORMALIZATION OF MICRO AND SMALL ENTERPRISES

Policies for the formalization of micro and small enterprises in Chile

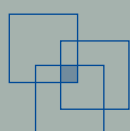


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Foreword

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.

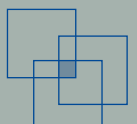
This series of focus notes reveal that notwithstanding the complexity of the issue, positive experiences exist in several countries in Latin America and the Caribbean, which are worth reviewing and sharing with policy makers. The experiences presented in this series of focus notes also show that countries 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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1. Introduction

The informal economy in Chile has traditionally represented a smaller proportion of workers and enterprises than elsewhere in Latin America. In 2006, the share of the working population employed in the informal economy stood at 39.5%.¹ In 2012, 69.9% of Chile's urban population enjoyed pension coverage, as compared to 60.5% for Latin America as a whole.²

The smaller size of the informal economy in Chile has to do not only with the country's solid economic growth record over recent decades, but also with its relatively effective institutions and its culture of respect for the law. The cost of starting up a company is relatively low and labor costs have traditionally been controlled. It should also be mentioned that employees in small firms account for a smaller portion of total employment relative to other countries in Latin America. In 2012, 52.8% of the urban employed worked in firms with six or more employees, compared to a weighted average of 40.3% in the region.

Despite this relatively favorable situation, private sector development in Chile is far from homogeneous and involves significant numbers of small firms characterized by low productivity, high informality and vulnerable employment situations. A large share of micro and small enterprises (MSEs) operates semi-formally, complying with some types of regulations and obligations but not with others.

Policies over the past decade to promote formalization have consisted mainly of legislative efforts to create a more favorable business environment and to reduce enterprises' regulatory burden, thus trying to increase competitiveness, particularly amongst smaller enterprises. At the same time, subsequent Chilean governments have taken on an active role in the promotion of private sector development. A role that has led to the consolidation over time of a solid network of institutions promoting enterprise start-up and growth, offering a wide range of financial and non-financial business development services and instruments.

2. Recent formalization trends

According to the national household survey, in 2011 there were 552,000 micro and small enterprises in Chile³ and 905,000 own-account workers.⁴ In the same year, a study undertaken by the Chilean small enterprise development agency SERCOTEC found that 49% of the workforce employed in the private sector either worked in micro and small enterprises or as own-account workers.⁵ Micro and small enterprises in 2011 accounted for around 8.9% of sales.⁶

One way of measuring informality in the Chilean economy is to compare the number of companies registered with the tax authorities with the number of persons declaring to be business owners or own-account workers in the national household survey. In 2011, the household survey identified 1,534,485 business owners and own-account workers, while the number of companies registered with the tax authorities stood at 825,366, which would imply a formalization rate of 54%. Ten years earlier, the national household survey reported 1,241,668 business owners and own-account workers as compared to 673,697 companies registered with the tax authorities, yielding the same 54% formalization rate. It should be noted that over the same period the number of own-account workers increased by 24%.

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

1 Ricardo Infante, *La economía informal en Chile*. ILO, 2008.

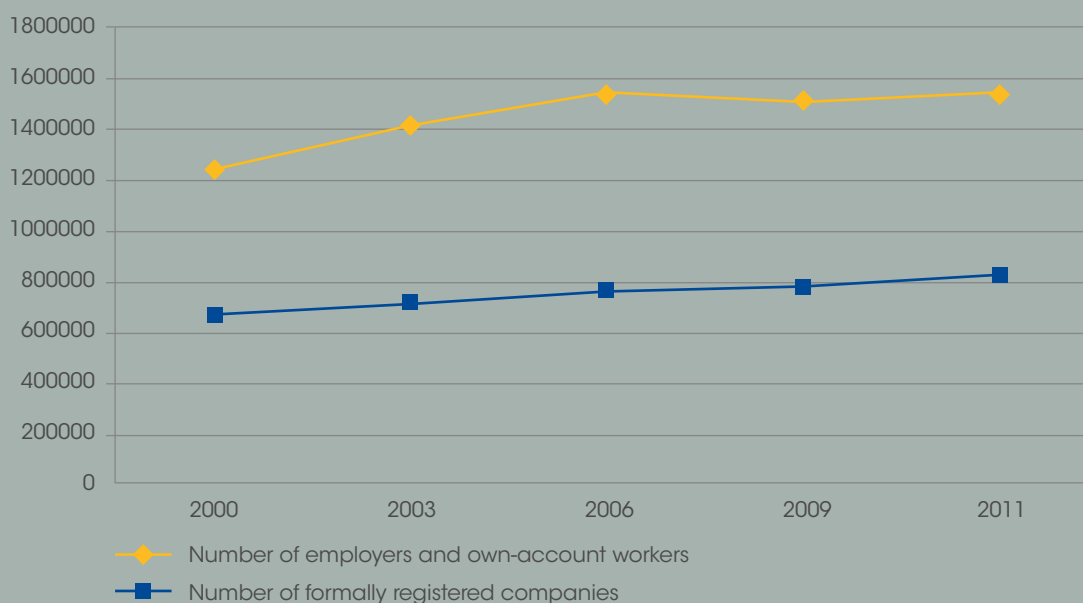
2 ILO, 2013 *Labour Overview Latin America and the Caribbean*. Lima: ILO, 2013.

3 The household survey (CASEN) reported 491,035 companies with 2-9 employees and 61,379 companies with 10-49 employees.

4 Of the total 1,534,484 business owners and own-account workers operating in Chile, 59% does not employ workers.

5 SERCOTEC, *La situación de la Micro y Pequeña Empresa en Chile*. 2014.

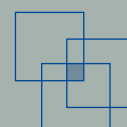
6 Ibid.

Figure 1: Number of productive units and formal enterprises in Chile, 2000-2011

Source: CASEN 2000, 2003, 2006, 2009, 2011 and Servicio de Impuestos Internos, Chile.

Based on figures from the 2013 microenterprise survey (*Tercera Encuesta de Microemprendimiento*⁷), the Ministry of Economy, Tourism and Development estimated that in that year 52% of all Chilean enterprises had formalized their operations.⁸ Of these formal entities, 28.4% had registered as independent workers, 53.7% as natural persons, 14.5% as sole proprietors or limited liability companies, and 3.4% as some other type of firm.

A good indicator to measure the level of formal employment in small firms is the percentage of employees covered by pension systems. According to the ILO, in 2011, 62.2% of urban workers in firms with five or fewer employees enjoyed pension coverage, substantially more than the weighted average for Latin America (Figure 1). A decade earlier 57.6% of Chilean urban workers in firms with five or fewer employees were covered by pension schemes, which at that point in time presented a larger difference with the regional weighted average.

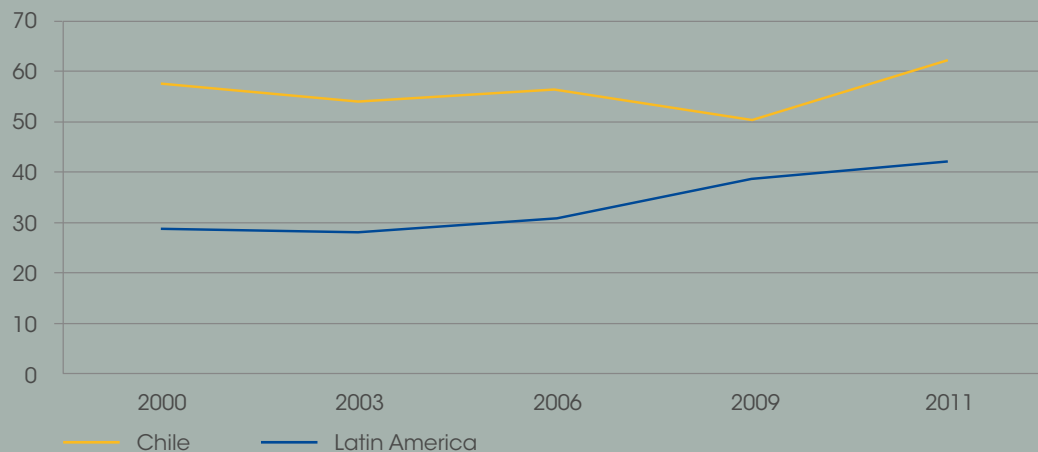


7 The sample of this survey (*Tercera Encuesta de Microemprendimiento*, 2013) involved almost 3,000 persons classified in the National Employment Survey (*Encuesta Nacional de Empleo*) as employers or own-account workers.

8 For the purpose of the survey, companies are considered "formal" if registered with internal revenue. (*Servicio de Impuestos Internos*).

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Figure 2: Percentage of urban workers in firms with less than five employees with pension coverage in Chile and Latin America



Source: ILO, 2013 Labour Overview Latin America and the Caribbean. Lima: ILO, 2013.

3. Policy approaches to encourage the formalization of micro and small enterprises

This section presents the main policies employed in Chile to promote the formalization of micro and small enterprises. Although none of the policies described here focuses exclusively on enterprise formalization, their design features included mechanisms and or incentives that encourage formalization. One landmark was the passing of Law 20,416 (2010), known as the Small and Medium Enterprise Statute (*SME Statute or Estatuto PYME*), which establishes the need for differential treatment of small companies. The law forms the basis for the establishment of an enabling regulatory framework for the start-up, growth and closure of small enterprises, based on the understanding that this segment of firms requires differential regulations and specialized institutions. The SME statute covers a wide range of general provisions, specific regulations and institutional arrangements, along with transitional provisions to improve small business competitiveness. Some of the policies described here formed part of this framework, while others were designed and implemented before or after the law.

Simplification of start-up procedures

One priority area for the Chilean government during the 2010-2014 period was to cut red tape and reduce transaction costs for business start-up. In 2011, the Government developed a national strategy to foster competitiveness (*Agenda de Impulso Competitivo*), which aimed to stimulate economic growth by eliminating red tape, streamlining procedures and improving the conditions for start-up and innovation. Led by the Ministry of Economy, Development and Tourism, this strategy led to the promulgation of several laws, the streamlining of several regulations, the development of new enterprise development programmes, and the simplification of certain administrative procedures.

In 2011, Law 20.494 (*Agilización de Trámites para la Iniciación de Actividades de Nuevas Empresas*) streamlined procedures for the creation of new companies. The law sought to facilitate the formalization of new firms, simplifying certain procedures that were considered obstacles to new businesses start-up. That same year, the government set a target of creating 25,000 new firms annually.

The law simplified procedures for obtaining business operation licenses by amending a law governing municipal operations (*Ley de Rentas Municipales*), obliging municipalities to issue permanent operating licenses immediately in case the business owner presents all necessary permits. Likewise, the law obliges municipal staff to provide the entrepreneur with a temporary license upon reception of the required permits even if these are still subject to verification by the municipal public works department and/or the local public health authorities. In case the public health office and/or the public works department fail to process the request within a period of 30 days, the municipality is obliged to grant the definitive operating license.

In order to reduce the costs and time involved in starting a business, Law 20.494 amended the national tax code so that new business owners can start issuing electronic invoices before the obligatory inspection of their premises by the tax authorities. For this to happen, the business owner needs to present a simple sworn statement specifying the address of the business premises. When requested, the tax office must also provide the business owner with the necessary stamped documents that allow the business to start issuing printed invoices and dispatch notes.

The law also allows new companies to publish the company's articles of organization on the web page of the official gazette (*Diario Oficial*), with electronic publication taking place after reception of the documents. Compared to previous procedures, involving publication in print edition, the fees involved have been cut in half and the procedures take one day, instead of ten.

"Your business in a day"

As part of the national competitiveness strategy, Law 20.659 (2014) created a new platform "Your Business in a Day" (Plataforma "Tu Empresa en un Día"), managed by the Ministry of Economy, Development and Tourism. The purpose of this platform is to streamline business start-up and modifications and to encourage informal businesses to formalize. At the same time, it is hoped that firms presently operating as natural persons modify their legal status into sole proprietorship or limited liability companies.

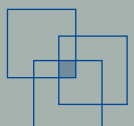
Registration through this platform requires filling out a digital form that replaces a series of steps previously required, including the notarization of the company's operating agreement, its incorporation in the commercial registry (*Registro de Comercio del Conservador de Bienes Raíces*) and the publication of its articles of organization in the official gazette. Registration is free, with the understanding that applicants assume the costs of obtaining an electronic signature or the costs of a signature provided by a public notary. Once registered, the company automatically obtains a tax identification number, and can start operations. The platform does not replace licensing requirements at the municipal level. According to the Chilean Government, during the first five months, some 10,025 firms were established using this platform.

Family-owned microenterprises

Prior to the measures discussed above, Law 19.749 (2001) governing family-owned microenterprises streamlined start-up and municipal licensing procedures for home-based microenterprises. This law made it easier for microbusinesses to formalize their operations, access financial and business development services and to establish themselves in formal markets. The legal recognition of family-owned microenterprises was also a major step forward toward the formalization and growth of women-owned businesses. ILO data show that the year this law was passed, 46.6% of female microentrepreneurs worked from home, almost doubling the number of men in this situation.

Law 19.749 facilitated the formalization of home-based microenterprises through a simplified low-costs procedure, provided they employ less than five non-family members, manage a working capital under UF1,000⁹ and develop activities that are not dangerous, polluting or disturbing.

⁹ The equivalent of US\$40,000 in 2013.



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Family-owned microenterprises do not have to comply with local zoning ordinances and regulations, and require no building permits or final reception certificates for the premises in which they operate. To obtain an operating license, the entrepreneur simply presents a sworn statement to the competent municipality, accompanied by a sanitation certificate in case the businesses would be handling or processing food.

The results of Law 19.749 have been mixed. Its efforts to simplify procedures at municipal level at times seem to clash with a bureaucratic culture accustomed to emphasize strict compliance with municipal rules and procedures. Some municipal governments demand additional documents and procedures that are not legally required. An initial evaluation in 2005 found 3,000 microenterprises registered. A survey (*Segunda Encuesta de Microemprendimiento*) undertaken by the Ministry of Economy, Development and Tourism in the year 2011 found that 7% of businesses had formalized their operations under the provisions of Law 19.749, which means that in that year there would have been around 10,000 family-owned microenterprises countrywide.

Substitution of labour inspection fines with training

Fear for the labour inspector deters many microentrepreneurs from formalizing their business, a situation that contributes to the high level of vulnerability that characterizes informal labour in this segment of enterprises. Reasons to avoid the labour inspection exist as non-compliance with regulations regarding labour contracts, working hours and occupational health and safety are common in this segment of firms. A factor that undoubtedly contributes to this situation is a lack of knowledge about the different types of regulations. To deal with this situation, the Chilean Government tries to increase compliance with the labour law through better information, education and support. The programme that replaces labour inspection fines with training (*Multas por Capacitación*) is part of this effort.

The current Labour Code (2001), allows microentrepreneurs that have violated labour regulations to participate in a course on labour legislation, instead of paying a fine. This scheme was established in response to high levels of informality in microenterprises combined with a generalized lack of knowledge about labour legislation. The programme reduces the risk for recently formalized microentrepreneurs to incur costs due to unfamiliarity with labour regulations, thus offsetting an existing disincentive for formalization.

Article 477 of the Labour Code specifies that in the case of firms with nine or fewer employees, labour inspectors can, if considered appropriate, approve a request from the culprit to replace the fine with attendance at a training programme provided by the labour inspection. The training programme consists of a six-hour workshop focusing on ways to create a more appropriate work environment through compliance with labour laws. A 2006 study¹⁰ found that 1,300 microentrepreneurs were participating annually, generally with encouraging results in terms of improved understanding of the law and positive evaluations of the programme by microentrepreneurs.

MSME Good labour practices programme

Another programme implemented by the Chilean labour inspection to encourage the formalization of micro and small enterprises is the good labour practice programme for micro, small and medium (MSME) enterprises (*Programa de Buenas Prácticas Laborales en Mipymes*), which provides technical assistance to employers and workers in complying with labour regulations, social security provisions and occupational safety and health standards in companies. Any type of business can participate in the programme, provided it has a labour union or an elected employees' representative, and it has incurred no formal complaints or court rulings against it for labour infractions over the previous six months.

¹⁰ Luis Montero, Gerhard Reinecke and Daniela Zapata, *Sustitución de multas por capacitación: Evaluación de una experiencia innovadora de aplicación de la legislación laboral en micro empresas*. 2006.

Participants voluntarily submit to an audit of the company undertaken by the labour inspection. Upon request by the parties involved, this audit may be further complemented by a training course for the company and its workers imparted by labour inspectors at no additional costs. Once the company is considered to operate in full compliance with the law, it receives a certificate of good labour practice, valid for one year. Upon reception of the certificate, the company will not be subject to further inspection during the next twelve months, provided no complaints against it are being filed. The labour inspection certifies about 180 companies a year under this programme.

PREVIRED

In 2002, a group of private pension funds operating in Chile launched the Previred portal, which allows companies to register their employees and pay their social security contributions through a single monthly payment. Previously, the employer had to prepare separate worksheets for the different pension funds to which their employees were affiliated, as well as for health insurance, occupational health and safety and other social security schemes, repeating the same information each time. Payments had to be made to the different agencies every 10th of the month, which used to produce long line-ups.

The Previred platform significantly reduces the administrative burden on formal companies. It is a free service that allows businesses to make a single bank transfer that combines the different social security contributions into one, saving numerous calculations and trips. Online payment is possible through connections with banks' electronic payment systems, but can also be done in person, by printing out the final statement and approaching a financial institution.

The required information on the company's employees is entered once and remains permanently stored in the system. Employers can print out officially stamped certificates and worksheets as well as legally valid instruments that may be required by the labour inspection. The system makes the necessary calculations and automatically corrects the amounts to be paid by the employer in the case of changes in contribution rates. Similarly, it automatically processes fines and interest on late payments.

For companies with fewer than 30 employees, a free software is provided for wage administration, which helps employers in preparing the monthly statements for their workers, along with the files necessary for electronic payment of benefits through PREVIREDD. Currently some 450,000 Chilean firms make use of Previred.

Social security education

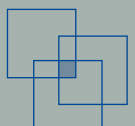
A core objective of Chilean's efforts to formalize micro and small enterprises is making sure that the persons working in these firms are covered by the different social security schemes. In 2011, only 62.2% of urban wage-earners in businesses with up to five employees enjoyed pension coverage. In the same year, 59.4% of these workers were covered by health care contributions.¹¹¹²

A study by the Small Enterprise Institute (*Instituto de las Empresas de Menor Tamaño*, IEMT) run by one of the country's most important small business associations (Confederación Nacional de la Pequeña Industria y Artesanado de Chile) found that in the year 2012 an estimated 68% of micro and small enterprise owners had an adequate understanding of the national social security system, with 58% of business owners interested in learning more and 10% declaring no interest due to other more pressing concerns.

In order to improve understanding of how social security works and foster a culture of compliance, the National Association of Pension Fund Managers (*Asociación de Administradoras de Fondos*

11 Employees of microenterprises whose employers do not provide health coverage usually access the public health care system through their poverty status

12 Sercotec, La situación de la Micro y Pequeña Empresa en Chile. 2014.



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de Pensiones AFP) has been delivering training and educational on this topic since 1998. Their programme includes training for teachers in order for them to provide information about social security in schools. It also comprises municipal training programmes for microentrepreneurs and the self-employed, provided through a national network (*Red Nacional de Capacitación y Asistencia Previsional a Microentrepreneurs y Trabajadores Independientes*), making the most of the municipalities' more direct contact with these groups.

As part of its 2008 pension reforms, the Chilean Government created the Social Security Education Fund (*Fondo de Educación Previsional*) to finance activities designed to improve citizen's knowledge on social security. The fund enables associations of micro and small businesses to organize training programmes and campaigns in order for their affiliates to understand the benefits of social security, their obligations, and the procedures involved. Some of these associations have created information platforms for micro and small business owners.

Streamlined taxation

A fundamental step in the formalization of micro and small enterprises is ensuring that these enterprises are registered with internal revenue. For many, this is a major barrier. Typically the owners of micro and small businesses consider tax registration and administration complex and costly, and do not see any clear benefits apart from the need to avoid fines. Chile, however, has introduced some major tax reforms for MSEs, simplifying procedures and reducing the costs of operating formally.

In 2007, article 14 of the national income tax law (*Ley del Impuesto a la Renta*) was amended, introducing a new tax and accounting system that simplifies and reduces the cost of calculating profit tax for micro, small and medium businesses. Companies can subscribe to the system provided they are sole proprietors or limited liability companies with annual revenues of less than 3,000 UTM¹³ and equity of less than 6,000 UTMs.¹⁴

The simplified tax regime exempts companies from the obligation to produce detailed profit and loss statements, balance sheets, inventories and amortization records, amongst others. Net taxable income is simply determined as revenue minus expenses. The regime also reduces monthly provisional tax payments (*pago provisional mensual, PPM*) to 0.25% of gross monthly sales, thereby improving businesses' cash flow.

The system allows micro and small enterprises to maintain their accounting records in electronic format, through an MSME portal (*Portal MIPYME*) that forms part of the virtual office of the internal revenue service (*Servicio de Impuestos Internos, SII*) or, alternatively, to keep their own income and expenditure books. The MSME portal offers companies a software that permits them to register commercial transactions, obtain financial statements, and generate tax declarations automatically.

To be able to subscribe to the simplified tax system, companies must use electronic billing through the MSME portal, which helps the company not only in issuing bills, but also in receiving electronic tax documents, and in generating income and expenditure statements. In April 2010, there were 44,356 firms registered with this programme.

"BancoEstado Microempresas"

An essential pillar of Chile's strategy for the formalization of micro and small enterprises consists of improving access to formal financial services for this segment of firms. Access to savings and credit instruments enhances business competitiveness and thereby the ability to comply with formal sector regulations. Similarly, financial services help companies to survive periods of losses without falling back into informality.

¹³ The equivalent of US\$220,000 at 2013.

¹⁴ The equivalent of US\$440,000 at 2013.

In 1995, BancoEstado, Chile's only state-owned commercial bank, created a subsidiary specialized in microbusinesses whose mission is to promote access to financial services for this segment of firms. Today, BancoEstado Microempresas has a portfolio of 90,000 clients, which represents 42% of all microborrowers served by regulated financial institutions, with a total loan portfolio worth CLP580 billion.¹⁵

BancoEstado Microempresas offers credit for both for working capital and production-related investments to formal and informal microenterprises who have been in operation for more than one year. While the formalization of the business is not a requirement prior to obtaining a loan, the bank helps customers to formalize by providing information and training on the procedures involved.

In 2013, BancoEstado MicroEmpresas launched the entrepreneur's account (*Cuenta Emprendedor*), as a new product which helps newly registered micro and small enterprises to manage their finances. Normally, microbusinesses in Chile do not have bank account registered in their name, as they have difficulties in complying with requirements related to the minimum number of years of operation, cash-flow statements, and limitations on outstanding debts.

The entrepreneurs' account allows these businesses to safely and easily manage the business' finances, reducing the risk of loss or theft. To be able to open the account the bank only requires the company's operating license and tax registration papers, together with the documents identifying its legal representatives. This financial product clearly reduces the costs of financial formalization and offers an incentive for businesses to formalize as only registered micro and small enterprises can make use of the service. In the first two months after the launch of the product, more than 700 micro and small companies opened an entrepreneurs' account.

MSE participation in public procurement

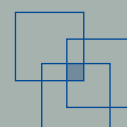
Access to public procurement opportunities, both at the national and local level, forms a powerful incentive to the formalization of micro and small enterprise, since only formally registered firms can sell to government. In 2012, MSE's share in public procurement represented 42% of the total value, far above their participation in overall sales which stood at 8.3% in the same year. The total value of public procurement awarded to micro and small enterprises in 2012 amounted to the equivalent of US\$3.9 billion.

Regulations on public procurement in Chile do not establish quotas or special treatment for smaller firms. They do, however, incorporate certain procedures that facilitate MSE participation. In 2006, Circular No. 23 issued by the Ministry of Finance established a deadline on payments to suppliers of no more than 30 days after reception of the bill. In 2011, modifications to public procurement regulations extended the time frame for presenting bids, allowed bidders to comply with the required bank guarantee presenting several letters of credit and increased the ceiling of public debt permitted. This reduced entry barriers for small businesses.

One fundamental step forward in improving micro and small enterprises' share in public procurement was the creation in 2007 of 16 public procurement business centres and access points throughout the country. ChileCompra, the government agency in charge of government acquisitions also organized two-hour training sessions for companies interested in registering as suppliers. The design and accessibility of the ChileCompra web portal has improved over time, facilitating participation by smaller businesses.

In 2013, ChileCompra created an MSE advisory council (*Consejo Propyme*), mandated to propose ways to promote small business opportunities in government procurement. The Council involves all relevant agencies and representatives of small businesses in jointly preparing a strategy to further consolidate MSE involvement in public procurement.

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¹⁵ Equivalent of 1.1 billion USD in 2013. See also: Red para el Desarrollo de las Microfinanzas en Chile A.G., Informe Estado de las Microfinanzas en Chile. 2011.

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Bankruptcy Law

In 2014, Chilean bankruptcy law, as contained in the national code of commerce (*Libro IV del Código Comercial "De las Quiebras"*), underwent important changes. The amendments pretend to put an end to recurrent problems in insolvency proceedings, which made closing a business down slow and costly, constituting another significant barrier to the formalization of micro and small enterprises. According to figures presented by the Chilean internal revenue service (*Servicio de Impuestos Internos*), the development of some 15,000 enterprises has been blocked due to deficiencies in bankruptcy law and procedures.

The new regulation focuses on saving viable companies, by reorganizing assets and liabilities through agreements between debtors and creditors. It also provides for more appropriate treatment of sole proprietors facing insolvency, as currently they must use the same procedure as legally constituted companies. The new framework allows them to renegotiate with their creditors or, when this is not possible, proceed to a rapid and simplified liquidation procedure.

The new legal framework reduces the maximum period in which liquidating must be completed to 12 months, clarifies workers' entitlements in the event of bankruptcy, and changes the role of the liquidators (*síndicos*). One important objective is to reduce the social stigma associated with insolvency and encourage entrepreneurs to stay in business after bankruptcy.

The new bankruptcy law foresees the creation of special tribunals to handle cases of insolvency. The Office of the Superintendent of Bankruptcy (*Superintendencia de Quiebras*) was moved from the Ministry of Justice to the Ministry of the Economy, Development and Tourism. The creation of a new official bulletin (*Boletín Comercial*) in which proceedings and resolutions are published should reduce notification costs to zero.

The importance of effective legislation covering reorganization and closure of businesses in the event of insolvency cannot be overestimated. The new law should be seen as part of legislation to simplify business creation, aiming to make both the start-up and closure of formal businesses more efficient. Although the final impact of the new bankruptcy law cannot be evaluated as yet, its design suggests it will reduce the risks facing formal companies of falling into lengthy and expensive liquidation processes, thus encouraging businesses formalization.

Subcontracting Law

In 2006, Chile passed a Law on Subcontracting (*Ley N° 20.123, regula el trabajo en régimen de Subcontratación*)¹⁶, which aims to improve compliance with labour regulations and increase social security coverage for workers in subcontracting arrangements. Many subcontractors in the construction, mining and agriculture sectors, among others, are small enterprises. With this law, not just these companies, but also the mother companies have the obligation to ensure that workers' rights in the subcontracting chain are being met.

According to Subcontracting Law, the principal company has the right to be kept informed by its subcontractors about their compliance with social security payments and labour conditions in respect of their workers. This same principle also applies further down the subcontracting chain. In instances where subcontractors do not comply with what is stipulated in the contracts signed by their workers, the principal enterprise can be held responsible. In these instances the mother company is legally permitted to withhold an amount of funds equivalent to what is owed to the workers and/or the different social security schemes, and make the necessary payments.

Evidently, the successful implementation of the Subcontracting Law depends on the effectiveness of the labour inspection and the level of workers' organization at the subcontracted firms. Despite

¹⁶ Law 20.123 "regulates the work in subcontracting schemes, the functioning of temporary services enterprises and the temporary services workers' contracts".

the existence of weaknesses in these two areas, the Law has had a positive impact on small enterprise formalization. Since 2007, a constant increase was registered in the amount of labour rights compliance certificates issued by the labour inspection to subcontracting companies. In 2012, 1,232 such certificates were granted in comparison to 311 in 2007. A study about the law's impact on occupational safety concluded that the Law achieved to reduce labor accidents by 15% between 2007 and 2010¹⁷.

4. Conclusions

The policies presented in this focus note were not designed primarily to combat informality, but rather to achieve other goals, such as improved competitiveness amongst micro and small enterprises or increased fiscal revenue. Many of the initiatives discussed here established formalization as a secondary goal or as an expected positive side effect, addressing it indirectly. Chile's policies to encourage company registration are primarily directed to business start-ups, encouraging new entrepreneurs to operate formally, rather than convincing existing informal businesses to formalize.

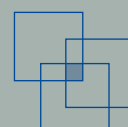
The country has registered satisfactory progress in micro and small enterprises' access to formal credit, which has eased the transition to formality for many firms. BancoEstado Microempresas as well as guarantee funds such as FOGAPE, have played an important role in supporting micro and small enterprises to become more productive and less vulnerable, serving markets that allow them and even require them to operate formally. A second major milestone was the simplification of MSE taxation, which in Chile was introduced together with a virtual office offering electronic accounting software and billing services.

One initiative intended to directly promote formalization was the law governing family-owned microenterprises, which simplified registration procedures for home-based businesses. While the design of this law fits very well the nature of these production units, its implementation would have been more effective would more consistent promotional efforts have been undertaken, both towards entrepreneurs and municipal staff. Surveys among microbusinesses reveal that entrepreneurs are often unfamiliar with the law, while municipal staff tends to demand more paperwork than required by law. Even so, some 10,000 family-owned microenterprises have been registered.

In general terms, most policies that would help micro and small enterprises in Chile to formalize, were concretized through legal instruments. The different laws to streamline procedures for the registration of new firms, to simplify bankruptcy procedures and to facilitate the creation of family-owned microenterprises were promulgated assuming that their effects would be positive without the need for major promotional or training efforts. Programmes that tried to reach out to entrepreneurs on the ground, such as the good labour practices programme and the social security education programme, are relatively small.

Results obtained to date for the economy as a whole suggest that promoting formalization among micro and small enterprises may require more of an effort in terms of information and awareness raising in the field. A significant segment of micro and small businesses continues to operate informally, with little information about registration procedures and their benefits. Similarly, municipal and public service staff tend to be only partly familiar with the procedures, rights and obligations of MSE employers and employees and do not always provide the necessary support.

¹⁷ Mutua de Seguridad de la Cámara Chilena de Construcción, Evaluación del impacto de la Ley de Subcontratación sobre la accidentabilidad y la prevención de riesgos en las empresas. 2011.



NOTES ON POLICIES FOR THE FORMALIZATION OF MICRO AND SMALL ENTERPRISES

SERCOTEC, as the main public agency recognized by small business owners for their important role in MSE development, should play a key role in the formalization of micro and small enterprises. Given its proximity to business owners, it is well positioned to help micro and small enterprises formalize as a first step toward greater access to markets, financial and non-financial business services.

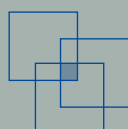
Similarly, the role of labour inspectors in supporting and monitoring micro and small enterprise compliance with labour legislation is very important. Existing programmes substituting fines with training and encouraging good labour practices are important efforts, but have not achieved sufficient scale. Innovative ways to inspect and support micro and small enterprises should be explored, for instance through improved cooperation between municipalities and labour inspection offices.



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