

Productivity, decent employment and poverty:

Conceptual and practical issues related to small enterprises

by Paul Vandenberg

InFocus Programme on Boosting Employment
through **S**mall **E**nterpris**E** Development
Job Creation and Enterprise Department



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Foreword

The ILO's Small Enterprise Development programme, SEED, has the longer title of "Boosting employment through small enterprises". Therefore, the ILO's activities in the field of small enterprise development are driven largely by the impact that small enterprises can have on both the quantity and quality of jobs. The SEED programme, through many of its working papers, has given considerable attention to examining aspects of small enterprise development, employment creation and poverty reduction.

This paper explores the issue of productivity in micro, small and medium-size enterprises (SMEs) and its relation to employment and poverty. It notes that labour productivity is consistently lower in smaller firms but that they are not forced from the market by competition because they do not compete directly with large firms. Instead, they focus on services and niche activities where economies of scale are less important. The paper also notes that 'labour productivity' can be a distorted measure of productivity because smaller enterprises are more labour-intensive. Their owners have less access to capital for equipment purchases. Therefore the output-to-labour ratio – the definition of labour productivity – is likely to be lower.

Nonetheless, it is true that lower productivity in SMEs often results in lower income for entrepreneurs and workers and thus contributes to poverty. A key approach to poverty reduction, therefore, involves increasing the productivity of small enterprises. The final chapter explores how productivity can be raised. It provides case studies from SEED's job quality activities in Ghana, India, Trinidad & Tobago, Uganda and Viet Nam.

The SEED Programme has contributed to the ILO's World Employment Report for 2004, and has produced this paper to provide more detailed comment on aspects of small enterprise development and its contribution to more and better jobs. The ILO has adopted the Global Employment Agenda as a means of promoting decent work in employment policies and programmes. It is important that employment and enterprise policies give due consideration to improving the productivity of SMEs to enable them to play a greater role in enhancing incomes and reducing poverty. National productivity centres, business development services providers and various training institutions should develop programmes to improve productivity in SMEs, and special emphasis should be given to ensure that women entrepreneurs and workers alike profit from these approaches.

SEED would like to acknowledge the efforts that have gone into preparing this paper, particularly of the author, Paul Vandenberg, and of those colleagues in SEED who provided ideas and comments on various drafts. It is hoped that the paper can contribute to further debate on this subject, both within the ILO itself as well as in the wider development and academic communities.

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Abstract

This paper explores the relationship between labour productivity, employment and poverty. It is organized around a question, a concern and a challenge. The *question* is: if small enterprises are less productive than large enterprises (which they are), why are they not driven from the market through competition, so that the cohort of small enterprises declines over time (which it does not)? The probable answer is that small enterprises do not compete directly with large enterprises.

The *concern* is that low labour productivity may result in very low wages and returns to owners. This means that people may be working but still are not able to move out of poverty. The evidence suggests that many of the smallest enterprises provide a meagre income but that others are more successful and generate decent returns, despite low labour productivity.

The *challenge* is to find ways in which productivity can be increased through low-cost methods that involve improvements in job quality. This last section draws on the work of SEED's job quality team and illustrates that work with 11 case studies. The cases suggest that job quality (including cooperative work practices) can increase productivity. For the smallest firms, however, a lack of demand, resulting in underemployment, is often more important than the organization of the (very small) work team. In this situation, an increase in market access is critical to raising productivity because it allows for the fuller utilization of human and capital resources.

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Acronyms and abbreviations

IYB	Improve Your Business
JQ	Job quality
KLEMS	Capital (K), labour, energy, materials and services
MCC	Management and Corporate Citizenship programme
MSEs	Micro and small enterprises
SMEs	Small and medium enterprises
TFP	Total factor productivity
WISE	Work Improvement in Small Enterprise

Introduction

The research on productivity and employment in small enterprises reveals three interesting characteristics. The first is that productivity tends to rise with enterprise size; that is, small enterprises are less productive than large ones. The second characteristic is that small enterprises¹ constitute an overwhelming proportion of all private sector establishments and normally employ 45 to 65 per cent of the workforce. They are an important source of employment in both developing and developed countries. Thirdly, wages are lower and workers' rights and conditions are less adequate (i.e. job quality is lower) in such enterprises. Taken together, these characteristics indicate that a significant portion of the labour force in many countries is employed in small, low-productivity establishments, where workers earn lower wages and have fewer rights than workers in larger enterprises.

This depiction of small enterprises throws up several important issues, which we can organize around a question, a concern and a challenge. The *question* is: why are inefficient enterprises not forced out of the market by large, more productive firms? This should happen according to the natural process of economic competition. The survival of these firms raises an important *concern*: that poor wages and working conditions, linked to lower productivity, may not be adequate to support a decent living. In many poor countries, but also in developed countries, people may be working but still be unable to move out of poverty. This concern raises an important challenge for those interested in reducing poverty through decent work. The *challenge* is to find ways to link productivity improvements with decent work in a virtuous cycle. In this cycle, enhanced productivity would lead to better wages, benefits and working conditions, while better working conditions, achieved through effective labour-management cooperation, social institutions and a broader process of social dialogue, would support higher productivity.

The present paper is organized around these three issues. The question is dealt with in the first section. The most probable answer is that small and large firms continue to exist side-by-side because they often do not compete directly. Very small firms, notably those in the informal economy, however, tend to be forced from the market through competition and through the offer of better employment elsewhere as the economy develops. The concern is analysed in the second section, where our review of the evidence regarding wages and working conditions reveals that job quality is lower in small enterprises. In many cases, people are earning below the minimum wage. We find a diversity of experience among enterprise owners, however: some are poor while others earn more than they would as formal sector employees. The challenge is considered in section three. Here we suggest how productivity and improvements in wages/working conditions can be encouraged together and may be supported by training and effective social institutions. The main focus is on SEED's job quality activities with examples from case studies.

The bias of 'labour productivity' in comparing small and large enterprises

Much of the research on productivity is based on a single indicator: labour productivity. This measure is relatively easy to calculate and is practical in the sense that it allows for comparison across time and between countries. It is not the best measure,

¹ Unless indicated otherwise, the term 'small' in this paper groups enterprises normally classified as micro, small and medium. The actual size of such enterprises varies according to country definitions.

however, and while its deficiencies may not pose grave concerns in general cross-country comparisons, they do pose a particular problem in comparing large and small enterprises.

Productivity is the relationship between output and inputs. It rises when an increase in output occurs with a less than proportionate increase in inputs, or when the same output is produced with fewer inputs. In either case, the ratio between the value of output (quantity and quality) and the value of inputs has increased. When data are available for all inputs, then ‘total factor productivity’ or TFP can be calculated. Due to its inclusiveness, this is the most complete measure. It is often difficult to record all inputs across a sector or an economy, however. Instead, the main inputs can be used to calculate ‘multi-factor productivity’. The KLEMS measure, which includes capital, (K), labour, energy, materials and services, is one of the broader multi-factor measures (Schreyer and Pilat, 2001).

Labour productivity, the most common indicator, is a single-factor measure. It results from a calculation of value added (output less intermediate or ‘component’ inputs), divided by the amount of labour used.² It is also called ‘value added per worker’. Despite its name, labour productivity increases when value added rises through the better utilization, coordination, etc. of *all* factors of production. Value added may increase when labour is working smarter, harder, faster or with better skills, but it also increases with the use of more or better machinery, a reduction in the waste of input materials or the introduction of technical innovations. Indeed, anything that raises value added will raise labour productivity. The term is therefore correct in that any change that increases value added makes workers more productive, but it is slightly misleading in that it denotes productivity in general, not specifically relating to workers.

Why is this understanding of labour productivity important and how does it relate to other issues such as poverty? A productivity increase allows for greater returns on the factors of production. If the increase in labour productivity arises from better trained, better treated or more efficient workers, it can support higher wages. But if the increase in labour productivity arises from the use of additional machinery, then the gains will need to pay, at least in part, for this machinery. This means that enterprises with high capital investment are obliged to have higher labour productivity because they need to pay for the additional capital. Statistics that compare the labour productivity of large firms with that of small firms (which normally exhibit lower capital investment) contain a systematic bias.

There is another bias in the empirical research. Much of the work focuses on data gathered from industrial censuses or surveys of manufacturing firms. Manufacturing is much more affected by economies of scale than service activities. A large proportion of small enterprises are engaged in services, notably trading but also catering, repair work and personal services. The extent to which these two biases affect the data is not known and requires further research. Despite the limitation of ‘labour productivity’ as a measure, it is used in this paper because much of the evidence reviewed is based on it.

1. Why are small enterprises not driven from the market?

This section reviews the evidence concerning the productivity gap between small and large enterprises. It considers the existence of a gap in a static sense (a snapshot) and contrasts this with the important role that small enterprises play in providing employment. The issue of whether employment shifts from small to large enterprises over time is also

² Or more correctly, the number of hours worked.

considered. The question in the title is answered with the suggestion that small enterprises survive by avoiding direct competition with large firms.

1.1 Cross-regional evidence of a size-productivity gap

A positive correlation between enterprise size and labour productivity is evident across the main regions of the developing world. That is, large firms are more productive. Table 1 indicates that the productivity of formal SMEs³ in ten Latin American countries ranges from one-quarter to three-quarters of that for large enterprises. Over time, the gap has decreased in half the countries surveyed but increased in the other half, suggesting no long-term regional trend. Data for seven sub-Saharan African countries show similar results, with productivity rising through five firm-size categories (see Annex, Table A1). There are anomalies, though, with lower productivity in the largest size category relative to the second largest for Kenya, Cameroon and Côte d'Ivoire. This is probably due to a large number of state firms in this category. Figures for four Asian countries, including Japan, again show a very consistent pattern of labour productivity rising through ever-larger size categories (Table A2).

1.2 Employment role of small enterprises

Despite the labour productivity gap between small and large enterprises, it is also apparent that small enterprises constitute an important part of the economies of developing (and developed) countries in terms of employment and, to a lesser extent, output (Table A3).^{*} Formal SMEs account for 17 per cent of total employment in low-income countries, rising to 57 per cent for high-income countries (Ayyagari et al., 2003, p.10). The shift is mostly accounted for by the decline in informal and agricultural employment that occurs as countries develop. Even in the manufacturing sector, where economies of scale would tend to favour large firms, SMEs provide an important source of employment in both high- and low-income countries. In Latin America, they account on average for 46 per cent of formal manufacturing employment and 32 per cent of output (Table 1). In countries as diverse as Ghana and Japan, 53 per cent of manufacturing workers are employed by enterprises with less than 100 workers (Mazumdar and Mazaheri, 2001, p. 35; Mazumdar, 1998, p. 47).

In addition, a significant portion of the labour force in low-income countries works for or owns/manages micro enterprises in the informal sector. This sector accounts for 29 per cent of total employment in the low-income countries and 15 per cent in high-income countries (Ayyagari et al., 2003, p. 10; see also Table A4).^{*}

Combining the productivity and employment figures, we find that many workers in the developing (and developed) world are employed by enterprises with relatively low labour productivity. This prompts the question: how do small enterprises survive?

³ Formal small and medium enterprises (SMEs), not including micro firms.

^{*} Sources often vary considerably according to the definitions used, notably regarding the inclusion of the formal economy and whether employment is considered as a proportion of total employment or only non-agricultural employment. See, for example, the figures provided in Tables A3 and A4.

Table 1: Relative productivity: SMEs and large enterprises in Latin America (for sector manufacturing)

	Base year	Final year	SME productivity as % of large enterprises	
			Base year	Final year
Argentina	1984	1993	44	57
Brazil	1985	1997	61	77
Chile	1990	1996	41	38
Columbia	1991	1996	48	45
Costa Rica	1990	1996	63	73
Ecuador	1991	1996	44	40
Mexico	1988	1993	48	56
Peru	1992	1994	33	25
Uruguay	1988	1995	53	48
Venezuela	1990	1995	22	25

Source: Peres and Stumpo, 2000, Table 9.

1.3 Shifting patterns of employment

It is possible that small enterprises represent a temporary phenomenon. Over time and as countries develop, small firms may be forced from the market by large firms. Data on employment share do not generally support such a possibility, although it is true that the informal economy tends to shrink as countries develop.

Regarding the formal sector, a study by Weeks (2002) of nine developed and developing countries shows a diversity of experience regarding SMEs over time. Over periods ranging from 20 to 45 years, small enterprises in five countries captured a greater share of total formal manufacturing employment (Table 2). In the four other countries, however, their share declined. Similar results are evident for ten Latin American countries in the 1980s and 1990s (Table A5). With periods ranging from two to 15 years, total employment in the formal SME sector grew in four countries, fell in five and was relatively stable in the remaining country (Peres and Stumpo, 2000, Table 9). In Japan, the share of manufacturing employment has dropped only marginally during the long period of post-war industrialization. Between 1955 and 1994, that share declined only 2.5 per cent to 53.2 per cent (Mazumdar, 1998, p. 47).

There has been a long-running debate in the United States on this issue, although the question is not whether employment in SMEs is declining but whether these firms create more net jobs than large firms. Early studies by Birch (1979, 1987) showed that small firms did create more jobs than large firms, thus suggesting that small firms were not being squeezed from the market due to scale economies or other sources of higher productivity. Measuring net job creation accurately is difficult, however, partly because over time firms cross the threshold distinguishing small from large. The most refined study of net employment creation was undertaken by Davis et al. (1996), using data from 1973 to 1988. The results showed no relationship between firm size and net employment growth. All three studies revealed that job creation rates are higher in small firms, but so are job destruction rates. This tendency is also common in developing countries.

Table 2: Change in SME share of total manufacturing employment

	Period		Small (10-49) ^a		Medium (50-499)	
	Base year	Final year	% in final year ^b	Change from base year (%) ^c	% in final year	Change from base year (%)
Increase in small enterprise share of total employment						
Brazil	1960	1980	24	3.5	55	7.2
Hong Kong, China	1951	1996	34	11.5	47	-2.0
France	1962	1990	19	4.3	36	2.8
Japan	1967	1990	33	2.4	43	3.0
U.S.	1967	1987	15	3.6	47	5.9
Decrease in small enterprise share of total employment						
Columbia	1956	1990	21	-10.5	n/a	n/a
Korea, R	1958	1990	22	-21.5	39	n/a
Pakistan	1954	1988	11	-7.8	33	12.1
S. Africa	1950	1988	12	-6.1	48	-4.2

^a no. of employees per enterprise.

^b share of total manufacturing employment accounted for by small enterprises, in final year.

^c for example, the small enterprise share in Brazil in 1960 was approx. 20.5%.

Source: Extracted from data in Weeks, 2002, pp. 13-14.

It is also important to know whether there is a general trade-off between productivity *increase* and employment. As enterprises become more productive, do they need fewer workers and thus shed them? This is a complex question which is difficult to evaluate empirically. Four general points can be made, however. First, there are various sources of productivity increase that may have no direct or indirect effect on the level of employment. Improvements in product quality, greater capacity utilization, more efficient use of materials and better organization, training and treatment of labour all increase productivity without affecting employment levels. Second, a productivity increase that leads to expanded market share and, therefore, employment creation at the enterprise or country level can prompt an employment decrease in competing enterprises or countries. This is the *displacement effect* and would need to be factored into any empirical analysis of net employment effects. Countries are constantly concerned with the loss of competitiveness and market share because of their effects on employment and output.

Third, a productivity increase based on automation can reduce the demand for labour. At enterprise level, the net employment effect will be determined by market demand. More specifically, it will depend on *whether the reduced demand for labour in per unit output is offset by an increase in labour demand due to output expansion*. Finally, a decrease in labour demand due to productivity increase may be offset by a higher demand for labour in the same or other sectors as a result of the creation of new products or the expansion of markets. In developed countries, the decline in rural employment caused by the introduction of agricultural machinery and other advances was offset by increased demand for workers in urban manufacturing and services.

A study of Taiwan, China concluded that small enterprises exhibiting higher productivity are most likely to achieve net employment gains (Aw and Batra, 2001). On the other hand, evidence for ten Latin American countries is inconclusive (Peres and Stumpo, 2001). Productivity improvements for the formal SME sector as a whole were associated with increased SME employment in some countries and decreased levels in others.

There is little evidence, therefore, that the productivity gap will cause a decline in the small enterprise sector over time or that productivity improvements in small enterprises will reduce employment. There will be a decline in the informal economy as a result of development, however.

1.4 A probable answer

The probable answer to our question is that small enterprises do not compete directly with large ones. Instead, they find a niche where small size can be an advantage. Kiosks for food and household goods that bring products closer to consumers are one example. Services such as restaurants and vehicle repair shops are another. In addition, the market may be limited and specialized, with small firms filling specific niches, often in clusters and/or as subcontractors for large enterprises. In these cases, they compete with other, less productive firms.

When small firms do produce goods similar to those made by large firms, they often produce at lower quality levels, thus avoiding direct competition. In poor countries, there are large markets for low-quality but affordable goods. It is also true that the statistics provided above are very general and that many small enterprises, especially but not exclusively in developed countries, achieve quality levels approaching those of large firms.

2. A concern for income, poverty and working conditions

The avoidance of direct competition may answer the productivity-employment question, but it remains true that small firms are producing less value added per worker. This affects the returns that such firms can pay to their owner(s) and to labour. The concern with small enterprises is not specifically that they exhibit low productivity, but that, because of low productivity, the wages they pay to workers and the income they generate for owners may not be sufficient to support a decent standard of living. Owners and workers may not be able to escape from poverty. This is the concern addressed in the present section.

While low productivity can limit wages and income, it must also be recognized that low wages can limit productivity. The notion of *efficiency wages* suggests that higher wages can have an incentive effect on the recruitment and retention of efficient workers and on their motivation. Raising wages to improve productivity will only work up to a certain point, of course, but it can be part of a broad strategy to raise productivity. The ILO's approach to enhancing productivity in small enterprises has a double focus on wages, bonuses and benefits as incentive factors and on working conditions, work organization, rights and market access. The strategy is outlined in the third part of this report. Here we focus on wages, owner income and working conditions as they exist in many small enterprises.

The connection between wages/income and poverty is fairly direct. Poverty is partly defined in terms of material well-being, related to such physical essentials as adequate food, clothing and shelter; it is also related to access to essential services such as education, water, sanitation and health care. The ability for a household to provide these essentials is based partly on its capacity to purchase them, partly on the ability to self-supply them and partly on the receipt of services (at low or no cost) from public agencies. The income derived from small enterprise activity is therefore important in the struggle against poverty because it allows for the purchase of essentials.

Generally, paid and self-employment will help to reduce the income aspects of poverty if they support:

- i) a move from unemployment to employment;
- ii) a rise in the total wages and benefits paid to poor employees (including informal employees, family workers);
- iii) a rise in income from low-paying self-employment (including the movement from under-employment to fuller employment);
- iv) a more general, long-term shift in an economy from lower paid informal, dependent or self-employment to better paid and better protected employment or self-employment.

The first and fourth aspects were dealt with in the preceding analysis on the amount of employment created by the micro and SME sectors. The second and third points are dealt with here.

Apart from its material aspects, poverty is also a condition in which people lack control over their lives (empowerment) and lack security about their future. These issues are closely related to aspects of decent work, notably workers' rights and social dialogue (empowerment issues) and social security (security issue). They can also affect the productivity of enterprises, both in terms of the motivation and retention of workers and in

terms of the way that work is organized. These issues are discussed near the end of the section.

2.1 The wage gap

In addition to a labour productivity gap, there is also a wage gap between small and large enterprises. This is not surprising as low productivity will tend to hold wages down and, simultaneously, low wages can limit productivity. In interpreting wage data, it is important to recall that wages will be lower for workers with fewer skills, less experience and other differences. Thus, wages may be lower generally in small enterprises if they hire less qualified personnel, which they tend to do. Low wages can be ‘justified’, wholly or in part, on this basis. Unfortunately, wage comparisons between small and large enterprises usually do not take account of differences in skills and experience.

Evidence from four Asian and Latin American countries confirms the wage gap (Table 3). On average, wages in small⁴ formal manufacturing enterprises are about two-thirds of the level found in large enterprises. Medium firms are closer, at four-fifths. Note that in more developed economies (Hong Kong, China and the Republic of Korea), the gap is narrower than in less developed countries (Brazil and Columbia). In Hong Kong, China, wages in medium and large firms are the same. In all cases, the percentage gap between wages is less (figures are closer to 100) than the gap in productivity. The wage gap is also evident for Africa. Wages in formal micro enterprises in Ghana were one-quarter of those paid in large firms. The average monthly wage for micro firms (C14,264) was slightly above the minimum wage (C13,617), possibly suggesting that workers in these firms earn an income that is above the poverty level (Mazumdar and Mazaheri, 2002). Similar differences are found for Tanzania (Goedhuys, 2002).

Table 3: Wage and productivity gaps by enterprise size

Country ^a	Years ^b	SME value added per worker as % of that for large enterprises (for productivity)	SME average wage as % of that for large enterprises
Brazil	1960-80		
Small ^c		56	64
Medium ^c		76	80
Columbia	1970-89		
Small		46	50
Medium		70	71
Hong Kong, China	1977-90		
Small		66	91
Medium		89	100
Korea, R.	1970-91		
Small		41	69
Medium		74	81

^a no. of total observations for each country: Brazil 270; Columbia 360; Hong Kong, China 195, Republic of Korea 360.

^b observations for five years within the time period given in the second column.

^c small = 10-49 workers, medium 50-499, large, 500+.

Source: Weeks (2002), p. 17.

⁴ Small formal enterprises; does not include micro enterprises.

2.2 Returns to owners: Gains-keeping

Most enterprises in developing countries consist of very small, ‘survivalist’ activities, operated by poor people. They exist alongside more substantial, competitive small enterprises, which generate greater returns for their owners. These differences have a great bearing on the extent to which enterprise activities allow their owners to escape from poverty and achieve a decent standard of living. In the next two subsections, we consider first the nature of microenterprise activity and then review some of the research on the returns to entrepreneurs.

An estimated 60 per cent of those earning a living in the informal economy are self-employed.⁵ Thus the microentrepreneur is often the sole person working for the ‘enterprise’.⁶ The entrepreneur pays no wages, as a result. Any increase in productivity will depend solely on the actions of the entrepreneur (possibly with the aid of one or two family members) and will translate directly into household income. Any gains sharing takes place not with outside workers but with family members. Critical decisions for poor households relate to the division of any gains between consumption, savings and re-investment in the enterprise.

Many microentrepreneurs take up business because they cannot find paid work. Being poor, they bring very little capital to the business, which forces them to concentrate on activities where investment and working capital requirements are low.⁷ As a result, a large number of poor people are drawn to the same activities. Together, they generate an abundant supply of simple goods and services that keep competition high and prices, sales and profits low. Not surprisingly, many vendors and artisans are underemployed. They stand the whole day on the street corner and sell very little. They wait at their shops unwilling to produce more because they are already surrounded by their unsold finished goods. Their poverty is self-reinforcing: they lack the capital to engage in more productive, higher-value work and their lack of productive work limits the surplus they can generate to invest in their enterprise. In her study of micro and small enterprises in Kenya, Daniels found that only 26 per cent of enterprise owners earned an income above the minimum wage (Daniels, 1999, p. 61; see Table A6).

In this situation, the implications for productivity are clear. With no employees or only one or two family members assisting, there is a limited basis for increasing productivity through the better management or treatment of the work team. Intra-firm productivity questions relate to the entrepreneur’s activities (how efficiently they work, how to invest in and manage tools, machinery, inventories, supplies, etc.). Productivity is low not because the work is inefficiently organized but because there is insufficient demand to keep everyone working productively. Extra-firm initiatives, notably finding and expanding into new and higher-value markets, are usually more critical to enterprise productivity because they can help reduce underemployment or work that generates low returns.

⁵ In some African countries, this figure rises to over 90 per cent (ILO 2002a, 20).

⁶ Often the owners would not think of their activities as bona fide ‘enterprises’.

⁷ The productivity of the self-employed is affected by the capacity to invest in tools and goods. However, women typically have less access to and control over resources to support their work. Among the informal sector activities of the poor in Dhaka, Bangladesh, for example, women were more likely to be engaged in home-based activities “involving small amounts of capital which generate less earnings” (Salway et al., 2003). On average, women owned less goods by value and lower valued tools and equipment than men.

In evaluating the productivity of survivalist activities, it is important to recall that this may be part of a larger household *multiple* or *multiplex livelihood strategy* (Bryceson, 2002; Carney, 1998). Such a strategy involves general income from a variety of sources, including: food and cash crop farming, plantation labour, informal enterprise activity, home-work/outputting, formal employment in enterprises, and migrant employment in other, richer, countries. A person may derive an income from two or more of these types of work and family members contribute income from different types of activity. Women, because of domestic duties (child-raising, farm work), are more likely than men to take on multiple household tasks, although they may not all generate income. These roles often include microenterprise activity, although they are not able to engage in it full-time.

Research on Kenya highlights the existence of these livelihood strategies (Daniels, 1999). Only 24 per cent of micro and small enterprises (MSEs), mostly in the informal economy, provide all or almost all of household income (Table 4). This aggregate figure hides important differences between urban (49 per cent) and rural (15 per cent) areas, however, as rural landholders have a greater opportunity to rely on food production to support consumption.⁸ Measuring productivity on a per-worker basis (instead of per hour) will be highly inaccurate if the entrepreneur is not working full-time on the enterprise activity.

Table 4: Contribution of MSEs to household income, Kenya

MSE contribution to household income	% of all MSEs	% of urban MSEs	% of rural MSEs
All or almost all	24	49	15
More than 50%	17	14	18
About 50%	20	15	22
Less than 50%	29	14	34
Negligible amount	10	8	11
	100	100	100

MSE = micro and small enterprises, with 0-10 workers.

Source: Daniels 1999, p. 61.

For households owning (or renting) land, important decisions about work are made on the basis of productivity and income-earning capacity. If enterprise activities are highly remunerative, then the best use of household labour may be to hire workers for farming and use household labour for non-farm activities. In Honduras, for example, the level of non-farm income contributes significantly to the use of fertilizers on the farms of poor households. This suggests that non-farm employment can raise the productivity of household farming activities (Ruben and van den Berg, 2001) and is an example of how farm and non-farm activities affect each other.

2.3 Higher incomes for successful entrepreneurs

Many entrepreneurs in the informal, microenterprise sector do generate a low but decent income, despite evidence of lower productivity. The research to date has tended not to focus on whether enterprise income is above the poverty line but on comparisons with a minimum wage (often a proxy for the poverty line) or with formal sector wages.

⁸ This opportunity is not available to the rural landless, of course.

Research on Peru has shown that small formal-sector enterprises were between 2.9 and 4.1 times more productive than informal enterprises in the same sectors (Table 5). However, these differences were not matched by earnings differences of a similar magnitude. Informal entrepreneurs in several sectors earned about nine-tenths of the wages paid to formal sector employees. In the transport sector, informal operators (notably drivers) earned more than their formal-sector counterparts (Kelley, 1994). Formal wages and entrepreneurial earnings might have a tendency to converge because formal enterprise owners can pay as low as the level of microenterprise earnings – which might act as a *reservation wage*. Stated more positively, workers will opt to become entrepreneurs if microenterprise earnings are likely to be higher than wages.

Table 5: Ratios of productivity and income, formal/informal, Peru

Sector	Labour productivity	Informal income/
	Formal/informal	Formal wages
Light manufacturing	3.5	0.9
Textiles	3.5	0.9
Construction	2.9	0.9
Transportation	3.3	1.3
Commerce	4.1	0.9
Diverse services	3.6	0.9

Source: Kelley, 1994, p. 1400.

Comparative income data for Mexico indicates that the movement from formal wage employment to informal self-employment results in a 15 per cent *increase* in income (Maloney, 1999).⁹ At the same time, the movement from formal wage employment to informal wage employment, in enterprises of a similar size, results in 12-15 per cent income *decrease*. The results depend, in part, on the value of medical and social security provisions that workers receive (and which are deducted from wages) in the formal sector. According to Maloney, many workers feel that health services are poorly delivered and that the health insurance deduction is a loss of income. In addition, health insurance is not necessary for one of two working family members because of family coverage.

The importance of taking into account the returns to capital was revealed in an earlier study of Côte d'Ivoire (Vijverberg, 1991). The study separated the labour earnings from the capital earnings of informal sector entrepreneurs. Labour earnings for informal entrepreneurs were lower than formal sector wages. For example, hourly labour income for the self-employed in non-food commerce and services was about 80 per cent of that for formal employees. In contrast, food-related commerce paid 25 per cent more to the self-employed.

However, these comparisons do not account for the income received by informal entrepreneurs in return for invested capital. These returns vary considerably from near zero to as high as 290 per cent per month and could push total earnings for entrepreneurs above those for formal sector wage employees.

The results of these detailed studies and the previous discussion regarding survivalist enterprises make it difficult to generalize about the income earned by micro and small entrepreneurs. Interventions designed to help owners escape from poverty will need to be sensitive to these differences, in order to avoid helping the more successful entrepreneurs rather than those who are truly poor.

⁹ The comparison is with net formal sector wages (i.e. after deductions).

2.4 Non-income dimensions of poverty

While income is an important aspect of poverty, participatory research on the nature of poverty has expanded the frontiers of our understanding. Based on responses from 60,000 poor women and men in 60 countries, the research revealed the importance of political and psychological elements in human well-being (Narayan et al., 1999; World Bank, 2000). Most notably, these elements include feelings of empowerment (control over one's environment) and security (ability to assure personal well-being over time). They are related to physical needs and income but suggest a longer time frame and the perceived ability and capacity to satisfy one's needs. Such aspects of poverty resemble certain elements of the ILO's concept of *decent work* (ILO, 2000). Along with the availability of remunerated, productive work, decent work includes rights at work, social dialogue and social protection. Fusing the two approaches provides us with the following additional factors related to small enterprises and poverty:

- i) ***Empowerment for workers and entrepreneurs***: Workers are entitled to freedom of association, collective bargaining and a constructive dialogue with owners and managers on the conditions of work, remuneration and benefits. Empowerment also includes social dialogue at the tripartite level, which allows workers to campaign for better living conditions (health, education, housing, water and sanitation). It also allows the owners/managers of enterprises to negotiate with government on the policy environment.
- ii) ***Security against income loss***: For workers, security derives in large part from access to social protection against illness, disability, unemployment, old age and the death of a main income earner. For enterprise owners, it also involves freedom from harassment by public officials, the right to hold private property and conduct business and the right to freedom from expropriation by the State.

In regard to these aspects of poverty, too, small enterprises workers and their owners tend to be disadvantaged. The level of unionization is much lower in small enterprises and workers' rights are much weaker. This is partly related to the informality of the smallest enterprises, which operate outside government regulation. The ILO's efforts to help them move into the formal economy are aimed at this problem. Small enterprises also lack effective representation *vis-à-vis* public authorities. In employers' associations and federations, their concerns are often overwhelmed by those of the larger members. This is changing, however, as many federations have sought to embrace the concerns of small enterprises and as small enterprises have built their own representative organizations.

Workers in small enterprises also have less security than those in large enterprises, notably in their access to benefits such as unemployment insurance, termination payments, health insurance, etc. For an illustration of these issues we draw on a detailed study, commissioned by the ILO, which compares conditions in micro, small, medium and large enterprises in Tanzania (Goedhuys, 2002).

According to the study, workers in small Tanzanian firms worked longer hours than those in large enterprises, with the standard working week reaching 55 hours for micro firms compared with 44 hours for large enterprises. Medium and large firms were much more likely to pay workers on a time-rate basis (hourly, daily, weekly) rather than a piece rate or as a percentage of sales. Indeed, 40 per cent of microenterprise workers did not work on a time rate, whereas 95 per cent of medium enterprise workers and 100 per cent of those in large enterprises did. The smallest enterprises were much more likely to pay workers daily (suggesting casual, highly insecure employment). Large firms were more likely to pay food, housing, clothing, and transportation allowances. Only 5 per cent of micro enterprises paid bonuses, probably because of the high rate of piecework and

percentage sales work as the main basis for payment. Small enterprises were also less likely to pay for overtime, leave and public holidays (Table A7).

Only 12 per cent of micro-enterprises and 35 per cent of small enterprises were unionized, compared to over 96 per cent of the large enterprises surveyed (Table A7). This might indicate for why wages were higher in large firms. In terms of social protection, small enterprise owners were less likely to contribute to worker and family health care, education, sick leave and pension schemes. Rates of contribution for large enterprises were normally twice as high as those for small enterprises and much higher than for micro enterprises.

Such aspects of empowerment and security highlight the non-income aspects of poverty, whereby the poor are obliged to accept lower standards. The ILO seeks to raise these standards, where possible, as a contribution to poverty reduction and the promotion of decent work. Non-wage improvements can contribute to increased productivity in the same way as wage increases can. Section 3 highlights some of SEED's work in this area.

3. The challenge of raising productivity: SEED's experience with job quality

3.1 Overview

The ILO's small enterprise support programme, IFP/SEED, confronts the productivity challenge by focusing on improvements in work practices – 'job quality'. It also emphasizes market access in an effort to reduce the problem of underemployment, which is an important constraint on productivity in micro enterprises. The overall effort is to create a virtuous cycle in which job quality, along with market access, can raise productivity, which can, in turn, result in better wages and income for workers and owners.

By focusing on the work organization aspect of productivity, SEED supports the global productivity movement, which has its roots in Japan and parts of Europe. SEED's contribution to that movement has been to develop curricula for management training and to initiate public awareness campaigns so that the principles of raising productivity through job quality can be transmitted to small enterprises in the developing world.

This section first takes a brief look at the productivity movement. It is followed by an overview of the approach to productivity improvement developed by SEED. The remainder of the section then provides case studies of enterprises whose owners have undergone such training and used the new ideas to improve their businesses.

3.2 The productivity movement

The productivity movement is a broad approach that emphasizes the organization of an enterprise's valuable human resources. It is based on respecting workers' rights, applying international labour standards (including health and safety) and supporting skills' training. These changes can reduce work-time loss caused by accidents and injury and they can increase the well-being of employees who are better motivated to contribute to enterprise performance. The approach emphasizes cooperative relations between workers and management, including discussions on the organization of production. Its best-known feature, derived from Japan, is the quality circle, where workers and managers regularly sit together to discuss how to improve production efficiency and product quality and reduce product defects. Cooperative work practices are designed to empower workers by reducing

the distinction between management and labour and allowing workers to influence production decisions.

The application of this approach to other countries is sometimes referred to as ‘Japanization’ or ‘Easternization’, due to the importance of Japan and Japanese enterprises in the dissemination process. The approach has spread through three main channels. First, Japanese foreign direct investment, prompted by high domestic production costs and the desire to overcome trade barriers, brought these approaches to other parts of East Asia and to the electronics and automotive sectors of Europe and North America.

Secondly, the success of Japanese multinationals in producing high quality consumer goods efficiently led consulting companies to advise other companies on their use. A number of interesting cases have been documented regarding the application of Japanese practices in large firms (for Zimbabwe see Posthuma, 1995; for India, Brazil, Mexico and the Dominican Republic see Kaplinsky and Posthuma, 1994; and for various countries in East Asia, see Hwang, 1995).

Thirdly, the practices have been disseminated through a regional network of productivity promotion centres. The Japanese Productivity Centre, a tripartite institution, served as the model for similar national organizations throughout Asia. They are networked and have received considerable intellectual leadership from the Asia Productivity Organisation (APO). Indeed, APO has been a principal organ of the productivity movement. A similar regional organization exists for Europe, with a number of non-European members. The United States also have such an organization, set up in the 1980s to address concerns that low productivity was resulting in the loss of market share to Japan in important sectors such as automobiles. The Management and Corporate Citizenship (MCC) programme at the ILO supports the productivity movement and is currently helping to establish new national centres in Africa, the Caribbean and elsewhere.

While much of the emphasis of the productivity movement has been on large enterprises or the large end of the SME category, most of the same principles apply to the management of small enterprises. Assistance to increase productivity may be channelled through business management training providers (as SEED does) or through sectoral or sub-sectoral social institutions that can assist enterprises grouped in ‘clusters’. SEED has used this approach for assisting the Moradabad brassware cluster in India.

3.3 SEED and productivity

SEED’s work on productivity is directed by the Job Quality (JQ) team. It has focused on small business management training but, more recently, has included social awareness campaigns to make people generally aware of the link between job quality/decent work and productivity. There are other aspects of SEED’s work that contribute to productivity, but in a less direct and focused manner than the JQ activities. For example, SEED works with governments to create a more conducive policy environment for small enterprises and it works with specific sectoral and business associations to promote decent work and enterprise performance. Its work on market access attempts to increase the demand for small enterprise products in an effort to reduce underemployment or raise the value of output. The full impact of SEED’s work on productivity, therefore, is difficult to gauge. We focus here on small enterprise management training because of its stated goal of increasing productivity and the availability of impact assessments. The assessments are based on specific enterprises and demonstrate the challenge of raising productivity in small enterprises through improvements in job quality.

The Job Quality team collaborates with ILO enterprise specialists in the field, project managers and business services producers. A ‘People and Productivity’ module has been developed for inclusion in SEED’s popular Improve Your Business (IYB) training

package.¹⁰ In addition, curricula have been developed to meet the needs of different target groups, ranging from very small, informal businesses to large, more established ones. The range of curricula and their target groups are presented in Table 6. While ILO develops the curricula, the actual training is conducted by business service providers operating as private businesses or public agencies. As a result, job quality and productivity issues are usually part of a broader curriculum of business management, which may include such issues as marketing and cost accounting.¹¹

3.4 Case studies

The case studies presented below involve enterprises whose owners or managers have followed SEED-designed small enterprise management training courses. Entrepreneurs were operating businesses prior to the training and were trained sometime between 2000 and 2002. Before presenting the cases, it is important to describe the nature of the training and of the impact assessments that generated the case material. Training is organized for groups of entrepreneurs at a central location. Courses range from 2 to 5 days. Part of the training involves giving participants time to analyse their own businesses in light of the new ideas and concepts being taught. This ensures that training will be relevant to the entrepreneurs. In most cases, they draw up a plan for implementation when they return to their own businesses. In some cases, trainers also make site visits to view the work environment and offer practical advice. Impact assessments were conducted on a random basis about three to six months after the training. They are used to provide trainers and SEED with feedback on how well the course has aided enterprise performance. Evaluators seek to obtain both qualitative feedback (interviews with owners, managers, employees) and quantitative evidence (data from accounting records on changes in output, costs, sales and/or profits). To assess productivity, evaluators generally use sales revenue as output, and costs as inputs. Productivity can be calculated as the percentage of sales revenue needed to pay costs. A decline in this figure represents increased productivity.

Table 6: Business management curricula and SEED's 'market segmentation'

Type of business	Curriculum
Fast growth	HRM module in 'Expand Your Business'
	Improving Your Productivity through Better Working Conditions
Small businesses	People and Productivity
Micro businesses	Improve Your Working Environment and Business
Micro/self-employed	Improving Business through Better Working Conditions
	Better Business through Better Work (little formal education)

Source: ILO-SEED.

Entrepreneurs follow the training course at various times of the year and, as a result, annual data often do not provide a neat 'before' and 'after' comparison. Some enterprises provide monthly data that allow for a more accurate picture. The relatively short time

¹⁰ 'People and Productivity' is the final version of a curriculum which was originally developed in Viet Nam as 'Managing People' and was also tested in several other countries.

¹¹ Combining job quality/productivity with other aspects of management training is what differentiates SEED's approach from the ILO's Work Improvement in Small Enterprise (WISE) programme, which focuses solely on working conditions. SEED has adopted concepts and learned from that programme.

between training and evaluation makes it difficult to assess long-term impact. However, allowing for a longer post-training period might introduce other factors that affect performance. In addition, there are seasonal variations in sales performance that might affect capacity utilization and therefore productivity results.

In many ways, the case studies speak for themselves and emphasize the diversity of challenges faced by small enterprises and the diversity of the attempts made to raise productivity by applying the concepts acquired. Summarizing those experiences can result in forcing that diversity into narrow categories: the reader might learn more by reading through that diversity, unencumbered by commentary. Nonetheless, a few guiding points might be useful.

In many cases, entrepreneurs are as interested in increasing sales as they are in improving work-floor productivity. This can be especially true for micro entrepreneurs, who, as mentioned, often suffer from low demand. Sales generation and work-floor productivity can be treated as two parts of a large concept called ‘competitiveness’ or ‘business performance’. However, there is a very real connection between output demand and productivity. When sales are low, existing staff, equipment and premises are under-utilized. Costs (notably those that are fixed or semi-fixed) are high relative to output, which translates into low productivity. An increase in sales allows the enterprise to produce at or near capacity and to boost productivity in the process.

In addition, not all of the cases are shiny examples of SEED’s work and the results are often not spectacular. Small changes were made and minor improvements in productivity were achieved. This is partly due to the evaluation timeframe, but it also depends on the nature of the business, especially for micro enterprises, where there may be few (if any) paid employees, little capital and not much of a production process to reorganize. It is generally true that the changes implemented in these cases involve minimal costs, which is important for resource-constrained enterprises. With these thoughts in mind, we move on to the cases.

Case 1: Improving hygiene and employee relations in food processing (Ghana)

Praise Export Services Ltd. has gone through fundamental changes since its inception in 1994. The managing director is a packaging and export professional trained in the United Kingdom and his wife, a director and general manager, holds a City and Guilds certificate in catering. They are also the owners. The company first provided packaging documentation and shipping services to Ghanaian exporters. A year later it began exporting goods itself, including yams, plantains, fish, gari and oil. In 1998, the enterprise manufactured its first food product and by the time the managing director (hereafter: manager) took the training course, the business was producing 20 products and exporting 95 per cent of its output (to six countries in North America, Europe and the Middle East). The workforce has grown from 15 to 75 in six years.

Despite considerable success, the manager thought that productivity could be improved. As a packaging and export professional, he was not very knowledgeable about work conditions and employee motivation. As a result of the training course, many changes were made to the work environment and employee relations.

Regarding safety, the manager had found it difficult to persuade his employees to wear protective clothing on a regular basis. Following the training, he took a consultative approach by meeting with employee representatives to discuss the purchase of new protective clothing, notably gloves and masks (to avoid the inhalation of dust from grinding). Changes were also made to the staff canteen. It was decided that employees who arrived at work on time and worked a full day were entitled to a free meal. The company

also provided a clean area to eat the meals, as well as a library with reading materials and games such as cards, ludo and draughts. In addition, the company started paying the employees' social security contributions.

Major changes were also made regarding the cleanliness of the workspace. Wash basins with soap were located at strategic points in the factory and posters put up to encourage employees to wash. Designated staff members were instructed to undertake cleaning every Thursday and all workers are engaged in a thorough cleaning on the last Saturday of the month. Unused machines, supplies and finished goods were identified and disposed of. Supplies, work in progress and finished goods were stored in better conditions with fewer hazards for employees. The production process was analysed and discussed with employees and changes were made to improve work flow.

These extensive changes improved worker morale considerably and the owner indicated that productivity and profitability had increased. Exact figures on productivity are difficult to provide, however, because the changes were made from September 2001 and evaluators were only able to obtain whole year figures for 2001 and 2002, and figures for the first six months of 2002. In addition, demand tends to be low in the early part of the year due to seasonal fluctuations. The owner told evaluators that sales had increased by 104 per cent in 2000 from a year earlier, but then increased 199 per cent in 2001 (the year in which changes were begun). He attributed this increase in large part to the improvements made after the training course. Figures presented by evaluators for 2001 and the first half of 2002 indicate that costs relative to sales declined from 65 to 61 per cent, indicating a productivity increase. However, overhead expenses increased (as a percentage of sales) and thus operating profit declined about one half of one per cent (on sales).

Interviews with staff revealed considerable satisfaction with the full range of measures undertaken by the manager, notably the free meals and factory cleanliness. One employee noted that there was greater consultation between management and staff and that a new work grades system had been implemented with clear steps for promotion. Employees had their own suggestions for improving working conditions, including better training on hygiene and other issues, the provision of a changing room and periodic fumigation to reduce flies. Employees also suggested that pay should be increased. Word has spread about the good working conditions and the company receives a regular flow of new job applicants.

Case 2: Improving work space and expanding bakery sales (Ghana)

After completing the training, the manager of La Bakery and Pastry Company Ltd., a retired army major, implemented two changes. One was to improve working conditions to boost morale among his employees and thereby increase productivity. The bakery's work environment was already modern, clean and safe but there was a problem with the chairs and tables used for the workers kneading bread. The chairs had no backrests and the tables were too low, causing back strain. He replaced the chairs and tables with more appropriate ones.

The second change involved an effort to increase sales. The company had begun with 21 employees but that had dropped to 17 due to low sales and low profitability. The bakery supplied three hospitals and an army base but had no retail customer base. The institutions were substantial customers but the bakery found it difficult to sign up other institutions and was facing intense competition to retain existing ones. Following his training, the manager opened three direct sales kiosks. He also decided on a second plan to motivate employees and increase sales at the same time. He began to sell bread to employees on commission (i.e. for re-sale to the public). They could buy the bread on credit and repay after sales, while keeping a portion of the revenue for themselves. He thought that this would give the

employees an added income source and increase their loyalty to the company. To limit the company's liability, employees were allowed no more than one-third of their take-home pay in the form of credit.

Subsequent interviews by project evaluators revealed that employees were very satisfied with the new chairs and tables. Morale had improved because working conditions were decent and healthier. The evaluation did not assess whether this led directly to higher productivity.

The effort to expand sales produced mixed results. Kiosks sales worked well but the employee retailing scheme did not. The kiosks were set up in October 2001 and accounted for 1.4 per cent of total sales by the end of the year. Sales continued to improve and in the first half of 2002, accounted for 8.8 per cent of total sales. The manager was pleased with the outcome. In contrast, the commission sales did not work well. Employees were very slow to pay back the credit advanced on the bread and there was little increase in sales.

Case 3: More and better tools for an aluminium business (Ghana)

The owner of Gudmann International is a 36-year-old mechanical engineer who started an aluminium production business in 1992 with one employee. He initially worked on customer sites and slowly built a workshop at home. Due to the limited space and to noise complaints from neighbours, he moved to a small shop. As a result of the training, he realized that he needed a large working space. He moved to an industrial estate to improve the working conditions of his 16 employees, manage large orders and make a better impression on customers. The move also allowed for production and administration to be located at the same site; previously it was divided between two sites. The entrepreneur also brought in more machinery to handle bigger jobs, improve quality and reduce delivery time. He began to be more involved in training his employees. While some of these developments arose directly from the training course, others were his own ideas, which he had been considering. This is one purpose of the participatory aspect of the training course. He ordered several new machines but they had not been delivered by the time of the evaluation.

Interviews with employees indicated that, following the training course, a new allowances programme was introduced to augment the basic salary. In addition, staff were provided with protective equipment. One employee noted that with more and better tools and machinery, the work is being done much more efficiently and delivery times have shortened.

Any changes in productivity are thus likely to arise from a variety of changes in work space, machinery and employee compensation. As a measure, evaluators calculated the ratio of net profit to contract income (revenue), which increased from 9.95 per cent in 2000 to 10.52 per cent in 2001. The ratio of production expenses to income dropped from 14.0 per cent to 13.3 per cent: salaries to contract income also dropped, from 2.17 per cent to 2.01 per cent. Electricity and raw material costs also declined. Thus, the changes have resulted in positive, although minor, improvements in productivity.

Case 4: Awakening computer students (Uganda)

Jamila operates the Natmasuba Computer and Stationery Centre, which provides office stationery and computer training to students at its premises. She noticed that students were drowsy during the lessons and that they preferred the morning sessions. Furthermore, classes were not full, resulting in low revenue per teaching hour (another form of low productivity).

She was originally hesitant to take the training course, but realized that it gave her time to think about these concerns and discuss them with the trainers. The consultant made a pre-training visit to her premises and found poor teaching and learning conditions. Ventilation and lighting were bad, and were probably the cause of drowsiness and poor afternoon attendance. The carpet was old and dirty and the room was untidy with cables lying about and a dangling electric socket. The shelves of the stationery shop were disorganized. Following the ILO course, Jamila attended to all these matters.

She decided to keep the backdoor of the classroom open to provide a current of air and to install more lighting and an electric fan was purchased and installed. A portion of the roof was replaced with transparent sheeting to give direct light to the computer room. The old carpet was replaced with new plastic floor covering. The socket was repaired and the cables made neater. She wanted to paint the walls a lighter colour as well, but lacked the funds. The total cost was \$30.25, plus \$5 for the two-day ILO course. These changes gave a very new appearance and feel to the premises. As a result, enrolment has increased by 40 per cent and the classes are now full. Higher student revenue is generated for each class, resulting in higher teaching productivity.

Case 5: Building a kitchen for the restaurant (Uganda)

Nagambye Betty owns a small restaurant which serves food in the evening. Her main problem was that she had no kitchen and so prepared the food in the open air. Her customers (and potential customers) did not think this was very sanitary. A big problem occurred in the rainy season when she was unable to operate because the cooking area was too muddy. "During the rainy season, my business comes to a standstill with mud all over the place. Not only do I lose income but I also end up using most of my working capital in order to survive", she noted. A pre-training visit revealed a host of problems: no kitchen, no garbage bins, no shelves for saucepans or plates (they were left on the ground), the cooking area was dirty and there were many flies. In addition, her helpers had to walk a long way to fetch water and they were poorly dressed.

Following the training course, she set out to improve the cleanliness of her operation. She built a temporary shelter over her cooking spot (\$21.50) and a shelf for her dishes and cooking utensils (\$3). She purchased blue uniform headcaps for her helpers to prevent hair from falling into the food. She bought a mobile water tap and basin, so that both workers and customers could wash their hands. She bought a bin for her garbage and emptied it regularly.

The changes have allowed her to operate in the rainy season. Over the three-month period she earned \$180 that she would otherwise have lost. Her client base is up from about 20 to 50 people per day. She attributes the increase to changes in the working environment of the restaurant and to its new, clean image. She told evaluators, "I am very grateful for this training because I had never sat down to think and realize the cost of building a temporary kitchen and the benefits gained. To me, the rainy season meant I would simply stop all my operations". She has increased her productivity because she can serve more customers in the evening and can work during the rainy season.

Case 6: Shop-floor conditions and marketing in a brassware cluster (India)

Shafique operates a brassware micro-foundry with his sons in Moradabad. The city is well known for its brassware, producing 80 per cent of India's output and accounting for 33 per cent of all Indian handicraft exports. The foundry is one of about 25,000 small and

medium enterprises engaged in the city's brassware sector, which employs as many as 200,000 people.

Shafique enrolled in a training course which forms part of the ILO's Moradabad Brassware Programme for Enterprise Development and Productivity Improvement. He learned that if he installed simple chimneys he could easily channel smoke and heat from the casting out of his workplace. This would improve productivity and reduce the health hazards of this type of work. In addition, he learned to organize his work space better, and painted his cooling pans different colours to separate hot from cooled castings. This was designed to reduce the incidence of burns. After making the changes, Shafique and his sons noticed a distinct improvement in air quality and temperature, which contributed to improved productivity. His son, Mohammed Yamin, had formerly produced about 40 castings per hour but could not produce more because of the smoke and the heat. With the new chimneys, he is able to produce 60 castings per hour.

SEED has a diverse and integrated programme in Moradabad, which includes not only training in the basics of improving working conditions but also involves links with government training institutions, the Entrepreneurship Development Institute of India and with exporters. The Moradabad cluster is facing decline due to a reputation for low quality among exporters-buyers and also because of cheaper producers from China. SEED is working to improve productivity through better working conditions and also to reorient the industry to produce for domestic niche markets so as to avoid direct competition with cheaper production sites.

Case 7: Training workers in paper packaging (Viet Nam)

Nguyen Duc Liem runs a paper packaging business in Hanoi. The training course helped him to identify two main problems: the lack of skilled workers and the small and untidy nature of his work space. He realized that both these points tended to create a negative image with potential clients and to reduce their trust in the quality of work. Over 18 months prior to the course, there had been almost no increase in business. Following the course he took a number of actions. Realizing that he did not have time to train the workers himself, he sent two of them to a training institute. He recruited two part-time workers, as well. He then rearranged the shop to create an efficient work environment. Finally, he raised the bonus for good worker performance by 20 per cent. The evaluator found a contented owner, pleased with the results of the changes. Figures indicated that monthly sales had increased by 50 per cent in three months since the training course. While this might partly reflect seasonal variation, the shop's productivity had also increased: costs as a percentage of sales decreased from 56 to 53 per cent. This occurred at the same time as a 40 per cent increase in wage payments, attributable totally to increases in merit pay. The case suggests that profitability and wage increases can go hand-in-hand.

Case 8: Finding items in a micro-variety store (Trinidad and Tobago)

Lene owns and manages a variety store (food and non-food) serving low-income people in Tobago. The course made her realize that her prices were often much higher than those of her main competitor. Some items, however, were not properly costed in terms of including a mark-up for hidden costs such as transport and utilities. The training taught her how to cost, monitor the prices of her competitor and improve her record-keeping. She also realized that her store was disorganized and both she and her customers had difficulty locating items. In some cases, this led to lower sales and in other cases to excessive ordering and high inventory. She rearranged the store and that, she says, has generated higher sales. She began bulk-buying non-perishable items, which led to a savings of \$320

over three months. In terms of the customer environment, two safety hazards were also corrected; loose linoleum near the cash register and an unpaved area outside the store. Regarding the latter, many customers tracked mud into the store that then had to be cleaned. Grit was placed in the unpaved area and the time spent cleaning the store was reduced. Three months after taking the course and implementing the changes, sales had increased and profits had risen by 6.4 per cent. Because the store is staffed by the owner and her daughter, there was little gain from the better treatment or organization of workers. The productivity increase arises from increased sales and reduced costs.

**Case 9: *Drum-making, drumming and driving:
Multiple livelihoods (Tobago)***

This example demonstrates how very small businesses often have difficulty increasing productivity, especially when demand for their products is weak. In effect, productivity is constrained by low-capacity utilization, including the low utilization (under-employment) of the entrepreneur's labour. This case also outlines a multiple livelihood strategy, in which income generation and therefore poverty reduction requires shifting effort between different work activities.

Dexter started his drum-making business, Afrilon Drums and Souvenirs, with \$16 after failing to find employment. He established a small shop at his home but it generated little revenue and he supplemented the income from the shop by drumming at tourist hotels. He later found a job as a driver for the Tobago House of Assembly but continued the business with the help of his wife, who manages it, and three seasonal employees.

The ILO training resulted in three changes, two of which focused on marketing. The first change was better organization of the workshop through the arrangement and storage of supplies and finished goods. This has allowed for a large work space. The second change was the erection of five signs to improve marketing. The third change was to exhibit his drums at the hotels where he plays. The signs resulted in a 50 per cent increase in the number of visitors to his shop, but he still receives 10-20 prospective customers each week. Sales over the three-month period covered by the evaluation dropped and profits went from \$54 to \$16 per month. Good money is made from the performances at local hotels and may be an area to expand in the future. In one month, he played every Friday at one hotel and received \$48. His performance at another hotel netted him (and his friends) \$64. He uses these various activities (home sales, hotel sales, drumming and driving) to support his family. While there may be important questions about costs and the design of the drums, it appears that the lack of demand (and not productivity) is constraining his drum-making business.

**Case 10: *Worker retention and plumbing problems
(Trinidad and Tobago)***

The owner of Beautique Unisex Salon established the business in 1992 after she was laid off from an insurance company that was downsizing. The business has seen strong annual revenue growth but is hampered by a problem of staff retention. After being trained during the first six months, workers then leave to take better paying jobs or start on their own. The owner has tried to counter the problem by giving her new workers an apprentice contract and a stipend. She also spends one day per month on training (at a cost of \$75 in lost sales) and contributes to a training fund to send her workers to specialized courses.

She attended the ILO course to find other ways to improve working conditions and thereby retain workers. Six changes were made as a result. First, she resumed payments for the employees' national insurance (she had recently discontinued the practice). Her workers also now have access to maternity and injury benefits. Second, she raised salaries

and introduced monetary incentives. A minimum day wage of \$8.96 was instituted and a bonus scheme was launched in which employees receive 20 per cent on braids (which usually cost \$24-\$40) and 15 per cent on weaves (which cost \$24-\$48). Because customers can ask for a particular hairdresser, this bonus system acts as an incentive for high quality work. Third, the owner still operates the training fund but now pays the full cost of training (previously the workers paid a portion). Fourth, to improve the work environment, a contractor was paid to retiling the floor and make other changes. Fifth, a water pump was installed to reduce reliance on the unreliable supply provided by the landlord. The problem was considerable in mid-2001 when two workers spent three hours each day hauling water to the salon. The ILO training course highlighted not only the impact on profitability but also on worker morale – they were hairdressers, after all, not water haulers. And six, the owner has changed her style of communicating with workers. One employee noted: “I have a better rapport with my boss and she is more receptive to my ideas. Communication is now two-way instead of one-way.

Despite these changes, the problem of worker retention remains. Two of the three employees left in the three months following the ILO training. The owner has hired one person in the meantime. Total worker hours have increased over the three months and so too has the wage bill. Revenue jumped by a much greater amount and profits were higher by 91 per cent over the three-month period. Thus, the business is more profitable and productive with better-paid employees but the problem of staff retention has not been solved.

Case 11: Retaining workers in a discount card company (Trinidad and Tobago)

The manager of a discount card club participated in the ILO training to address personnel retention and cost issues. The business sells a card for \$8 that grants the holder discounts on goods and services from 500 participating businesses in Trinidad and Tobago. Begun in 1996, the club currently holds just under 50 per cent of the market. Success is based on the low price of the card and the high discounts at participating businesses. In many cases, the company pays for the signs for participating business, on an agreement that the card is also advertised.

The major problem is staff retention, which is related to low worker satisfaction. Staff turnover is very expensive in terms of training time. The company began with three employees in 1996; the number grew to 28 by 2001 but then shrank rapidly to five in January 2002. Some employees were laid off because they were caught stealing from the company, while others were discharged because they were not performing.

As a result of her ILO training, the manager developed a plan to increase employee satisfaction and loyalty. A health insurance plan was set up and training became more regular. The manager has always offered training but decided to set aside one day per quarter for the task. She also changed her approach to employees by becoming less authoritarian and more communicative. Employees told evaluators that there is increased two-way communication and the manager listens more. They also felt more motivated and more secure in their employment. There has been a significant increase in worker productivity as a result, according to the manager.

The evaluation provides no figures on financial position. In 2000, some 500 cards were sold per month, a figure which increased to 600 in 2001. The training took place in September 2001 so the total increase cannot be attributed to the new measures; sales had been climbing continuously since 1997. However, the fact that sales have climbed while the workforce has declined does suggest an important increase in productivity. In addition, long-term changes have been made. A database of subscribers and participating businesses was developed. The demographic data on subscribers should improve future efforts to

target specific segments of the population. This may generate a further increase in productivity as resources (personnel, mailing, advertising) are directed to high potential audiences.

Summary

These case studies provide evidence of how improved job quality can enhance the productivity of small enterprises. Demonstrating the precise impact of small business management training on productivity is difficult because the training also seeks to improve competitiveness and market penetration. While such training does influence the performance of individual enterprises and the lives of their employees, there is a need to expand the impact more broadly across sectors and throughout the economy. This is where SEED's recent work on social awareness, the policy environment, sectoral activities and business associations plays a role (SEED, 2003). The effects of these activities are much harder to capture in case studies because there is often no direct contact between SEED partners and the individual businesses that are affected. These activities are, however, part of a large-scale effort to reinforce the idea that job quality is a key factor in productivity improvement, along with physical capital, skills and technological change.

4. Conclusion

Productivity is a key source of competitiveness and business survival. Small enterprises, which generally exhibit low productivity, often survive by avoiding direct competition with larger, more productive firms. They do this by supplying small, niche markets or catering to a lower quality segment of the market. Low labour productivity translates into lower incomes for workers and owners. When that income is very low, it may not be sufficient for individuals and households to escape from poverty. People can work and still be poor. For small enterprises, the source of low productivity may be the organization of the work process and job quality, but it may also derive from a lack of demand. An enterprise may exhibit low productivity because human and capital resources are underutilized; for micro-enterprise owners this means under-employment.

The ILO's small enterprise programme (IFP/SEED) has sought to increase the productivity of small enterprises through improved job quality and market access. This has been pursued, in part, through the development and use of management curricula for different types of small enterprises. Working through service providers, the curricula have been used for courses in a variety of countries. The paper has reviewed a number of case studies based on the training and has shown the variety of ways in which a more cooperative, empowered and contented workforce can help to increase productivity. It is also clear that market demand is an important aspect of productivity and critical for the smallest firms.

For a global organization such as the ILO, instituting management training to support productivity increase is an important first step in testing the job quality approach. The full benefit of this work will come, however, from ensuring that these curricula are widely disseminated and take on a life of their own, independent of ILO support. The incorporation of the 'People and Productivity' module in the global SIYB programme will allow the approach to have greater impact. Furthermore, recent efforts to use a social awareness campaign in Ghana to reach a broad audience appear to have achieved good outreach and impact. Other interesting examples include work at the sector and cluster levels in developing countries, with local, collective institutions. There is still much that can be done to increase productivity through job quality and market access, thus bringing the benefits of the productivity movement to the poor.

Annex: Tables

Table A1: Value added per worker*, by enterprise size, Africa

	Cameroon	Côte d'Ivoire	Ghana	Kenya	Tanzania	Zambia	Zimbabwe
Enterprise size**							
0-9	28	13	22	56	39	38	44
10-49	41	53	35	118	38	67	63
50-99	111	69	33	119	61	65	79
100-249	113	103	72	165	55	71	81
250+	100	100	100	100	100	100	100

* Relative 'very large' enterprises (250+ workers);

** Size based on number of workers.

Source: Mazumdar and Mazaheri, 2001, p. 37.

Table A2: Value added per worker, East Asia

Enterprise size (workers)	Korea (R.) 1986	Japan 1987	Hong Kong, China* 1982	Taiwan, China 1986
5-9	31	32	54*	34
10-49	42	39	61	35
50-99	59	50	66	38
100-199	56	59	71	49
200-499	81	76	82	-
500+	100	100	100	100

* 1-9 workers

Figures are based on an index relative to the labour productivity of the 500+ category

Source: Mazumdar and Mazaheri, 2001, p. 37.

Table A3: SME contribution to employment and exports

	No. of SMEs as % of all enterprises	% of workforce employed by SMEs	% of SME exports in total exports
Australia	97	46	50
Canada	99	78	14
Indonesia	97	42	11
Japan	98	66	-
Korea, R.	99 ^a	69	43
Malaysia	84 ^a	40	15
New Zealand	99	53	23
Philippines	96	66	-
Singapore	92	52	16
Taiwan, China	98	78	56
United States	96	69	33

^a Manufacturing or industrial only; size based on national definitions.

Source: Harvie and Lee, 2002.

Table A4: Informal economy: Employment and output, 1990s

		Informal employment as % of		Informal economy
		total non-agricultural employment	total employment	output as % of total non-agricultural GDP
Algeria	1997	43	32	26
Benin	1993	93	33	43
Chad	1993	74	13	45
Kenya	1999	72	58	25
India	1991	83	26	45
Indonesia	1998	78	43	31
Mexico	1998	55	44	13
Philippines	1995	72	40	32
Tunisia	1995	50	39	23

Source: ILO, 2002, pp. 19, 24, except col. 4, calculated from col. 3 using World Bank WDI.

Table A5: Production, employment and productivity in manufacturing SMEs, Latin America, 1980s-1990s

	Base year = 100	Comparison year	Change in index value relative to base year		
			Production (gross output)	Employment	Productivity
Argentina	1984	1993	148	76	195
Brazil	1985	1997	111	86	130
Chile	1990	1996	156	134	116
Columbia	1991	1996	116	111	104
Costa Rica	1990	1996	123	79	155
Ecuador	1991	1996	109	93	117
Mexico	1988	1993	149	117	127
Peru	1992	1994	117	108	108
Uruguay	1988	1995	103	75	137
Venezuela	1990	1995	95	98	96

Source: data (rearranged) from: Peres and Stumpo, 2000, Table 9.

Table A6: MSE owners making above the monthly minimum wage, Kenya (full-time equivalent basis, 1995)

	% of owners making above minimum wage	Sub-group significance*
All MSEs	26	
Gender		
Male-owned	26	No
Female-owned	23	No
Education		
Primary or less	24	No
Some secondary or more	38	No
Paid workers		
None	25	Yes
Some	38	Yes
Credit received from formal institutions		
None	26	No
Some	23	No

* is there a statistically significant difference between the sub-groups?

MSEs: micro and small enterprises, having 10 employees or less.

Source: Daniels, 1999, p. 61.

Table A7: Wages, payments and benefits, by enterprise size, Tanzania

	Enterprise size (no. of employees)			
	1-4	5-25	26-99	100+
Average monthly wage (Tshillings)	10,502	9,078	12,757	13,173
as a % of large enterprises	80	69	97	100
Average weekly hours	51	46	45	44
Mode of payment ^a				
Time rate	60	79	95	100
Piece rate	24	15	5	0
as % of firm sales	16	6	0	0
% of firms paying ^a	13	45	72	96
Overtime pay	22	57	82	100
Paid leave	33	59	80	96
Paid public holiday	13	45	72	96
% of firms paying allowances ^a				
Food	18	48	60	88
Housing	18	49	70	96
Clothing	16	44	67	92
Transportation	16	44	67	96
Bonuses	5	30	49	32
% of firms unionized ^a	12	35	64	96
% of firms paying ^a				
Health care	25	54	82	100
Health care for family	12	37	48	78
Education for worker or family	4	12	20	54
Sick leave	24	52	68	100

All data refers to production workers in manufacturing enterprises.

^a Chi-square test showed significance at 1% level.

Total no. of enterprises = 257.

Source: Goedhuys, 2002, pp. 28-30.

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