# Chapter 1. Economic Context and the Role of SMEs in Latin America and the Caribbean

## The economic context

### *Achieving a sustained, sustainable and inclusive growth is necessary for Latin America to confront important challenges*

During the last two decades, the Latin American and Caribbean region has registered relatively dynamic economic growth, above the OECD average, although less than that of other emerging countries such as the Association of Southeast Asian Nations (ASEAN). This growth, which in many cases has been influenced by the levels of production and prices of basic products such as minerals, oil and food, has allowed the reduction of extreme poverty (from 29% to 16% between 2000 and 2014). ) and moderate poverty (from 17% to 14% for the same period) (OECD, 2016[1]).

Growth has continued, albeit with some volatility in some countries in recent years. During 2010-2013, the Latin America and the Caribbean region enjoyed high economic growth rates that then stagnated in 2014-2016 and even turned negative in some countries (Argentina and Ecuador - see Table 1.1). The region returned to the growth path in 2017 with an expansion of real GDP of 1.3%, on average, and continues a recovery trend that is expected to continue until 2020 (IMF, 2018[2]). Although expectations for 2018 had been favourable, in June 2018 the International Monetary Fund (IMF) revised downwards its estimates for the second semester of 2018 and 2019 in which the region is expected to continue growing, but less than what was originally projected. In addition, it should be noted that the growth rates forecast for the region for 2019-2020 are well below the average of those of other emerging countries such as Southeast Asia (above 6%).

The countries of the Pacific Alliance (Chile, Colombia, Mexico, and Peru) and the other three countries participating in this report (Argentina, Ecuador, and Uruguay) experienced a less pronounced slowdown in 2015 and 2016 and enjoyed growth rates in excess of regional average in 2017 and 2018 as noted in Table 1.1. However, these differences are expected to be reduced in 2019 and 2020, where their projected growth rates converge with the regional outlook. While the prospects are considerably more positive for Chile and Peru (4.0 and 4.1% in 2018, and 3.4 and 4.1% in 2019, respectively), the IMF considers that the economic crisis in Argentina will not diminish before 2020 (a decline of -2.6% in 2018 and -1.6% in 2019).

The main risks that can divert the region from this path of economic recovery are disruptions due to natural disasters, the uncertainty in the implementation of policies after electoral processes in several countries of the region in 2017 and 2018, and the potential negative effects on the intensification of the trade policies of some of the region's main partners, particularly the United States (BBVA, 2018[3]; World Bank, 2018[4]). Other geopolitical risk factors include the uncertainties between US-China relations, volatility in financial markets during 2018, the process of separation of the United Kingdom from the

European Union (Brexit) and the growing evidence of global slowdown at the end of 2018 early 2019, especially in China.

**Table 1.1. Real GDP growth for selected countries (2010-2020)**

| Real GDP growth (%) | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Argentina | 10.1 | 6 | -1 | 2.4 | -2.5 | 2.7 | -1.8 | 2.9 | -2.6 | -1.6 | 2.2 |
| Chile | 5.8 | 6.1 | 5.3 | 4.1 | 1.8 | 2.3 | 1.3 | 1.5 | 4 | 3.4 | 3.2 |
| Colombia | 4.3 | 7.4 | 3.9 | 4.6 | 4.7 | 3 | 2 | 1.8 | 2.8 | 3.6 | 3.7 |
| Ecuador | 3.5 | 7.9 | 5.6 | 4.9 | 3.8 | 0.1 | -1.2 | 2.4 | 1.1 | 0.7 | 1.3 |
| Mexico | 5.1 | 3.7 | 3.6 | 1.4 | 2.8 | 3.3 | 2.9 | 2 | 2.2 | 2.5 | 2.7 |
| Peru | 8.5 | 6.5 | 6 | 5.8 | 2.4 | 3.3 | 4 | 2.5 | 4.1 | 4.1 | 4.1 |
| Uruguay | 7.8 | 5.2 | 3.5 | 4.6 | 3.2 | 0.4 | 1.7 | 2.7 | 2 | 3.2 | 3.4 |
| LA7 | 6.4 | 6.1 | 3.8 | 4.0 | 2.3 | 2.2 | 1.3 | 2.3 | 1.9 | 2.3 | 2.9 |
| LAC region | 6.1 | 4.6 | 2.9 | 2.9 | 1.3 | 0.3 | -0.6 | 1.3 | 1.2 | 2.2 | 2.7 |

*Source*: Own elaboration based on (IMF, 2018[2])

Although the economic recession of the middle of this decade seems to have been overcome, the LAC region continues to face considerably lower growth rates than other developing regions and its enterprises continue to be characterized by very low levels of productivity (OECD/CAF/ECLAC, 2018[5]) The latter continues to be one great economic challenge for LAC, whose levels of internal productivity have remained stagnant since 1970 and have continued their prolonged decline compared to markets operating at the technological frontier (IDB, 2016[6]; OECD/CAF/ECLAC, 2018[5]). Consequently, and in spite of the heterogeneity characteristic of Latin America, the convergence with respect to the living standards of the advanced countries has slowed down, and in some countries it has even begun to reverse (OECD, 2016[1]).

To face such challenges, the region must continue and accelerate the pace of structural reforms in terms of education and skills, and a better allocation of human resources and capital to activities of greater productivity. This implies actions on different fronts such as the improvement of human capital, the consolidation of the business and investment environment, the strengthening of innovation frameworks, the improvement of infrastructures and the strengthening of public governance, including through the fight against corruption (OECD, 2016[1]).

Other challenges for the region include the development of a more diverse and numerous export base (after the fall in the external balance for the fourth consecutive year), a greater emphasis on savings and productive investment, and the strengthening of regional collaboration networks (BBVA, 2018[3]; IMF, 2018[2]; OECD/CAF/ECLAC, 2018[5]).

## SMEs in the LAC region

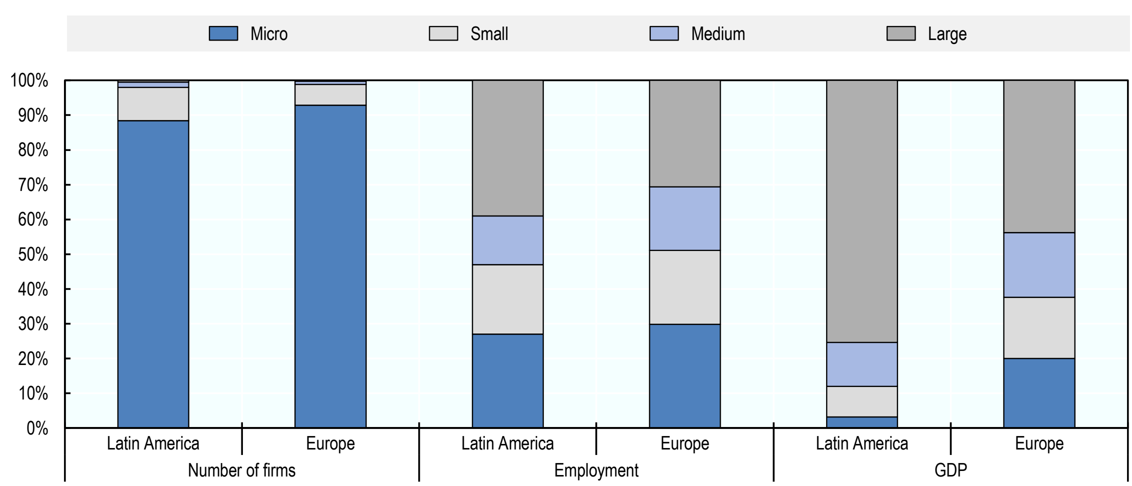
### *Latin America has many SMEs, but their productivity levels are low*

Micro, small and medium-sized enterprises (SMEs)[1] are a fundamental component of the economic fabric of the LAC region, as well as of the region's promotion and economic growth strategies. This leading developmental role is consistent with the high number of small enterprises operating in the region and their significant contribution to employment. According to some traditional measurements based on surveys such as the World Bank's *Enterprise Surveys*, 90% of enterprises in the region can be considered SMEs (Lederman et al., 2014[7]). However, these surveys are limited to formal manufacturing companies with more than five employees; so although they are useful, they do not describe the entire business universe of the region. Another limitation of these surveys is that they use a single threshold to define large enterprises (100 employees) that does not necessarily coincide with national definitions.

More-recent measures have sought to remedy some of these shortcomings by basing their calculations on household surveys that allow them to derive a more accurate picture of the smallest firms in the spectrum and the self-employed population. According to these calculations, 99.5% of Latin American firms are SMEs, with almost nine out of 10 firms classified as microenterprises (OIT, 2015[8]; Dini and Stumpo, 2018[9]). Together, SMEs represent 60% of formal productive employment in the region, but are responsible for a quarter of the total production value of LAC economies (Dini and Stumpo, 2018[9]).

The difference between labour market participation and value-added generation suggests a significant productivity gap between smaller and larger firms, in which a comparison with more developed regions is revealing. As shown in Figure 1.1, the proportion of formal enterprises that are considered SMEs is similar in LAC and Europe, covering almost the entire business universe (99.5% of the total). These enterprises generate around six out of every ten available formal jobs in the LAC region, while SMEs in Europe generate around seven out of every ten jobs. However, in Europe, SMEs contribute more than twice as much to the generation of wealth as their LAC counterparts. This difference is particularly large for companies at the end of the size spectrum: LAC microenterprises account for about 3.2% of production whereas in Europe they contribute six times more (20% of GDP) even though they have a fairly similar participation in the labour force (28% in LAC and 30% in Europe).

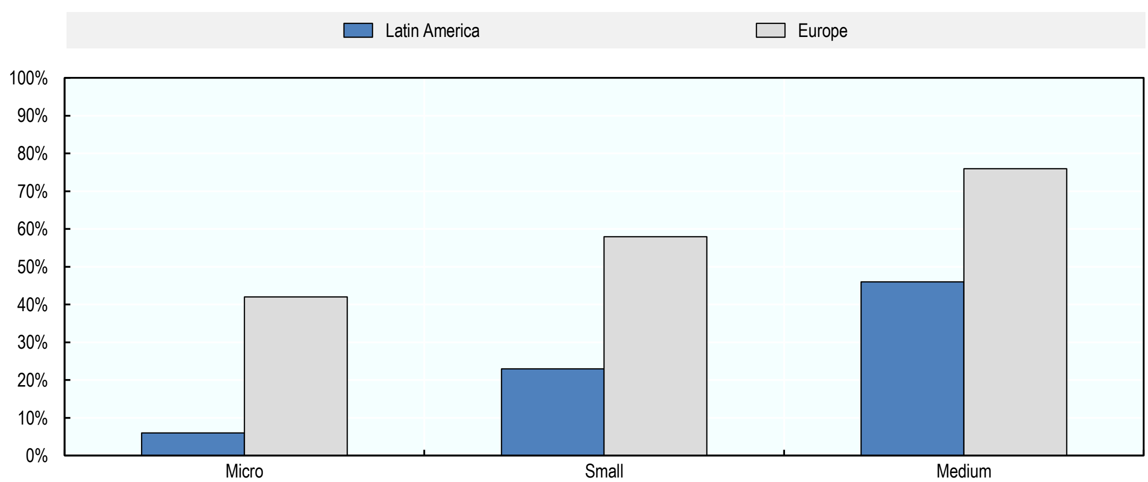
**Figure 1.1. Number of firms, share of employment, and share of gross domestic product (%)**




*Source*: Own elaboration based on (Dini and Stumpo, 2018[9]).

The large number of small firms and their relevance in the workforce contrasts sharply with their limited impact on GDP, revealing a marked productivity gap between large firms and the rest of the business universe in the LAC region. However, this relationship is better described after taking into consideration the different assets of productive factors (land, capital and labour) employed by each of the companies. Figure 1.2 compares the total factor productivity[2] of firms of different sizes. This provides a better measure of the magnitude of internal productivity gaps and how they are associated with enterprise size. Based on this measurement, within LAC, microenterprise productivity reaches only 6% of the productivity of large firms in the same country. Although small and medium-sized enterprises are considerably more productive than microenterprises, they are far from reaching the productivity levels of large firms in the region: the productivity of small firms is less than a quarter of the productivity of large firms, while the productivity of medium-sized firms is less than half the productivity of large firms. While there is also a positive relationship between enterprise size and relative productivity levels in Europe, the existing gaps are much more moderate. For example, the productivity of microenterprises in Europe is 42% of that of large enterprises, which is similar to the 46% achieved by medium-sized enterprises in Latin America (Dini and Stumpo, 2018[9]). Numerous studies maintain that these differences in productivity are a stylized (i.e. accepted) fact[3] in the different economies of the region (OIT, 2015[8]) and confirm that these gaps with large firms have widened over the past 50 years (Infante, 2011[10]). Older studies such as (Peres and Stumpo, 2000[11]) had already highlighted this trend towards a growing disparity in terms of productivity in past decades.

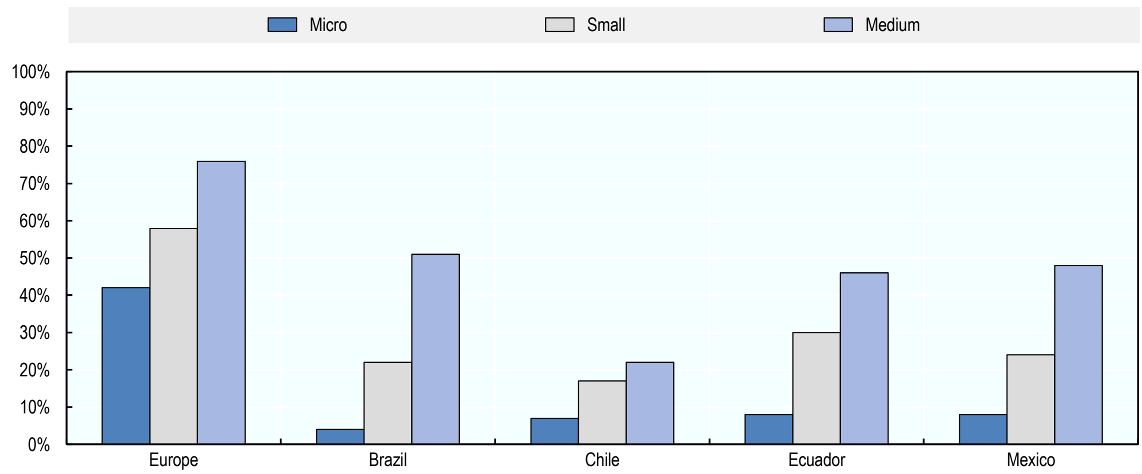
**Figure 1.2. SME internal productivity relative to large enterprises**




*Note:* Average productivity levels for micro, small and medium enterprises are expressed as a percentage of that of large enterprises, with average large enterprise productivity totalling 100%.
*Source*: Own elaboration based on (Dini and Stumpo, 2018[9]).

However, these regional comparisons hide important differences between countries. As shown in Figure 1.3, the productivity gap between microenterprises and larger firms is notable - particularly in Brazil, where microenterprises account for only 4% of the productivity of large firms. On the other hand, the notable gap sustained by small and medium-sized enterprises in Chile, whose relative productivity with respect to larger firms is considerably lower than that observed in other countries in the region, is striking. In other cases, such as Ecuador and Mexico, there are also notable differences in relative productivity levels, but they are less pronounced.

**Figure 1.3. SME productivity relative to large enterprises (Europe and selected Latin American countries)**




*Note:* Average productivity levels for micro, small and medium enterprises are expressed as a percentage of that of large enterprises, with average large enterprise productivity totalling 100%.
*Source*: Own elaboration based on (Dini and Stumpo, 2018[9]).

Part of the productivity gap identified is explained by the relative concentration of SMEs in economic activities with low added value and low productivity. As shown in Table 1.2, large companies dominate in mining, electricity, gas and water supply, and financial intermediation activities. While this is not surprising due to the economies of scale inherent in these activities, these sectors stand out for levels of productivity that are much higher than in the rest of the region's economy. Specifically, the mining sector is characterized by productivity that is nine times higher than the average, while service providers and financial operators have productivity levels that are two and four times the average for the region, respectively (Stumpo and Correa, 2017[12]; Dini and Stumpo, 2018[9]).

**Table 1.2. Participation in employment by economic activity**

| Sector | SMEs | Large |
|---|---|---|
| Agriculture, livestock, hunting, forestry and fishing | 66.1 | 33.9 |
| Mining | 32.6 | 67.4 |
| Manufacturing | 48.7 | 51.3 |
| Electricity, Gas and Water | 22.7 | 77.3 |
| Construction | 62.3 | 37.7 |
| Trade | 76.5 | 23.5 |
| Hotels and restaurants | 86.1 | 13.9 |
| Transport, storage and communications | 52 | 48 |
| Financial intermediation | 32 | 68 |
| Real estate | 55.8 | 44.2 |
| Education | 46.5 | 53.5 |
| Health and social services | 51.4 | 48.6 |
| Other | 82.3 | 17.7 |
| Total | 61.2 | 38.8 |

*Source*: Own elaboration based on (Dini and Stumpo, 2018[9]).

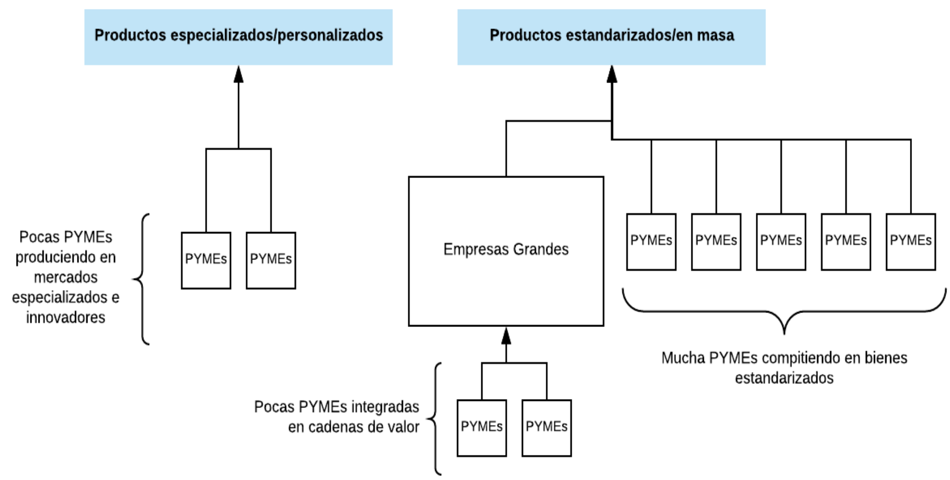
In contrast, smaller economic agents tend to specialize in economic sectors with lower requirements in terms of scale, technical capabilities, productive complexity and other barriers to entry (Burachik, 2002[13]; OIT, 2015[8]). Therefore, it is not surprising that SMEs dominate in activities such as retail trade, or in more traditional and low-productivity segments such as the agricultural sector (GEM, 2016[14]; OIT, 2015[8]; Dini and Stumpo, 2018[9]). In the last decade, this latter sector presented the greatest growth in the number of SMEs (Dini and Stumpo, 2018[9]).

While comparisons of SME productivity levels of SMEs in the LAC region are revealing, they underestimate the magnitude of the productivity problem for two reasons. First, most of these productivity measurements are based on formal enterprises and in some cases are even restricted to enterprises with more than five employees in specific economic sectors (Ibarraran, Maffioli and Stucchi, 2009[15]; CAF, 2013[16]). Since the informal and self-employed sector can be expected to have productivity levels that are even lower than those captured by these measurements, the gaps between large firms and the rest of the region's business universe summarized so far are an underestimation of the real existing gaps. Secondly, these comparisons reflect the differences between SMEs and large firms in the same country and therefore do not take into account the potentially larger external productivity gap: that is, the difference with firms of similar characteristics operating in countries with efficiency levels closer to the technological frontier. This last flaw is particularly relevant since the low levels of aggregate productivity of LAC economies have been consistently identified as one of the fundamental causes of the income gap with respect to other countries (IDB, 2016[6]; OECD, 2016[1]; Thompson Araujo, Voctrokutova and Wacker, 2016[17]).[4]

### *SMEs in the LAC region, while heterogeneous, lag behind more-developed markets in terms of SME integration into regional value chains*

One of the key characteristics of SMEs in developing countries is the way they interact with the rest of the business ecosystem. In the LAC region, most SMEs participate in sectors with low aggregate levels of value added and low levels of human capital, competing in markets with poorly differentiated products such as retail trade and agriculture. These firms are therefore highly exposed both to operating at low rates of return and to being displaced by larger firms (which are able to benefit from economies of scale and lower production and distribution costs). In contrast, only a small proportion of SMEs are integrated into value chains by providing specialized goods and services according to the specific requirements of their clients, or by providing intermediate goods and services to larger firms (see Figure 1.4). These SMEs, although scarce, tend to operate with high levels of both human capital and innovation (Altenburg and Eckhardt, 2006[18]; OIT, 2015[8]; Dini and Stumpo, 2004[19]).

**Figure 1.4. Productive Insertion of SMEs: LAC region**

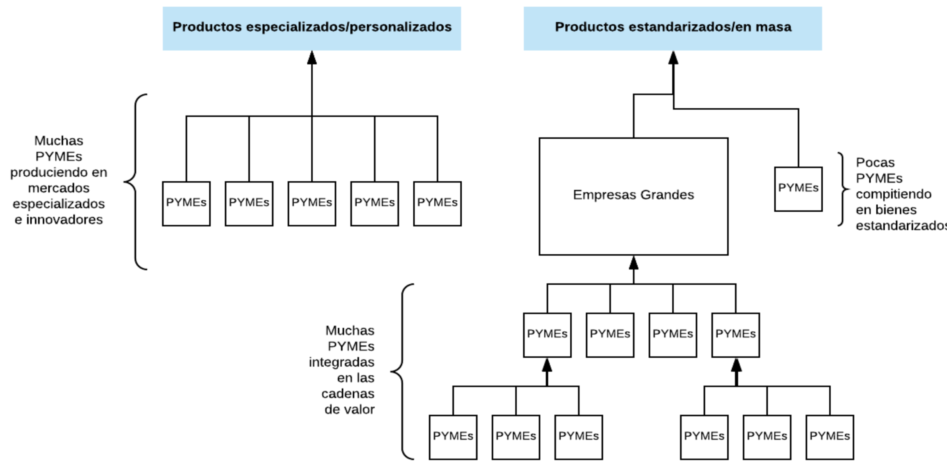



*Source*: Own elaboration based on (Altenburg and Eckhardt, 2006[18]).

Overall, however, SMEs' productive linkages to business remain weak, even in the most successful cases in the region. This is because these linkages depend on such factors as physical proximity to business agglomerations that generate economies of scale (such as the creation of a specialized labour market or access to public goods). Although these agglomerations are relevant, the advantages they provide are relatively static and do not provide solutions to the constant changes in the internal and external markets where these companies operate.

On the other hand, more advanced co-operative relationships usually require the collective and intentional action of the different participants, which allows them to adapt to changing market conditions. Two types of co-operation can occur: *horizontal* co-operation between competitors in the same market (for example, through the joint purchase of commonly used production machinery or the joint sale of products) or *vertical* co-operation between companies at different stages of the same production process. Although the LAC region has several development poles that seek to exploit some of the advantages of agglomeration, intentional and well-coordinated collective efforts among SMEs are less common than in more advanced markets (Dini and Stumpo, 2004[19]). Furthermore, in developed markets, smaller firms are better integrated into value chains by producing goods and services for larger firms or highly customized specialized products (Figure 1.5).

**Figure 1.5. Productive Insertion of SMEs: developed markets**




*Source*: Own elaboration based on (Altenburg and Eckhardt, 2006[18]).

Despite the productivity gap among SMEs in the LAC region, their heterogeneity should be noted. They cover the entire spectrum from small business organizations or one-person initiatives with very low value-added (developed as a refuge from unemployment), to highly specialized companies that are integrated into value chains and possess high levels of innovation and growth potential. In this sense, the World Bank (Lederman et al., 2014[7]) highlights the importance of differentiating between (a) self-employed individuals whose businesses are small but have limited growth potential and (b) young companies that, although still small, have high potential for growth and innovation. The authors argue that enterprise development policies should focus on new firms rather than small ones.

### *Many ventures in LAC are a refuge from unemployment*

According to a 2016 report by the Global Entrepreneurship Monitor, seven out of every ten entrepreneurs in LAC claim to have started their businesses to take advantage of a relevant opportunity (GEM, 2016[14]). However, this view seems too benevolent in light of the results of a 2013 CAF report (CAF, 2013[16]), according to which three quarters of microentrepreneurs can be catalogued as "subsistence enterprises" since their incomes and levels of job satisfaction are very similar to those observed in the informal sector.

Although these findings present a less favourable image of the region's entrepreneurial ecosystem, it would be wrong to conclude that most entrepreneurs in the region operate in the informal sector. The reality in the region is the opposite: the number of formal microentrepreneurs is higher than those who remain in an informal condition (Lederman et al., 2014[7]). However, the similarity between the two segments suggests that many ventures begin as a refuge from the difficulties of the formal labour market. In fact, even the Global Entrepreneurship Monitor recognizes that some of the region's economic difficulties in recent years translated into a greater proportion of individuals starting businesses as a response to unemployment (GEM, 2016[14]).

Another characteristic of these economic units is their high birth and death rates (CAF, 2013[16]; OIT, 2015[8]). According to the aforementioned 2016 GEM report, the percentage of nascent entrepreneurs is higher in LAC than in other developing regions with similar economic structures, although it also has one of the highest discontinuation rates of the regions considered (GEM, 2016[14]). However, the aforementioned 2014 World Bank report suggests instead that (a) business birth rates in LAC are below the levels expected for the region's level of economic development and (b) they also hide considerable heterogeneity among countries: while Costa Rica is in a very favourable position, others such as Argentina and Brazil are considerably behind what would be expected given their income levels (Lederman et al., 2014[7]).

These differences are usually attributed to entry barriers to the formalization of business activities. However, birth rates of formal enterprises have not risen, despite this area being a focus of policy development in the past decade. This suggests that entry barriers are not the most relevant constraint and that a series of deeper structural reforms would be necessary to stimulate the birth and growth of firms in the region.

A potential explanation for the LAC region’s unexpectedly low business birth rates underscores the distinction between (a) the relatively low limitations on undertaking low value-added businesses, the low differentiation among businesses, and the high vulnerability to economic cycles (GEM, 2016[14]), and (b) the higher entry barriers and structural weaknesses that hinder the emergence and consolidation of formal enterprises with greater growth and productivity potential (Lederman et al., 2014[7]).

### *Exporting and innovating are not the objectives of most SMEs in the region*

For many entrepreneurs, exporting has two potential benefits. First, it allows them to expand the size of the markets where they place their products. Second, it offers opportunities for learning and technology transfer: by interacting with customers with more sophisticated requirements or a greater inclination toward high quality, the entrepreneurs learn to operate with higher levels of productivity (Atkin, Khandelwal and Osman, 2017[20]). Access to new markets is also often associated with more innovative ventures that seek to exploit new market niches with novel products or modify the production processes of existing goods to make them more attractive to the public (Lederman et al., 2014[7]).

However, despite these potential benefits, the internationalization of commercial operations is not a high priority for most SMEs in the region. According to GEM data, on average, 71% of the region’s enterprises have no income from other markets; this percentage exceeds 90% in Argentina and Brazil, two of the region’s largest economies (GEM, 2016[14]). In contrast, in Chile, Colombia and Panama the proportions of exporting firms are considerably higher, but local markets still account for the overwhelming majority of their commercial activities. A 2016 CEPAL report (Urmeneta, 2016[21]), developed a unified definition of exporting SMEs for 14 countries in the region that considers internal and external sales and consolidates information from different public agencies. According to this definition, less than 1% of companies participate in foreign markets, although nine out of ten exporting companies can be considered SMEs. Although this percentage seems high, it should be interpreted in relation to the fact that almost all companies in the region are SMEs. Similarly, exporting SMEs represent only 5% of the value of external sales and 25% of the labour force involved in exporting activities. In developed regions, SME sales represent more than 40% of total exports, eight times more than the average in LAC (Urmeneta, 2016[21]).

Moreover, the few SMEs that do manage to export do not manage to do so in a sustainable manner: only 62% successfully repeat their activities in other markets annually. In contrast, more than 85% of the large enterprises that export are able to continue to sell their products in foreign markets (Urmeneta, 2016[21]). One reason for this difference is that many SMEs concentrate their activities on a single product and a single destination (45% of exporting SMEs), while larger companies export multiple products to several destinations, making them less vulnerable to changes in one of them. In other words, changes in the export activity of small companies occur mainly on the *extensive* margin (i.e. whether or not to export) while the decision of large companies focuses on the *intensive* margin (i.e. how much to export).

## SMEs and the role of the State

SMEs have remained at the centre of policy agendas in LAC as they attempt to foster economic growth while reducing poverty and inequality.

Policies designed to support SMEs can be justified from an economic point of view by the existence of market failures that limit their growth (Ibarraran, Maffioli and Stucchi, 2009[15]). First, SMEs are particularly vulnerable to information asymmetries that, for example, affect their access to credit through traditional financial institutions. Similarly, various factors prevent SMEs from integrating into value chains. In terms of access to finance, for example, the low unit value of loans required by SMEs may not be attractive enough for financial intermediaries to cover the fixed costs associated with processing the necessary information. This situation may also extend to many other factors such as the intensive labour market margin, as workers may not be willing to be employed for a discrete number of hours.

In addition, support for SMEs can be justified in view of the existence of positive externalities derived from their associative capacity to generate demand for goods and services from other productive sectors. In this case, these positive attributes would be an argument to subsidize the emergence and development of SMEs.

A second set of arguments are rooted instead in equity issues. Since SMEs represent a high percentage of the labour force – particularly those with lower levels of training and more limited labour opportunities – supporting the growth, technological upgrading and productive development of SMEs can be considered a mechanism to improve the living conditions of those who derive their livelihood from the commercial activities of these enterprises.

### *Government initiatives for SMEs in LAC*

The SME policies of LAC governments have generally been designed with three main objectives in mind: creating jobs, addressing market failures and increasing competitiveness. However, other issues have also been considered as central objectives by some national strategies, including the development of human capital and innovation capacities (Ferraro, 2011[22]; SELA, 2015[23]).

These SME promotion schemes address a variety of policy areas, among which the following stand out: (Ferraro and Stumpo, 2010[24]; Ferraro, 2011[22]; SELA, 2015[23]; GEM, 2016[14]; Dini and Stumpo, 2018[9]):

- **Enabling factors.** These are measures that benefit all productive entities. They include, for example, (a) macroeconomic stability to allow the development of business activities in a stable and predictable context that facilitates investments made over longer-time horizons; (b) development of the minimum infrastructure required to facilitate productive processes - for example in the area of roads and reliable public services; and (c) physical and legal security that allows entrepreneurs to enjoy the fruits of their own labour without the risk of appropriation by State officials or third parties.

- **Regulatory framework**. The legal framework for SMEs is usually contained within special legislation that provides (a) a formal definition of the sector for the country and (b) guidelines for the preferential treatment granted to this group.
- **Tax transfers and benefits**. In some cases, the regulatory framework may include fiscal measures that provide tax benefits for small businesses, as well as non-refundable transfers for the development of early-stage business activities.
- **Reduction of entry barriers.** These policies include the simplification of legal processes and reduction of costs associated with the formation of formal enterprises – through, for example, the creation of a simplified business typology applicable to smaller enterprises within the legal regime.
- **Access to finance**. The policy tools available in this case are highly varied, and include the following:
  - Providing funds and lines of credit - either directly through State financial institutions, or indirectly through second-tier agencies that direct resources to the financial system under better-than-market conditions;
  - Developing financial products appropriate to the size and needs of SMEs, such as factoring;
  - Facilitating access to accurate information to judge credit risks, for example by creating registers of credit information goods or services; and
  - Reducing market failures, for example by using government guarantee mechanisms to facilitate access to traditional banking for those without collateral.
- **Technical assistance, technology transfer and training**. These measures include consulting and training services designed to provide entrepreneurs with the financial and technical tools necessary to increase the competitiveness and growth potential of their firms. These also tend to be accompanied by technology transfer programmes to boost the productivity of enterprises through the more efficient use of other productive factors.
- **Innovation and improvement of productive processes.** These measures seek to discourage the paradigm of SMEs as a source of self-employment, while facilitating SME's use of more-advanced technology. The policy tools used for this purpose include subsidies, financing and technical assistance programmes, and business co-operation schemes aimed at encouraging smaller firms to invest resources in improving their production processes and developing new products and services.
- **Export incentives**. Because SMEs represent a very low percentage of the region's export volume, many governments in the region have developed tools to promote the integration of these companies into foreign-exchange-generating markets. The support measures usually employed include promotion efforts with entrepreneurs in foreign markets, provision of information on potential markets, consulting services and legal and technical advice, preferential financing lines, and guarantee schemes for access to credit, among others.

- **Co-operation and articulation in value chains**. These policies tend to follow two distinct approaches. First, there are programmes that seek to promote integration among peers that share a sectoral and/or regional approach, the objective being to exploit the benefits of associativity in terms of technology transfer and knowledge of the business area. Secondly, there are strategies that seek to integrate groups of small entrepreneurs into the supply chains of goods and services for larger companies to provide them with better economic conditions.
- **Public procurement**. The purchasing power of the State has also been used as a catalyst for the production of smaller firms. In this sense, measures have been implemented that favour SMEs in public bids or reduce the transaction costs of participating in these processes – through, for example, the implementation of electronic auction systems.

The multifaceted nature of productive policies aimed at SMEs highlights the importance of an integrated strategy that allows different tools to be used to remove the barriers limiting the birth and development of productive enterprises that are better integrated into the region's value creation systems. However, a fundamental requirement for the development of an integrated strategy is to carry out a holistic diagnosis of the support initiatives that have been implemented by a country in order to identify shortcomings and areas for improvement. This first SME Policy Index within the LAC region represents an effort in this direction.

## Notes

[1] For the purpose of this publication and due to varied definitions of micro, small and medium-sized enterprises across the region, the authors of this report typically use the term "SME" to refer collectively to micro, small and medium-sized enterprises, unless specified otherwise. See Chapter 2 for more information on the assessment methodology.

[2] Total factor productivity (TFP) refers to the proportion of the production of a company that cannot be explained by changes in the number of productive factors (normally capital and labour) used by a company in its production processes.

[3] In economics, a *stylized fact* refers to empirical findings that are so consistent (for example, across a wide range of markets and time periods) that they are accepted as fact.

[4] According to (Thompson Araujo, Voctrokutova and Wacker, 2016[17]), if Latin American countries could close the productivity gap with countries such as the United States, their income level would double without any other change in the assets of productive factors.

## References

Altenburg, T. and U. Eckhardt (2006), *Productivity enhancement and equitable development: challenges for SME development*, UNIDO. [18]

Atkin, D., A. Khandelwal and A. Osman (2017), "Exporting and Firm Performance: Evidence from a Randomised Experiment", *The Quarterly Journal of Economics*, Vol. 132/2, pp. 55-615. [20]

BBVA (2018), *Latin America Economic Outlook*, BBVA. [3]

Burachik, G. (2002), “Supervivencia de nuevas empresas industriales: una reseña de la literatura”, *Desarrollo Económico*, Vol. 42/165, pp. 85-116. [13]

CAF (2013), *Reporte de Economía y Desarrollo. Emprendimientos en América Latina: Desde la subsistencia hacia la transformación productiva*, CAF. [16]

Dini, M. and G. Stumpo (2018), *MIPYMES en América Latina. Un frágil desempeño y nuevos desafíos para las políticas de fomento*, CEPAL. [9]

Dini, M. and G. Stumpo (2004), *Pequeñas y Medianas Empresas y Eficiencia Colectiva. Estudios de caso en América Latina*, CEPAL. [19]

Ferraro, C. (2011), *Apoyando a las pymes: Políticas de fomento en América Latina y el Caribe*, CEPAL. [22]

Ferraro, C. and G. Stumpo (2010), *Políticas de apoyo a las PYMES en América Latina. Entre Avances Innovadores y Desafíos Institucionales*, CEPAL. [24]

GEM (2016), *GEM America Latina y el Caribe 2015/16*, Global Entrepreneurship Monitor. [14]

Ibarraran, P., A. Maffioli and R. Stucchi (2009), “SME Policy and Firms’ Productivity in Latin America”, *IZA Discussion Paper Series 4486*. [15]

IDB (2016), *The Productivity Gap in Latin America: Lessons from 50 Years of Development*, IDB Department of Research and Chief Economist. [6]

IMF (2018), *Regional Economic Outlook. Western Hemisphere. An Uneven Recovery. Oct 2018*, International Monetary Fund, Publication Services. [2]

Infante, R. (2011), *El desarrollo inclusivo en América Latina y el Caribe. Ensayos sobre políticas de convergencia productiva para la igualdad*, CEPAL. [10]

Lederman, D. et al. (2014), *El emprendimiento en América Latina. Muchas empresas y poca innovación - Resumen*, World Bank. [7]

OECD (2016), *Promoting Productivity for Inclusive Growth in Latin America*, OECD. [1]

OECD/CAF/ECLAC (2018), *Latin American Economic Outlook 2018: Rethinking Institutions for Development*, OECD Publishing. [5]

OIT (2015), *Panorama Laboral Temático. Pequeñas empresas, grandes brechas. Empleo y condiciones de trabajo en las MYPE de América Latina y el Caribe*, OIT. [8]

Peres, W. and G. Stumpo (2000), “Small and Medium-Sized Manufacturing Enterprises in Latin America and the Caribbean Under the New Economic Model”, *World Development*, Vol. 28/9, pp. 1643-1655. [11]

SELA (2015), *Políticas Públicas de apoyo a las MIPYMES en América Latina y el Caribe*, SELA. [23]

Stumpo, G. and F. Correa (2017), *Brechas de productividad y cambio estructual*, CEPAL. [12]

Thompson Araujo, J., E. Voctrokutova and K. Wacker (2016), *Understanding the Income and Efficiency Gap in Latin America and the Caribbean*, World Bank. [17]

Urmeneta, R. (2016), *Dinámica de las empresas exportadoras en América Latina*, CEPAL. [21]

World Bank (2018), *Global Economic Prospects*, World Bank. [4]


**From:**

# Latin America and the Caribbean 2019

## Policies for Competitive SMEs in the Pacific Alliance and Participating South American countries

**Access the complete publication at:**

https://doi.org/10.1787/d9e1e5f0-en

**Please cite this chapter as:**

OECD/CAF Development Bank of Latin America (2019), “Economic Context and the Role of SMEs in Latin America and the Caribbean”, in *Latin America and the Caribbean 2019: Policies for Competitive SMEs in the Pacific Alliance and Participating South American countries*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/c9838890-en