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The importance paradox: an analysis of the microenterprise landscape in Colombia

by María Camila De La Hoz, Juan Tenjo and Juan Sebastián Vallejo¹

Even though microenterprises in Colombia represent approximately 80 percent of the national productive sector, accounting for 33 percent of the labor force and approximately 5 percent of the aggregated value, the microenterprise segment has many problems in productivity, formality and innovation compared to its bigger brothers. This is a paradox of utmost relevance as these structural problems have greatly influenced the COVID-19 impact on microenterprise, one of the most affected sectors during the crisis. Taking advantage of a new, detailed national microenterprise survey (EMICRON), this document sheds a light on the structural and institutional problems that affect the wellbeing of microenterprises in Colombia and characterizes the junctural impact of the COVID crisis in the sector. It was found that microenterprises in urban areas, with limited access to information and communication technologies (ICTs), female-owned, having more than one employee, relatively new to the market and highly informal, were the most impacted in terms of ceasing operations and a significant drop in sales. This is related to costs in COVID restrictions, closures and their lack of resources (knowledge, finance and tech) to deal with the crisis and adapt to the 'new normality'. Based on these findings, this document indicates that the direction of the economic recovery should not only focus on overcoming the crisis but should incorporate long-term and structural policies. This includes fostering an environmentally conscious and gender-oriented economic growth so that microenterprises can offer better employment conditions and increase the general welfare, simplify labour and tributary laws to promote easier formalization and offer tech modernization opportunities and expand human capital to increase productivity and access to governmental aid.

Lockdowns and many of the measures taken to prevent the spread of the COVID-19 virus during the pandemic have increased inequalities in several countries as they represented an economic shock in terms of supply and demand: the productive sector suffered major disruptions, translating into higher rates of unemployment, loss of purchasing power, increasing levels of poverty, reduction in private investment and reduced productivity levels, which at the same time modified the preferences and demand levels of households (Consejo Privado de Competitividad, 2021). This profound recession in Latin America and the Caribbean (LAC) and Colombia is reflected in a negative Gross Domestic Product (GDP) growth rate of 6.3 percent and 6.8 percent, respectively (DANE, 2021a; World Bank, 2020).

While firms of all sizes have been affected during COVID-19, micro, small, and medium enterprises (MSMEs) have been more deeply affected around the globe in both sustained decline in sales and higher rates of permanent closure (López-Calva, 2021; World Bank, 2021). At the same time, the economic sectors most affected by the COVID-19 crisis are those overrepresented by MSMEs: wholesale and retail trade, accommodation and food services, real estate, professional services and other personal services (OECD, 2021).

Nonetheless, the COVID-19 crisis impacted the economy with already-existing underlying disadvantages for MSMEs in Colombia and LAC: MSMEs are mainly family-owned or run by self-employed individuals, rely on very limited resources and have limited access to formal financing and insurance, belong to vulnerable supply chains and are vulnerable to adverse shocks due, in part, to their informal nature² (Caballero-Morales, 2021; López-Calva, 2021; OECD, 2021). Additionally, these firms are particularly vulnerable to climate change and extreme weather events, limiting their organizational resilience capacity (Gannon, 2020; Linnenluecke & Griffiths, 2010; Skouloudis et al., 2020).

Additionally, MSMEs have, on average, lower productivity levels than large firms. Latin American MSMEs present a significant productivity gap, being responsible for only 30 percent of the region's total GDP, which contrasts with the contribution of MSMEs to GDP in Organisation for Economic Co-operation and Development (OECD) countries, which is 60

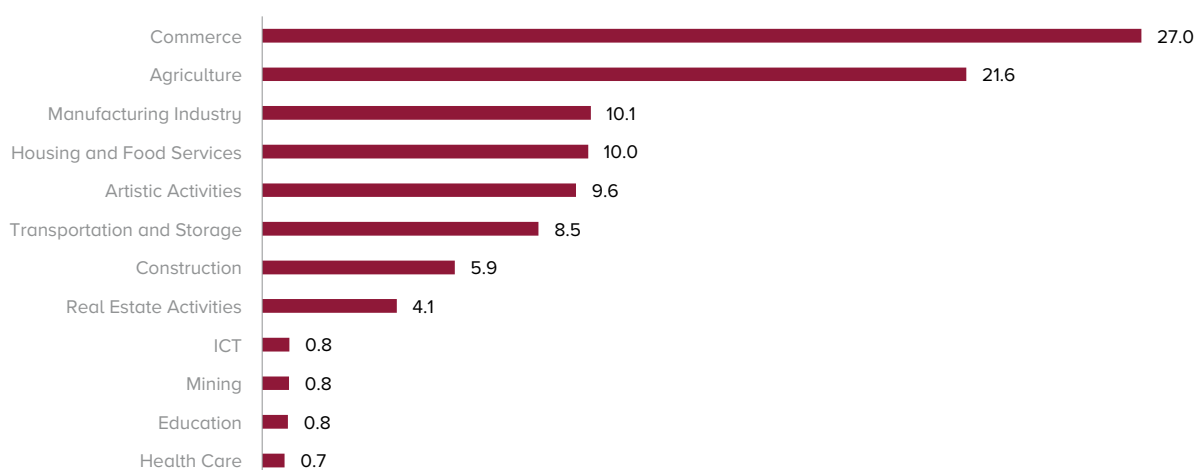
percent (OECD & CAF, 2019). MSMEs in the region account for about 3.2 percent of production, while in Europe they contribute six times more (20 percent of GDP) even when having similar participation in the labor force (OECD & CAF, 2019). This gap has been deepened even more with the COVID-19 crisis: many MSMEs face difficulties in the uptake of digital tools and technologies, which are fundamental tools to build resilience during the pandemic (Consejo Privado de Competitividad, 2021; OECD, 2021). This situation is worsened by the fact that MSMEs are less likely to innovate compared to large enterprises (OECD, 2021), which limits their ability to adapt.

Comparing the productivity gaps of industrial MSMEs in Colombia with large industrial companies, it is found that microenterprises produce, on average, a little more than a tenth of that of large companies, while MSMEs produce around half (Gómez-Restrepo & Borda, 2020). Some studies have concluded that very few large companies coexist in Colombia that foster value creation and formal employment, with a big ecosystem of informal and low-productive firms (Consejo Privado de Competitividad, 2021; McKinsey Global Institute, 2019). According to Dieppe (2021), in the context of the current crisis and at the current rate, it will take more than a century to halve the productivity gap of emerging economies versus advanced ones.

For all the reasons mentioned above, it is important to understand the MSME context in Colombia. Therefore, and taking advantage of a new detailed survey representative at the national level of the microenterprise context in the country, the next two sections of this brief will characterize and analyse the COVID-19 impact in this important subgroup of the MSMEs.

A 'familiar' context: The microenterprises in Colombia

According to the 2020 survey of microenterprises³ (EMICRON), in Colombia, there are 5.4 million microenterprises, located mainly in the urban areas (71 percent), accounting for 33 percent of the labor force and approximately 5 percent of the aggregated value. Almost half of the microenterprises have 10 years or more in the market and are from the commercial and agricultural sectors, denoting a low degree of economic diversification (see Figure 1).

Figure 1 Share of microenterprises by economic sector (%)

Source: EMICRON (2020)

From a demographic point of view, 64 percent of microenterprises have a male proprietor, close to two times the number run by women, and almost all proprietors are self-employed (90 percent). This ratio is maintained when we look up the total workforce of the microenterprises, where once again the women have a minority share relative to men (34 percent). Nonetheless, it highlights the fact that in all the working categories (owner, salaried worker and partner), the women's share in labor is less relative to that of men, except for unpaid work, where women represent 53 percent of the total.

On the other hand, of the total microenterprises, 88 percent stated that they had not paid social security contributions and 87 percent were not registered with the local commerce institution, signs of a deeply informal and vulnerable economy. This situation is closely related to unskilled and unproductive labor, depicted in a disproportional aggregated value share (5 percent) and labor market share (36 percent) of the microenterprises in Colombia.

In terms of ICTs, 90 percent of microenterprises do not have access to a tablet, computer or laptop, which directly affects other important areas in the digital realm, like not having access to the internet (69 percent), not having a webpage (98 percent) and lack of presence in social media (92 percent), and therefore no possibility of e-commerce. Additionally, data from the same survey for 2019 showed that 99 percent accepted only cash as a payment method, and only 19 percent had asked for a bank loan.

Given the above, we conclude that the microenterprise landscape is quite homogeneous, characterized by the structural problems identified in LAC, with microenterprises in Colombia primarily owned by a self-employer, informal, not diversified and with very limited access to technology or finance. This is of utmost importance because lack of financial access is constantly referred to in the literature as the first obstacle of growth in MSMEs (Grazzi & Pietrobelli, 2016), hindering their ability to invest in ICT adoption, research and development and therefore depriving them of the virtuous cycle of innovation and productivity (Grazzi & Pietrobelli, 2016). Additionally, the informality profile of the majority of the microenterprises makes them a difficult target for public policies that aim to improve productivity and accumulation of human capital and increases the vulnerability of their employees due to lack of social protections (Basto Aguirre et al., 2020).

Impact of the COVID-19 crisis in microenterprises in Colombia as of 2020

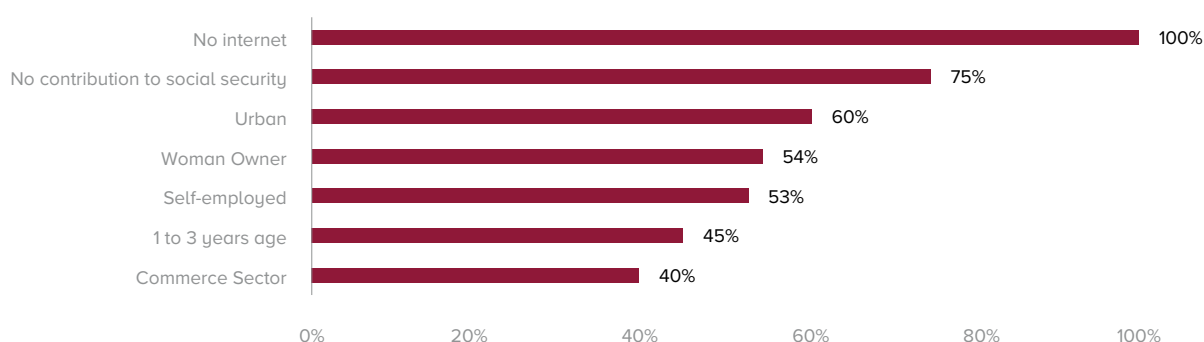
In general terms, the COVID-19 crisis caused a drop in the number of microenterprises by 7.3 percent between 2019 and 2020. As shown in Figure 2, of those 427,000 businesses that ceased to operate, 100 percent did not have internet access and 75 percent did not make contributions to social security. The businesses were mainly urban (60 percent), had self-employed proprietors (53 percent), were relatively young (45 percent) and belonged to the commercial sector (40 percent). In general, these results reflect the overall characteristics of the average microbusiness described above. Nonetheless, several facts stand out.

First, even though it was foreseeable that most of the lost businesses wouldn't have had internet access due to the poor ICT and internet penetration that characterized the microbusinesses in the country, it highlights the fact that the microenterprises with internet connections rose 18.5 percent between 2019 and 2020. This result is aligned with the type of crisis experienced, as the pandemic forced a big share of the economy to transition to a virtual and digital model to continue operating.

Second, even though female-owned microenterprises were a minority relative to male-owned (36 percent), they accounted for 54 percent

of the closed microenterprises, equivalent to a two-fold drop in women-owned micro-enterprises (12 percent) relative to men-owned (6 percent). Furthermore, even though this outcome is mainly driven by an urban effect, the gap increases in rural areas by approximately six percentage points, with a decrease in women- and men-owned microenterprises of 19 percent and 7 percent, respectively. The above clearly shows a biased impact of the crisis towards women, aligning with other studies regarding the impact of the pandemic on the labour market, showing that women had a bigger share in unemployment, more women entered inactivity and women presented a slower recovery of employment relative to men.

Figure 2. Microenterprises that stopped operating between 2019 and 2020 by characteristics



Source: EMICRON (2020)

Last, it stands out that 47 percent of the closed microenterprises were not run by a self-employed proprietor and 45 percent were businesses less than three years old—especially since, according to the 2019 microenterprise survey, these types of businesses accounted for only 12 percent and 18 percent of total microenterprises, respectively. This is reflected in a deeper impact in these categories, where businesses not characterized as self-employment dropped by nearly 28 percent and those in operation for one to three years dropped by 18.3 percent. In fact, unlike age, business size holds even when the microenterprises are disaggregated by the number of employees, suggesting a positive correlation (see Table 1).

Table 1. Annual variation in microenterprises by the number of employees.

| Number of employees | Percentual variation | Contribution (p.p.) |
|---------------------|----------------------|---------------------|
| 1 | -3.5 | -2.6 |
| 2 - 3 | -16.7 | -3.4 |
| 4 - 9 | -31.5 | -1.3 |

Source: EMICRON (2020)

These results are complemented with the data of employee variation by type of labour relations. According to the survey, paid workers dropped by 30 percent, accounting for 46 percent of the total employment lost between 2019 and 2020. The above suggest labour costs as a possible channel for the link between the size of the microenterprise and a bigger impact of the crisis. From a gender perspective, women presented a 32 percent drop (representing 32 percent of the total drop in salaried workers), which, along with the 54 percent reduction in female ownership, greatly explained the 1 percentage point reduction in women's participation in the microenterprises labor market.

Furthermore, a sales variation analysis was developed to assess the effect of the pandemic in terms of the magnitude of the impact on microenterprises that survived. There was a national total 27 percent decrease in sales, but the drop within informal businesses stands out. Even though the fall in sales was greater for those that do not have a taxpayer registry (RUT), the difference is low compared to the ones that do have it. It is also found that businesses that contributed neither to health insurance nor to a

retirement fund had a greater loss in sales (-23 percent) than those that did contribute to one or both of those funds (-14 percent). In this context, informal microbusinesses showed a greater drop in sales related to less productivity, lower savings rates, and less capital accumulation, making it harder for them to overcome temporal stops. Additionally, informality also represents a barrier for microenterprises to access the benefits provided by the government in times of crisis (OIT, 2021).

Regarding gender, female owners had a greater drop in sales (-27 percent) compared to male business owners (-20 percent). This can greatly be attributed to schools closing, which increased the number of hours women had to spend as caretakers within the family, thus impacting their productivity. Evidence in this matter shows that in

Colombia, there was an increase of 67 percent in the number of hours a week spent in childcare and 89 percent in the hours a week spent cooking, cleaning, doing homework with children and taking physical care of other members in the family (BID & Mujeres Connectamericas, 2021).

Another important aspect lies in the great difference in the drop of sales between businesses with employers (-1 percent) and those with self-employed owners (-23 percent). A good reason for this difference might be related to the impact of lockdowns in specific sectors. Studies have shown that the self-employed worked 86.5 percent fewer hours a week during quarantine, making them also the most affected at gaining profit from their work. Bigger companies with more employees usually have more emergency funds and financial opportunities to recover (OIT, 2021)

Table 2. Sales variation rate between 2019 and 2020 on specific categories.

| Variable | Category | Variation in sales 2019-2020 (%) |
|-------------------------------------------|-----------------------|----------------------------------|
| Sector | Construction | -48 |
| | Commerce | -12 |
| | Agriculture | -0.7 |
| Gender of the owner | Male | -20 |
| | Female | -27 |
| Class | Urban areas | -24 |
| | Rural areas | -6 |
| Owner-status | Employer | -1 |
| | Self-employed | -22 |
| RUT (Colombia's taxpayer registry) | No | -22 |
| | Yes | -18 |
| Social security contribution | No | -23 |
| | Yes | -14 |
| | Only retirement fund | -32 |
| | Only health insurance | -14 |

Source: EMICRON (2019, 2020)

Based on the analysis above, structural vulnerabilities affect most microenterprises, therefore permeating the closed business characteristics as well. The lack of access to ICTs and adoption of technologies seriously limits the innovation capabilities as well as the productivity and competitiveness potential of the microenterprises in a modern and globalized

environment—issues that expanded in a crisis that severely limited the face-to-face operation.

The widespread informal status and the inability to thrive if the business is relatively small or new in the market denote profound institutional limitations to creating a suitable environment to engage in business. According to the 2020

Doing Business report for Colombia, it is relatively easy to start a new business, but the tax framework is inefficient and access to credit is limited. The ability of microenterprises to increase their resilience to external shocks as well as their productivity and competitiveness depends heavily on overcoming these barriers through long-term public policies that will be described more in detail below.

On the other hand, there are junctural vulnerabilities, such as belonging to the commercial or construction sector in an urban area, given that restrictions were stronger in

the cities where the pandemic virus spread more rapidly. Additionally, relatively bigger microenterprises were more affected in a context where labour and operation costs were more weighted in an almost entirely virtual operation. Finally, women-owned businesses were especially affected through both more frequent closures and further drops in sales. This is linked with a more profound impact on the labour market sectors with female overrepresentation, like food and housing services, artistic activities and health care, as well as bigger increases in women's inactivity relative to men's, due to unpaid domestic labor.

Policy considerations

The ability of microenterprises to face the COVID-19 crisis at the lowest cost depends on addressing not only the junctural issues that determined the impact of the crisis but also structural variables that directly impact the productivity and competitiveness of the businesses in the long term. To achieve a successful and resilient recovery process, it is not enough to just return to the path of economic growth before the crisis, but also to ensure that it is a sustainable and regenerative economic growth, one that aligns with long-term emission reduction goals, factors in resilience to climate impacts and knowledge about adaptation options, slows biodiversity loss, increases circularity of supply chains and factors in climate-smart inputs and services (Gannon, 2020; OECD, 2020).

UNDP has broadly worked towards achieving Sustainable Development Goal 8, "decent work and economic growth," fostering institutional capacities to enhance markets and microenterprises capabilities, as the biggest part of the labour supply

increasing the costs of informality without reducing welfare.

Per the 2020 report of the Global Competitiveness Index for Colombia, the dimensions that need more improvement are the ones related to innovation capabilities, institutions and ICT adoption, all fundamental for effective support of microenterprises. Therefore, it is necessary to: simplify the tax regime and improve the tributary and overall benefits for firms that affiliate to the local commerce or business development institutions; foster greater participation by microenterprises in the public procurement; implement public policies focused on relatively small and young microenterprises, oriented to technical assistance, basic business development programs and financial and ICT education, among others; and create accompaniment and formalization programs to monitor the development of new microenterprises to design more efficient and better-targeted programs based on the

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