



## Governing Body

320th Session, Geneva, 13–27 March 2014

GB.320/POL/2

Policy Development Section

POL

Date: 12 February 2014

Original: English

### SECOND ITEM ON THE AGENDA

## Area of critical importance on productivity and working conditions in small and medium-sized enterprises

#### Purpose of the document

The document provides an overview of the rationale, focus and strategic orientation for this area of critical importance (ACI). It seeks guidance from the Governing Body regarding focus and strategic orientation (see draft decision in paragraph 37).

**Relevant strategic objective:** All.

**Policy implications:** The guidance of the Governing Body will inform the implementation of the Office's strategy concerning the ACI on productivity and working conditions in small and medium-sized enterprises (SMEs).

**Legal implications:** None.

**Financial implications:** Work under the ACI will be carried out within the existing budgetary allocations, relying heavily on extra-budgetary resources.

**Follow-up action required:** Integration of the guidance provided by the Governing Body into the strategy and workplan.

**Author unit:** Enterprises Department (ENTERPRISES).

**Related documents:** Strategic Policy Framework 2010–15; Programme and Budget for 2014–15; International Labour Conference conclusions concerning the promotion of sustainable enterprises (June 2007), Job Creation in Small and Medium-Sized Enterprises Recommendation, 1998 (No. 189).



## I. Vision, rationale and focus of the area of critical importance (ACI)

1. The ILO Programme and Budget for 2014–15<sup>1</sup> has identified eight Areas of Critical Importance (ACIs) in relation to the world of work for priority action. This includes ACI 4 on productivity and working conditions in SMEs.

### The rationale

2. The needs of constituents and the key policy challenges they face have been the basis for the selection of the eight ACIs. The state of productivity and working conditions in SMEs and the relationship between them is high on the agenda of ILO constituents. As Paul Krugman famously put it: “Productivity isn’t everything, but in the long run it is almost everything. A country’s ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker”.<sup>2</sup>
3. SMEs provide between 60 and 80 per cent of formal employment in most economies. If informal employment is included, this share is even higher in developing countries. SMEs, particularly young and small firms, also create nearly all new employment, even after allowing for enterprise mortality. However, SMEs also face the greatest challenges in attaining high levels of productivity and in adopting sustainable and responsible workplace practices.
4. The quality of jobs in SMEs, particularly in developing countries, is often poor in terms of physical working conditions, such as workplace facilities and occupational safety and health, and in terms of compensation, social protection, education levels, opportunities for skills development and social dialogue. In addition, SMEs typically have significantly lower levels of productivity, even after allowing for the higher capital endowment in larger enterprises. They also face difficulties in accessing demanding global value chains. Underperforming SMEs also cause the bigger spread around the mean of productivity for a given sector in many developing countries, which reduces economy-wide productivity.<sup>3</sup> This means that SME workers are disadvantaged, that SMEs are missing opportunities to compete domestically and globally, and that a potentially substantive contribution to economic and social development is being lost.
5. The scale of the job quality problem is at least as big as that of job numbers. A ten-year programme to eradicate working poverty would have to upgrade at least 80 million jobs per year, compared to the 60 million decent jobs that are needed to absorb new entrants into the labour market and current levels of unemployment.
6. The coexistence of poor working conditions and poor productivity in SMEs is not a mere coincidence. The ILO has long argued that the two are interdependent. Research and field

<sup>1</sup> ILO: *Programme and Budget proposals for 2014–15*, Governing Body, 317th Session, Geneva, Mar. 2013, GB.317/PFA/1.

<sup>2</sup> P. Krugman: *The Age of Diminished Expectations: US economic policy in the 1990s* (Washington, DC, The Washington Post Company, 1994).

<sup>3</sup> World Bank: *World Development Report 2013*, Washington, DC, 2012; Inter-American Development Bank: *The Age of Productivity: Transforming economies from the bottom up*, Washington, DC 2010; ILO: *World Employment Report 2004–05: Employment, productivity and poverty reduction*, Geneva, 2005.

experience<sup>4</sup> show that a virtuous circle can be created at the enterprise level whereby investments in improved working conditions lead to higher productivity, which, in turn, generates greater wealth that can be shared. This has the potential to boost economic growth significantly, to promote more sustainable production patterns and to improve conditions for a large segment of the global workforce.

7. Research commissioned by the ILO suggests that a 1 per cent increase in productivity in SMEs translates into a 0.6 to 0.7 per cent increase in GDP.<sup>5</sup> Medium-sized firms (50<250 workers) are particularly important, as productivity growth therein has high multiplier effects. The weakness of this segment is sometimes referred to as the “missing middle” and is considered a major factor behind the low productivity in some developing countries. Small enterprises (10<50 workers) are important because of the underutilized potential in a large number of such enterprises and their high share of employment, but are difficult to reach in a cost-effective manner.
8. Regarding the income distribution effects of faster growth, earlier ILO research has shown that SMEs have lower productivity and pay lower wages than larger enterprises. However, they do pay a higher proportion of their value added in the form of wages. Together with the geographic spread of SMEs, this means that the extra value added would, a priori, contribute to greater income equality. A second important variable is the sharing of the additional gain between employers and workers. The aim of this ACI is to foster an adequate understanding of these interrelationships so that they can be harnessed for effective policies and interventions at the enterprise level.

## Focus

9. The ILO has developed and successfully adopted approaches that generate synergies between improved working conditions and productivity. The Sustaining Competitive and Responsible Enterprises (SCORE) project, the System for Integrated Measurement and Improvement of Productivity (SIMAPRO) and Work Improvements in Small Enterprises (WISE), as well as Better Work for large enterprises, have demonstrated how substantial gains can be achieved at the enterprise level.
10. These approaches target the main driver of aggregate productivity increase in most national economies: firms becoming better at what they do. Continuous improvement within enterprises has been the hallmark of industrial development. Innovation in products and processes in firms is empirically associated with productivity and employment growth.
11. There is evidence that interventions at the firm level aimed at improving productivity by focusing on work organization, working conditions and workplace cooperation can be effective and have favourable cost–benefit ratios for firms of all sizes. Since SMEs almost by definition have lower capital endowments, the ILO approach, which focuses on the better use of existing resources rather than on capital investment in technology, has a higher chance of uptake. It also enhances the firms’ ability to make efficient use of new technology and to invest, thanks to higher productivity.

<sup>4</sup> R. Croucher et al: *Can better working conditions improve the performance of SMEs?: An international literature review* (Geneva, ILO, 2013); D. Brown, R. Dehejia, R. Robertson: *Is there an efficiency case for international labour standards?* (Geneva, ILO, Better Work Discussion Paper Series: No. 12, 2013); ILO: SCORE (Sustaining Competitive and Responsible Enterprises) Phase I Final Report 2013, Small Enterprise Unit, Enterprises Department (Geneva, 2013).

<sup>5</sup> A. van Stel, N. de Vries and J. de Kok: *Macroeconomic effects of SME productivity increases* (Geneva, ILO, forthcoming).

12. Based on these considerations, this ACI focuses on:

- small and, in particular, medium-sized enterprises;
- the synergies between improvements in working conditions and higher productivity and the key role of workplace cooperation and sound industrial relations for reaping these benefits;
- cost-effective and sustainable delivery models for training and follow-up at the firm level;
- enabling constituents to advocate successfully for conducive policies; to stimulate investment in enhanced productivity and working conditions; and to provide relevant services to their members.

## Vision and objectives

13. Responsible and sustainable workplace practices are introduced in SMEs in key sectors on a significant scale and drive national sustainable development: economic (productivity), social (working conditions, dialogue, gain sharing) and environmental (greening enterprises).

14. The goal of the ACI is to demonstrate that productivity in SMEs can be boosted substantially by investing in workers and working conditions, and to demonstrate how this can be done on a significant scale, thereby accelerating economic growth and making it more sustainable. It aims to introduce this approach in the growing number of countries adopting policies and creating institutions for private sector development.

15. This translates into three main objectives, namely:

- ILO constituents adopt approaches to improving productivity and working conditions in SMEs that have been developed and tested under the ACI and proven to be effective and capable of achieving impact and scale, in addition to being sustainable.
- Constituents and ILO staff make use of a robust knowledge base on cause–effect chains, attainable levels of improvement, cost–benefit ratios at the firm and national levels, and policies and enterprise practices that deliver improvements at scale, built on research and institutional learning under the ACI.
- ILO constituents and partners have acquired the capacity to promote the approach above in policy-making and to implement it in practice.

16. The results to be achieved under this ACI will effectively combine work under several outcomes in the current Strategic Policy Framework, in particular those on enterprise development, skills, social protection, working conditions, occupational safety and health, and workers' and employers' activities.

## Linkages to and coherence within main ILO policy frameworks

17. The ACI articulates relevant aspects of all four of the objectives of the Decent Work Agenda: productive and decent employment, fundamental principles and rights at work, social protection and social dialogue. International labour standards on the aspects

included in the ACI have informed the approach and will also inform the selection and definition of indicators for monitoring and evaluation.

18. The synergies to be generated by the ACI between productivity, working conditions and social dialogue will reinforce the notion that these dimensions are interrelated, inseparable and mutually supportive. It aims to achieve results that are more than the sum of these parts.
19. The ACI strongly reflects the ILC 2007 conclusions concerning the promotion of sustainable enterprises, as well as the Job Creation in Small and Medium-Sized Enterprises Recommendation, 1998 (No. 189). The notion of responsible and sustainable workplace practices set out in the conclusions is central to the ACI. However, the ACI also considers the relation of those practices to enterprise growth and the wider enabling environment. In addition to the fundamental principles and rights at work, the standards listed in the appendix to the 2007 conclusions are of particular relevance. Exploratory work has included an analysis of the potential for and the cost of maternity protection in SMEs.

## **II. Strategic interventions, main deliverables and links to other ACIs**

### **Office approach and relevant expertise**

20. An extensive stocktaking of existing knowledge, an identification of gaps and initial research to fill these gaps were carried out under a global product in 2012–13. Even this short-term joint initiative involving four departments (former TRAVAIL, EMP/SKILLS, SAFEWORK and ENTERPRISE) demonstrated the potential value of the ACI approach to the Organization in terms of improved knowledge sharing, the cross-fertilization of ideas and the development of a more empirical, self-critical and holistic ILO approach to important challenges.
21. The results show that there is considerable practical and some scientific evidence for the synergies between productivity and some dimensions of working conditions, in particular occupational safety and health. However, most of the scientific evidence is based on studies conducted in Organisation for Economic Co-operation and Development (OECD) countries, which raises the question of its transferability to developing countries.
22. New econometric research conducted by the ILO using micro-panel data yielded interesting preliminary results on the positive causality between better working conditions and the performance of firms. According to results from Viet Nam,<sup>6</sup> the extension of social security coverage by 10 per cent could increase profitability by 1.1 to 2.4 percentage points in the long term. However, over an initial adjustment period of one or two years, the introduction of such schemes increases costs and reduces profits for SMEs, which often struggle to survive. The timing of government regulatory and support policies may be as important as their substance.
23. Important know-how to be generated to inform effective policies and intervention models relates to scope of impact:

<sup>6</sup> N. Torm and S. Lee: *Does better protection improve enterprise performance? Social security and firm performance in the case of Vietnamese SMEs* (Geneva, ILO, forthcoming).

- What are the best ways to promote social dialogue and sound industrial relations in an SME context where dialogue is often non-existent and organization levels of workers and employers are low?
- How can the ILO link interventions at the enterprise level with access to social protection and broader skills development policies?
- How can productivity gains be achieved through improvements in environmental performance?  
And to scale of impact:
- How to improve tools, interventions and policies so as to maximize the scale of impact, particularly for small enterprises, to reflect gender dimensions and to ensure they are demand-led.
- Ways to embed the ILO approach in national policies and institutions.
- The cost–benefit relationship of changes in working conditions and productivity at the firm and the national levels.
- The linkages between the enabling environment, productivity and working conditions at the firm and national levels.
- The role of labour re-allocation as a result of structural change versus productivity gains in existing enterprises.

## Strategic interventions

24. Strategic interventions take place at both the firm level and the institutional and policy level, at which private sector development is governed, focusing on the role of ILO constituents at both levels.
25. Four main deliverables aim to achieve impact at scale:
  - Macroeconomic and policy assessments are carried out to establish the linkages between interventions at the enterprise level and outcomes on the one hand, and policies and broader economic outcomes on the other.
  - Specific capacity-building strategies and materials for constituents and other partners, emulating the success of the Enabling Environment for Sustainable Enterprises Toolkit, which employers' organizations are using successfully for evidence-based policy dialogue. These will enable the social partners to gather evidence, contribute to policy-making and offer relevant services to their members. Exploratory work in this area has already been undertaken with workers in Ghana and with employers in Botswana.
  - New training packages for small enterprises, in addition to existing ones for medium-sized firms, using new IT-based delivery tools and channels (such as financial institutions and NGOs).
  - New tailored packages for sectors, which are the key to development and job creation in many countries, on building and construction, infrastructure and hotels and tourism.

26. Four main deliverables relating to scope include assessment and implementation tools for: (1) the extension of social protection to workers in SMEs; (2) vocational skills development; (3) the greening of SMEs; and (4) industrial relations models for SMEs and possible trajectories beyond basic workplace dialogue and cooperation.
27. Managing relevant knowledge and making it accessible is a key function of the ACI. This includes monitoring and evaluation methods, as well as high-quality impact assessment through randomized control trials, the creation of a dedicated knowledge platform and the creation of a functioning community of practice.

### **Links to other ACIs**

28. There are strong linkages between the eight ACIs. This offers opportunities for complementarities but also poses the potential risk of overlap. Both are being addressed by the Policy Portfolio and the ACI leaders.
29. In the case of this ACI, the link between the supply and demand sides of the economy, as well as the link between micro (at the enterprise level) and macro (economy-wide) perspectives, provide a major opportunity for complementarity and joint learning.
30. Specific links identified and incorporated into concept notes and workplans so far relate to:
  - ACI on promoting more and better jobs for inclusive growth: research on the economy-wide effect of productivity increases in SMEs on growth, income and poverty reduction; research on the link between the enabling environment for enterprise development, productivity and working conditions; the integration of the enabling environment and the measures which generate synergies between productivity and working conditions into employment policy.
  - ACI on creating and extending social protection floors: effects of social protection on workers and employers, particularly in small enterprises, as well as on productivity and ways to provide access to social protection.
  - ACI on the formalization of the informal economy: research on the economics of formalization, incentives and barriers, and integrated approaches to the formalization of micro- and small businesses.
31. In addition, the results of the ACI on productivity and working conditions in SMEs will be useful for future work on decent work in the rural economy, in particular for informing the sectoral approaches thereto, and for strengthening workplace compliance through labour inspection, in particular for gaining a better understanding of non-compliance patterns and reaching out effectively to SMEs.

### **III. Implementation strategy**

32. The ACI will focus its efforts on a limited number of countries where the issues are priorities for constituents, as reflected in the Decent Work Country Programmes, country outcomes and the current engagement of constituents in ongoing projects. For example, scoping studies and consultations have been carried out in South Africa at the request of the Motor Industry Bargaining Council to explore how the SCORE methodology has been applied in this key sector, in collaboration with the United Nations Industrial Development Organization (UNIDO).



33. This focus also helps to achieve critical mass in human and financial resources, as the ACI builds upon and leverages existing technical cooperation concerning workplace practices. The ACI also pools and leverages contributions from the Regular Budget and from national partners. The research, development, testing and capacity-building efforts targeting scale and scope are funded by existing resources.
34. Like all ACIs, this is an interdisciplinary effort made possible through team work. An Office-wide task team has been guiding the preparation of the concept note and the workplan for the ACI. ILO staff from the field offices and projects, as well as from headquarters, including from the Bureau for Workers' Activities (ACTRAV) and the Bureau for Employers' Activities (ACT/EMP), and the International Training Centre of the ILO in Turin have contributed to the design of the concept note and the workplan and will take responsibility for their implementation. In support of this Office-wide effort, the Director-General convened and chaired a town hall meeting in December 2013 to introduce the concept of this ACI and to collect inputs from ILO colleagues from around the world.
35. To ensure "delivery as one", all activities, deliverables and resources are part of a shared, logical framework for the ACI. The workplan assigns responsibility and deadlines for delivery to units, offices and projects, primarily in the field. Resources are put at the disposal of implementing units, mostly in the field. The task team monitors implementation and delivery against the workplan.

## Conclusions

36. This ACI provides a major opportunity to enhance the ability of the Office to support its constituents in addressing the very substantial and interrelated challenges of poor job quality and low levels of productivity. It focuses on the enterprises that provide and create most employment but which, at present, seldom make their potential contribution to national development and well-being. The ACI builds upon existing know-how and capacity in the Office, but addresses the dimensions of scope and scale, which have limited the ability of existing approaches to overcome some of the key problems faced by workers and employers in SMEs, and the ability of constituents to achieve impact at scale. It is expected to lay a much stronger and comprehensive foundation for policies by filling knowledge gaps, producing conclusive evidence and making practical tools available.

### ***Draft decision***

- 37. The Governing Body requests the Director-General to take account of its guidance in implementing the strategy for the ACI on productivity and working conditions in SMEs.***