

Executive summary



International  
Labour  
Organization

# WORLD EMPLOYMENT SOCIAL OUTLOOK

**2017 Sustainable enterprises and jobs:  
Formal enterprises and decent work**

### **In the global economy, the environment for firms and job dynamics are constantly evolving...**

The global and regional environment for firms has been constantly evolving since 2008. The impacts of lower economic growth and trade on global supply chains and the resultant concerns regarding job quantity and job quality are high on the agendas of many countries. Other important trends, notably technological changes and innovation, are shaping the world of work in new and different ways and have complicated the post-crisis environment. Against this backdrop, this thematic edition of the *World Employment and Social Outlook 2017* report examines how firms – as the engine of job creation – have been affected by and responded to these developments. In particular, the report analyses the implications of these developments on firm performance and job dynamics and considers how policies to support enterprises and the environment in which they operate could help to create more and better jobs and, in turn, achieve inclusive and sustainable growth.

Over 201 million workers worldwide are currently unemployed, an increase of 3.4 million compared to 2016. The global unemployment rate stands at 5.8 per cent, and is not expected to drop any time soon. Despite some progress made over the past decades, nearly 780 million workers in emerging and developing countries (corresponding to almost every third worker) are still living in conditions of extreme or moderate poverty. More than 1.4 billion workers the world over are in vulnerable employment, many of them in emerging and developing countries. The number of workers in vulnerable employment increases by around 11 million each year. This situation poses significant challenges, as these workers are less likely to have secure jobs with regular incomes and access to social protection. Even today, the world hence faces significant decent work deficits.

Private sector formal enterprises play a crucial role in creating decent jobs. This notion is echoed in the goals laid out in the Agenda for Sustainable Development, which places the promotion of job creation, entrepreneurship and the formalization and growth of micro-, small and medium-sized enterprises at the heart of achieving the goal of “decent work and economic growth” (Goal 8).

In 2016, the private sector employed 2.8 billion individuals worldwide, representing 87 per cent of total employment. This figure covers both the informal and formal sectors, and while enterprises in the former employ substantial numbers of workers, especially in some emerging and developing economies, formal sector firms employ more than half of the world’s wage and salaried workforce in the private sector.

Moreover, while large enterprises are the principal source of employment in the formal private sector relative to small and medium-sized enterprises (SMEs), the contribution of SMEs to total employment has grown over the past years. Novel estimates of employment by firm size suggest that the number of employees within SMEs in the formal sector almost doubled in the 132 countries for which estimates are available, with SMEs’ share of total employment rising from 31 to 35 per cent. But, there is considerable heterogeneity across regions and income groups. For example, in developing economies, SMEs account for 52 per cent of total employment, compared with 34 per cent in emerging economies and 41 per cent in developed economies. SMEs and young firms are also often more dynamic with respect to employment growth.

### **...and since the onset of the crisis many firms, notably SMEs, have struggled and remain underdeveloped in emerging and developing economies...**

Before the global and financial crisis of 2009, the average employment growth for SMEs – focusing on full-time permanent employment only – was substantially higher than that for large firms, at 4.7 and 3.3 percentage points, respectively. However, full-time permanent employment growth in SMEs has stagnated in recent years. Similarly, job dynamics among young firms in terms of full-time permanent employment have weakened since the crisis. During the pre-crisis period, the employment growth rate among young firms was on average 6.9 percentage points higher than for established firms, but the difference declined to 5.5 percentage points in the post-crisis period. This change reflects developments in the overall business environment, whereby employment creation in large firms has remained weak, while new and younger firms have been shedding jobs at a much faster pace than before.

Firm-level employment dynamics also differ according to level of development. In fact, the capacity of SMEs to generate job growth, relative to large firms, increases with income per capita. In developing economies, the rate of job creation among SMEs is similar to that for large firms, but in emerging and developed economies, employment growth is higher among SMEs than large firms (although the premium relative to large firms is considerably lower in emerging economies than that in developed economies). This may reflect the fact that many SMEs in developing economies, and to a lesser extent in emerging economies, are entrepreneurs out of necessity, whose primary focus is to survive and not necessarily to expand.

### **...but, in addition, underlying these recent changes in firm-level employment are a number of structural issues that are constraining enterprise growth.**

The environment within which firms operate – beyond recent cyclical developments – has an important effect on firm growth. The report shows that a range of country-specific factors, such as labour market institutions, historical patterns of organization, access to trade and global supply chains, market size and financing availability, affect firm growth and, in some instances, explain the persistence of informality – which can have widespread, negative consequences for businesses, workers and society.

A large number of firms, and by default workers, remain in the informal economy, and so the analysis presented in the report considers the wide-ranging effects of informality. These include, for example, a firm's ability to grow and create wealth and jobs which, in turn, affects the ability of workers to access social protection.

At the same time, in today's ever-changing business environment, individual firms must make decisions on how to respond to fluctuations in demand. Decisions regarding hiring practices, training and efforts to innovate can have profound – in some cases counterproductive – implications for firm performance and labour market outcomes.

### **First, trade can help firms grow and create jobs, with significant distributional consequences for both firms and workers...**

International trade stimulates employment growth by providing firms with opportunities to enhance their competitiveness, to export to foreign markets and to make use of the best available production inputs through importing. However, for economic, social and political reasons, global trade has entered a period of stagnation, with important implications for employment growth. In 2016, an estimated 37 per cent of workers (equivalent to 167 million workers) were employed by exporting firms in the 132 countries analysed, which is less than before the economic and financial crisis. As trade has stagnated, so too has trade-related employment.

However, the impacts of trade in terms of productivity and quantity and quality of jobs vary considerably between firms, indicating that the gains from trade are not necessarily shared in an inclusive manner. The report finds that exporting and importing firms are more productive than firms that do not engage in trade, and that they pay higher wages than their non-trading counterparts. However, the productivity premiums for exporting and importing outweigh the wage premium by 13 and 5 percentage points, respectively. Similarly, for firms there are significant disparities. For instance, exporting firms that

supply inputs into global supply chains (GSCs) have higher productivity levels than other exporters. However, here too the wage premium is smaller than the productivity premium. Interestingly, being both an exporting firm and participating in a GSC as a firm that assembles final goods is associated with having a larger share of temporary employment. These findings confirm the importance of addressing distributional dimensions in making trade and GSCs work for all.

Moreover, the expansion of GSCs into countries lacking the institutional capacity to regulate and effectively enforce labour standards poses challenges to workplace compliance. In response, many multinational enterprises, which are key players in the coordination of GSCs, have undertaken voluntary initiatives to improve the monitoring of compliance with labour standards in their supply chains. While this is an important positive step, the analysis in the report shows that commitment by firms to the implementation of freedom of association remains a challenge.

### **...second, the business environment, in particular access to finance and labour market regulations, affects firms' human resources and financial strategies...**

While firms need labour flexibility for production efficiency and for responding to changing market demands, there are various ways of securing such flexibility, with different outcomes for firms and workers. The report finds that by opting for internal functional flexibility (e.g. worker training), firms can maintain their overall competitiveness without sacrificing job quality. Flexibility can also be achieved through external numeric flexibility (e.g. by relying heavily on temporary workers), but gain tends to be short term in nature and associated with overall long-term negative implications for firms and workers. Indeed, in some cases it may lead to long-term negative productivity growth, which may trap enterprises within a vicious cycle of low wages and low productivity. The analysis indicates that labour regulations, if properly designed and implemented, can play a role in encouraging enterprises to pursue internal flexibility. In particular, ensuring that fixed-term employees have equal treatment to permanent employees may induce enterprises to make less use of temporary employment and to provide more training for workers, particularly permanent employees, yielding better outcomes for both workers and firms.

Securing sufficient funds for working capital and investments through formal external financing has strong positive implications, not only for the wages of workers but also for competitiveness, in terms of higher labour productivity and lower unit labour costs. Yet, access to finance consistently emerges as one of the major constraints facing enterprises, especially in developing economies. Part of the challenge lies in the fact that many firms do not apply for bank loans because of the high costs involved. The report finds that SMEs and young firms make greater use of bank loans for working capital when there are fewer financial market imperfections. This suggests that improving the institutional environment, through greater accountability, transparency in information and respect for the rule of law, has an important role to play in allowing financially constrained firms to gain access to external formal funds for their working capital, which may in turn allow them to invest, expand and hire more workers.

Importantly, greater efforts are needed to encourage the formalization of firms, such as measures to strengthen institutions and the rule of law. The ILO's Transition from the Informal to the Formal Economy Recommendation, 2015 (No. 204), provides guidance on facilitating the transition of workers and enterprises from the informal economy to the formal economy.

### **...and third, innovation is a major driver of enterprise transformation.**

Innovation is another important source of competitiveness for enterprises, as well as a key driver of sustained growth and development. Yet there have been mixed views about whether innovation creates or destroys jobs and how workers are impacted in terms of job quality – a debate which has only intensified lately as new technologies risk to disrupt means of production. In fact, in recent years, considerable job contraction in non-innovative low-technology firms has also been observed, highlighting the high risk of job loss among low-skilled workers in the manufacturing sector. Moreover, the pace and spread of recent technological changes that could affect high- and low-skilled sectors have amplified these concerns.

Regarding sources of innovation, the report underlines that while R&D engagement is a significant determinant of successful innovation, other sources also play important roles, including public funding, external acquisition of technologies and on-the-job training. Overall, innovation leads to better labour

market outcomes: innovative firms tend to be more productive, create more jobs, employ more skilled workers – meaning that they employ more educated workers and offer more training – and hire more female workers. Yet, in some cases innovation has led to more intense use of temporary workers, and different types of innovation (product, process, marketing and organizational) can lead to differential effects. For example, firms that implement product and process innovations are more likely to hire workers on temporary contracts, while firms that adopt marketing and organizational innovations tend to employ more female workers.

Thus, adequate education, training and social protection policies are necessary both to foster innovation and to prepare workers (and firms) effectively for the changing job environment. This means that social partners and other stakeholders will be required to participate in reflections on the types of jobs and skills that will be relevant in the future. Additionally, these findings reinforce the importance of ensuring equal treatment for all workers in terms of social protection. Moreover, the importance of public funding and publicly funded research to innovation in firms highlights the role that public institutions can play in promoting innovation.

### **Looking forward, sustainable enterprises are at the centre of inclusive growth.**

A comprehensive approach that addresses the systemic barriers characteristic of the prevailing business environment can assist firms to organize themselves in a win–win manner, i.e. one conducive to improving conditions for both firms and workers. Such an approach would lead to the growth of sustainable enterprises, and hence inclusive growth and decent work outcomes.