



International  
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# MSME Productivity, Inclusive Growth and Decent Work Creation

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## Executive Summary

This joint ILO-OECD report focuses on the relationship between MSME productivity, inclusive growth and decent work creation. Labour productivity is a key long-term driver of income growth. Emerging and developing economies where labour productivity has grown the most over the last 35 years are also those where poverty rates have dropped the most. However, the link between labour productivity growth and income growth cannot be taken for granted, as the recent experience of some high-income economies shows (i.e. decoupling of average wage growth from labour productivity growth).

While MSMEs are the main source of employment worldwide, they are lagging behind larger companies in terms of labour productivity. Existing evidence even suggests that productivity gaps by firm size have widened over the last 10 years in many OECD countries, possibly due to increased market concentration. These important productivity gaps by firm size fuel income inequalities, a critical area of concern for policy makers.

Increasing productivity levels across the whole spectrum of MSMEs requires a comprehensive approach that leverages the main drivers of MSME productivity at macro, meso (i.e. sector) and micro (i.e. firm) levels. A “Productivity Ecosystem for Decent Work” framework is needed that addresses the main MSME productivity drivers such as management and workforce skills, business digitalisation, enterprise formalization and access to social protection. In addition, taking a sector and local lens in the promotion of MSME productivity growth is particularly important to account for the significant variations in productivity challenges across sectors and regions, calling for adapted and tailored policy solutions.

Building on the stock taking of key trends, the report offers some broad policy recommendations (i.e. policy leads) to enhance MSME productivity. Given the cross-cutting nature of MSME policies, which span different policy areas and levels of governance, many of these measures require close coordination between different government ministries and private sector stakeholders. However, measures where labour ministries can take the lead include:

- Introducing an employment policy framework that offers adequate social protection and upskilling and reskilling opportunities to workers in MSMEs, including those transitioning from the informal to the formal economy.
- Developing an integrated approach to workforce skills upgrading that is tailored to industry needs and built upon consultation between employers’ and workers’ organisations.
- Encouraging social dialogue with social partners to ensure that MSME productivity policies are informed by and address the needs of employers and workers.
- Promoting workplace-based cooperation mechanisms to ensure that workers understand and implement new productivity-enhancing practices introduced by managers and that eventual productivity gains also trickle down into higher wages.

## Introduction

Given the relationship between productivity levels and wages, productivity growth has traditionally been a major driver of income growth and improved living standards. However, average productivity levels in micro, small and medium-sized enterprises (MSMEs) are lower than those in larger companies, which affects global income inequalities as MSMEs are the main providers of employment worldwide.

This joint ILO-OECD report focuses on the relationship between MSME productivity, inclusive growth and decent work creation. The first section of the report examines the importance of productivity growth for income growth and presents evidence on the labour productivity differential between MSMEs and larger companies. The second section provides a holistic policy framework (i.e. the Productivity Ecosystem for Decent Work Framework) that helps policy makers identify and act on the key drivers of MSME productivity growth and decent work creation. The third section summarises the main messages of the report and offers some broad policy recommendations on what governments, both at national and subnational levels, can do to encourage productivity growth in MSMEs.

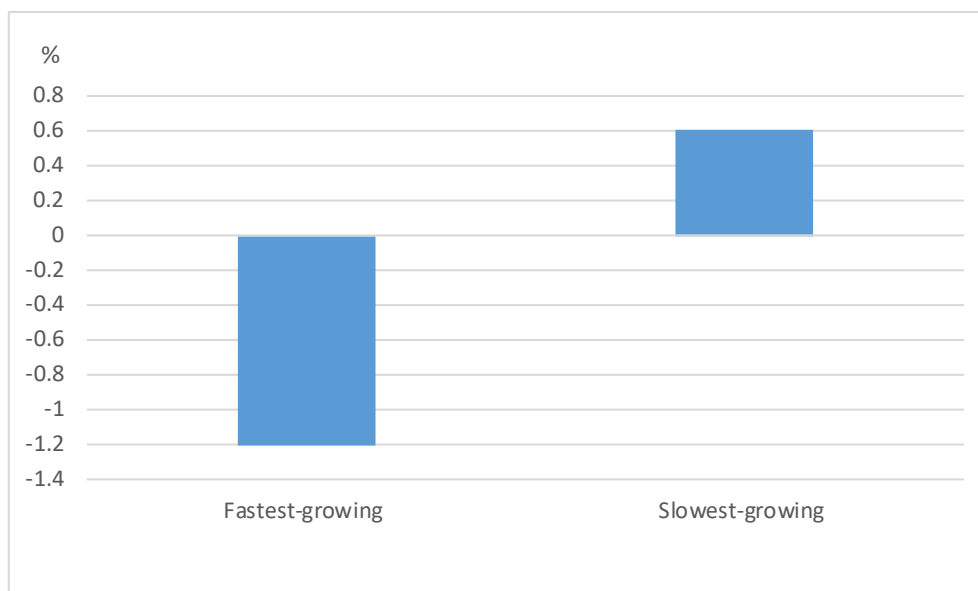
## Recent trends in aggregate and MSME productivity

### ***Productivity is a key driver of income growth***

Productivity is a key driver of income growth; labour productivity growth, especially when measured in terms of value added per hour worked (see Box 1 for statistical definitions), is a good predictor of income per capita growth. Moreover, there is a cross-country association between higher productivity growth and declining poverty. For example, a recent World Bank report shows that the top quartile of emerging and developing economies ranked by labour productivity growth over the period 1981-2015 reduced their poverty rates by an average of more than 1 percentage point per year, while poverty rates increased by 0.6 percentage points per year in the lowest quartile of countries ranked by labour productivity growth (Figure 1) (Dieppe, 2021<sup>[1]</sup>).

**Figure 1. Annual labour productivity growth and variation in extreme poverty, 1981-2015**

Annual rate of poverty reduction in the top and bottom quartiles of emerging and developing economies ranked by labour productivity growth



Note: Labour productivity is defined as output per worker in U.S. dollars. Poverty rate is defined as the share of the population living on less than USD 1.90 a day (2011 PPP).

Source: (Dieppe, 2021<sup>[1]</sup>)

### Box 1. What is productivity

Productivity is the ratio between a volume measure of output and a volume measure of input. Labour productivity, which is the most widely used type of productivity measure, corresponds to the amount of output generated by a unit of labour input, preferably measured by “hours worked”, although data constraints often result in estimates based on “persons employed”. Whilst gross output can be used to measure the volume of output, this is affected by the level of vertical integration of the firm and the process of substitution between labour and intermediate inputs, and so measures of gross value added (i.e. including depreciation) are preferred and widely used.

Another measure of productivity is capital productivity, which is less commonly used by policy makers and corresponds to the volume of output (value added) generated by a single (monetary) unit of capital input. Capital productivity tells us how productively capital assets are used to generate value added.

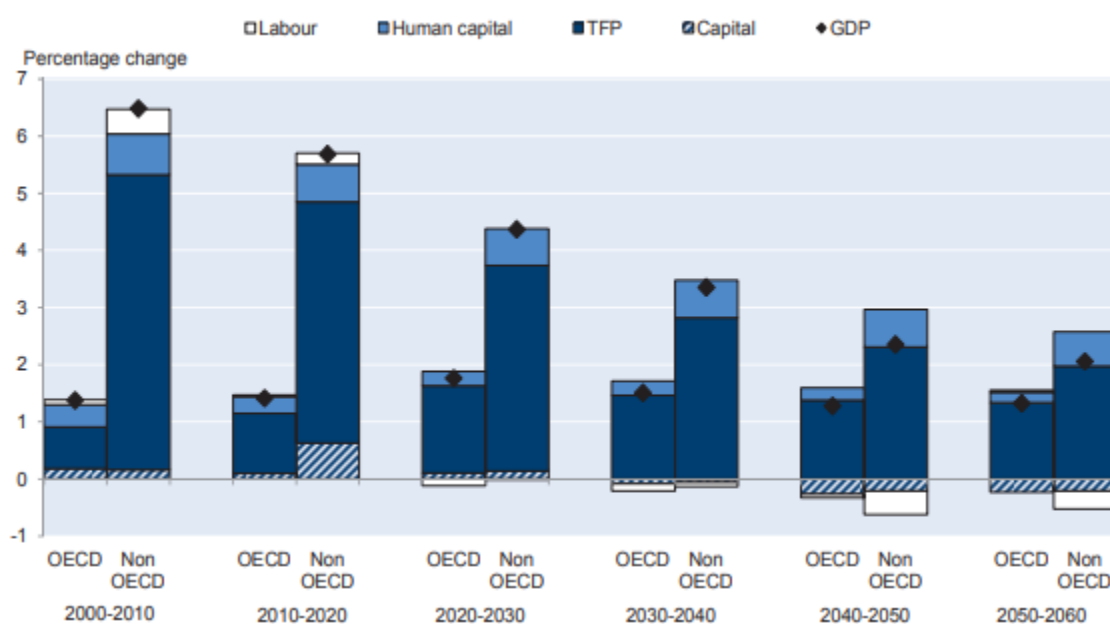
Finally, total factor productivity (TFP) can be defined as the volume of output (value-added) that is not explained by the contribution of the two main factors of production: labour and capital. Accordingly, when value-added is used as the measure of output, TFP is interpreted as a measure of efficiency in the production process and technological progress (only disembodied technological change). If measures of gross output are used, then, in addition to labour and capital inputs, intermediate inputs, such as energy and materials, are included (typically referred to as KLEMS approaches).

Source: (OECD, 2001<sup>[2]</sup>)

From a growth accounting perspective, total factor productivity (TFP) (see Box 1 for the definition) is also a critical source of GDP growth, as the strength of other sources of growth such as labour (increase in the working-age population, which has an upper limit) and human capital (increase in the average level of education) tends to dwindle with economies becoming more advanced (Figure 2). In turn, TFP growth, in practice, captures pro-competition reforms, where regulations are relatively restrictive, dissemination of new discoveries and innovations made at the technological frontier (and not captured in the values of new assets recognised as such in the System of National Accounts, SNA) as well as changes in the contribution of knowledge-based capital outside of the SNA asset boundary (OECD, 2015<sup>[3]</sup>)

**Figure 2. Contribution to growth in GDP per capita, 2000-2060 (annual average)**

Percentage contributions

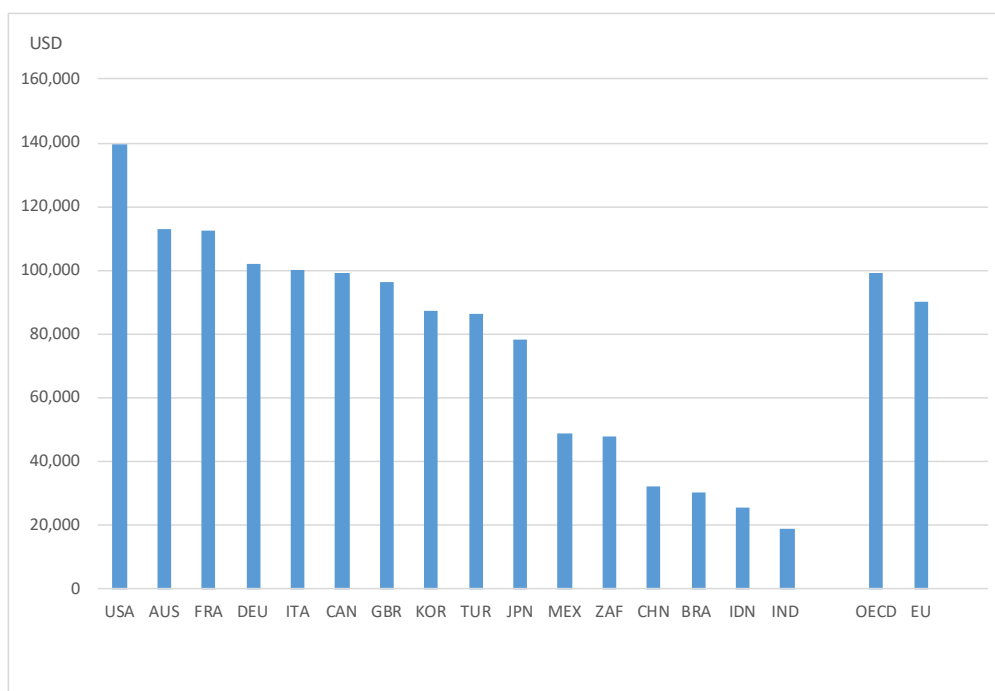


Source: (OECD, 2015<sup>[3]</sup>)

Across G20 economies, labour productivity levels (GDP per person employed) range from nearly USD 140 000 per person employed in the United States to less than USD 20 000 in India (Figure 3). However, G20 emerging economies have shown a significant process of convergence in the last 30 years, which has been more sustained for China, India and Indonesia – also due to lower starting levels – than for Turkey and South Africa. Brazil and Mexico, similar to other Latin American economies, have been an exception, as they have seen little productivity convergence in the last 30 years (Figure 4). The convergence process started in the 1990s and accelerated in the 2000s, although the 2008/09 great financial crisis imposed slower growth rates across all G20 members, especially those from Europe.

**Figure 3. Labour productivity levels across G20 economies, 2020**

Labour productivity measured as GDP per person employed, current prices, current PPPs

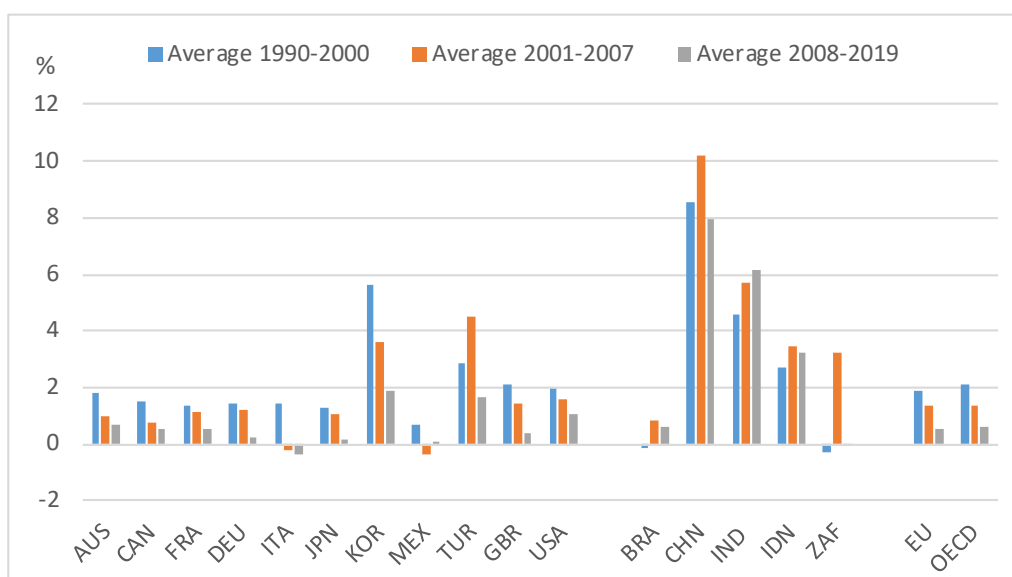


Note: Data for Brazil refer to 2018. Data for Argentina and Saudi Arabia are missing

Source: OECD Productivity Indicators

**Figure 4. Average labour productivity growth, 1990-2019**

Labour productivity measured as GDP per person employed, constant prices



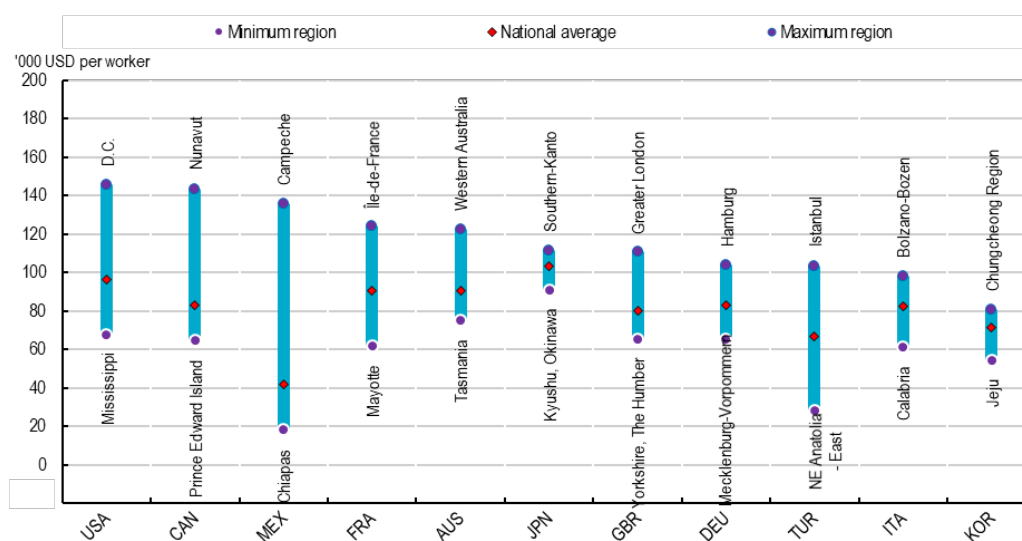
Note: For Brazil, data series starts from 1997; for India from 1998. Data for Argentina and Saudi Arabia are missing.

Source: OECD calculations based on OECD Productivity Indicators.

While productivity levels change significantly across countries, there are also important regional differences at country level. For example, in two-thirds of OECD members, labour productivity varies two-fold across regions (Figure 5) (OECD, 2020<sup>[4]</sup>), pointing to the importance of keeping a local lens in the analysis of productivity trends and in the design and implementation of MSME productivity policies (see also next section of the report).

**Figure 5. Labour productivity regional disparities in selected G20 countries, large regions (TL2), 2018**

Labour productivity measured as gross value added per person employed



Note: 2018 or latest available year. Data for Australia and Canada refer to 2017; data for Japan to 2016; data for Turkey to 2015.  
Source: (OECD, 2020<sup>[4]</sup>)

### ***MSMEs are the largest employers in most countries***

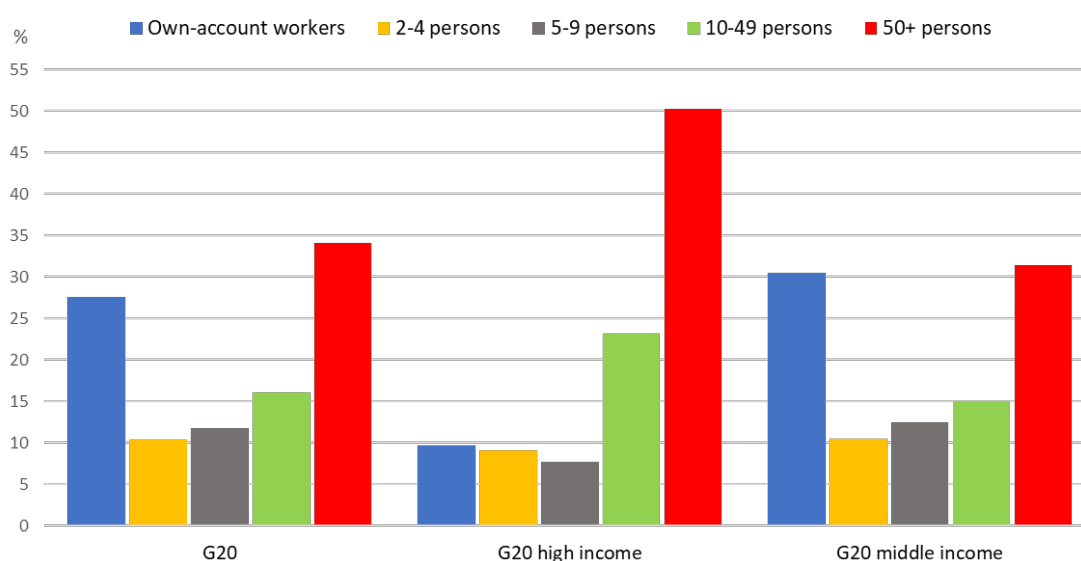
MSMEs, including the self-employed (i.e. business owners who do not hire other workers), are the employment backbone of both high- and middle-income economies. In OECD countries, MSMEs (i.e. enterprises with fewer than 250 people employed) accounted for about 65% of employment and 53% of national value added in the business sector in 2019, based on data from the OECD Structural and Demography Business Statistics (SDBS) database<sup>2</sup>. In G20 middle-income economies, the official MSME share in national employment and GDP is usually lower, reflecting in part the fact that structural business statistics do not typically capture activities and employment in the informal economy and agriculture – where these activities are generally larger in emerging economies than in developed economies – unlike official statistics on GDP and employment, which, at least in theory, do.

<sup>2</sup> The OECD SDBS database is built on information from business surveys, economic censuses and business registers. As such, it does not cover informal enterprises. The OECD SDBS database only includes information for the so-called business sector or economy, which does not include primary activities (agriculture, fishing and forestry), financial sector activities and non-market activities. Micro-enterprises may also be underrepresented in some cases.

Based on household and labour force survey data<sup>3</sup>, the ILO estimates that small economic units (i.e. companies with fewer than 50 workers) accounted for 66% of total employment in G20 economies in 2019, although there are large variations by country income group (Figure 6). In particular, small enterprises made up 68.5% of employment in G20 middle-income economies, but only 50% in G20 high-income economies. A finer disaggregation shows that the smallest economic units, i.e. the self-employed, accounted for nearly one-third of total employment in G20 middle-income economies but only for 10% in G20 high-income economies, pointing to one of the reasons behind the existing productivity gaps between high- and middle-income economies worldwide.

**Figure 6. Share of employment in G20 economies by firm size and country income group, 2019**

Percentage values



Note: ILO estimates based on national household and labour force surveys. No data available for the United States and Saudi Arabia.  
Source: ILO calculations

### ***However, MSME productivity is only a fraction of productivity in large companies***

While MSMEs are the main source of employment worldwide, average MSME productivity levels are only a fraction of productivity levels in larger companies, with the average productivity gap increasing with decreasing MSME size. This gap is partly linked to the skills profile of workers, as larger companies are better able to attract higher-skilled workers and offer better wages. However, many OECD countries have also experienced an increase in the productivity gap between MSMEs and larger companies during the last decade, which might reflect increased market concentration (OECD, 2019<sup>[5]</sup>) and might be partly behind the decoupling of average wage growth from average productivity growth which some high-income economies have recently experienced (OECD, 2018<sup>[6]</sup>)<sup>4</sup>. Across selected G20 economies for

<sup>3</sup> ILO estimates, which are based on national household surveys and labour force surveys, tend to include the informal sector and agriculture.

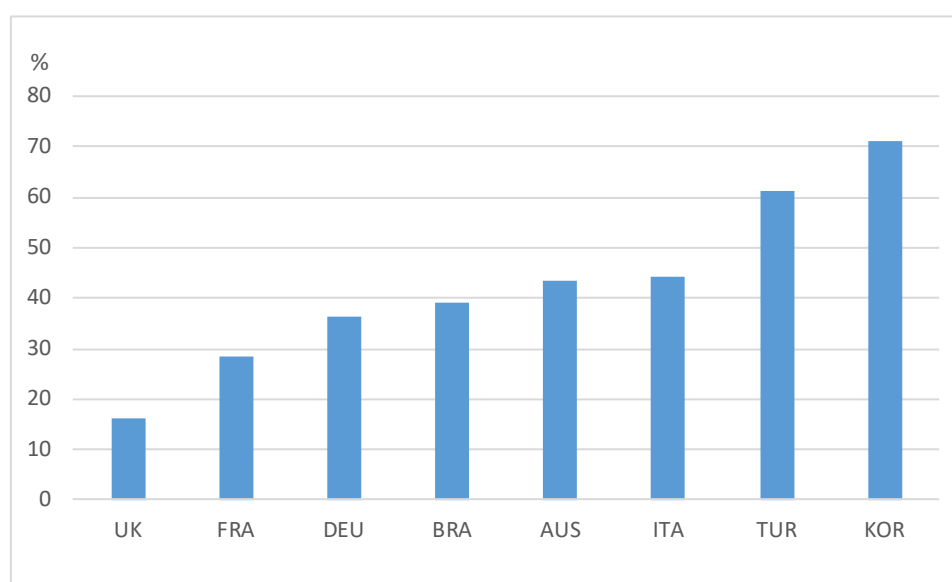
<sup>4</sup> Some high-income economies have been grappling over the last 20 years with a slowdown in real average wage growth relative to labour productivity growth (i.e. decoupling of wage growth from productivity growth), which has



which the OECD has information, the productivity gap between MSMEs (1-249 employees) and large companies (250+ employees) ranged from 16 percentage points (United Kingdom) to 71 percentage points (Korea) in 2019 (Figure 7).

**Figure 7. The labour productivity gap between SMEs and large companies in selected G20 economies, 2019**

Percentage gap in average labour productivity, value-added per person employed, national currencies.



Note: The labour productivity gap between SMEs and large companies is calculated as follows. Labour productivity gap =  $100 - (\text{average SME productivity} / \text{average large-firm productivity}) * 100$ . Labour productivity is defined as value added per person employed. SMEs are companies with up to 249 people employed. Large companies are companies with 250+ people employed. Data for Brazil and Korea refer to 2015.

Source: OECD calculations based on OECD SDBS database.

The causes behind lower average MSME productivity at the whole-economy level are partly internal to the firm, including lower access to resources, skills and markets and lower economies of scale, and partly external, including the sector representation of MSMEs (i.e. MSMEs are overrepresented in sectors with lower-than-average labour productivity levels). Nonetheless, it is also important to recognise that MSMEs are a heterogeneous group in which there are both micro and small enterprises in low value-added sectors and dynamic small and/or young companies, both in traditional and high-tech sectors, which are very productive and able to experience rapid growth (OECD, 2018<sup>[7]</sup>). Supporting productivity growth in the whole spectrum of MSMEs, from micro-enterprises to growth-oriented mid-sized firms, is key to promoting inclusive growth and decent work.

### ***Business scale-up is closely linked to higher productivity, job creation and better working conditions***

Given that average labour productivity levels grow with firm size, there is unsurprisingly a close relationship between businesses scaling up and productivity growth, although the direction of causality is not always straightforward. A recent OECD analysis confirms this, showing that “scalers” (i.e. SMEs that

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been reflected in a falling share of labour income in GDP. Furthermore, growth in low and median wages has lagged behind average wage growth, which has compounded wage inequality.

grow fast over a short period of time, either in terms of employment or turnover) are a major source of job creation and are positively correlated with productivity<sup>5</sup>. Employment scalers account for only 13-15% of the small and medium-sized enterprise population, but for 47-69% of all jobs created by the same stock of enterprises. Importantly, scaling in employment and turnover tends to happen at the same time, which suggests that the increase in the workforce does not come at the cost of productivity growth (OECD, 2021<sup>[8]</sup>). In particular, employment scalers tend to be more productive than similar firms just before the high-growth period, suggesting that stronger productivity underpins the scale-up phase<sup>6</sup>.

As to turnover scalers, they prepare for the scale-up phase by hiring new staff, which results in a drop in productivity the year before scaling. During the subsequent period of high growth, however, employment grows at a slower pace than turnover, making turnover scalers more productive than comparable non-scalers (OECD, 2021<sup>[8]</sup>). The new productivity level is sustained beyond the high-growth phase and translates into higher wages for workers, underpinning the importance of business scale-up also for improving workers' remunerations.

Policies that support business scale-up are, therefore, particularly important. Based on a literature review and early evidence from the microdata work of a multiannual OECD/EC pilot project, there are a number of internal factors that can drive the scale-up of MSMEs, including innovation, investments in financial, human and knowledge-based capital, and market and network expansion, including abroad. These drivers can operate in isolation or in combination, but suggest that supporting business scale up can leverage a broad set of measures and requires a well-calibrated policy mix, consisting of both framework measures and targeted policies and programmes that support access to finance and technology, among others (OECD (forthcoming), 2022<sup>[9]</sup>)

## Promoting an MSME productivity ecosystem for decent work

This central part of the report presents the main elements of the “Productivity Ecosystem for Decent Work” framework. A “productivity ecosystem” approach means addressing the issue of MSME productivity in an integrated way – across the levels of enterprise, sector and national and subnational performance – rather than through interventions at only one single level. It also means looking beyond the immediately visible symptoms of MSMEs' low productivity levels and growth rates to understand and address the root causes of the problem. Low productivity levels, for example, may not be simply the result of lack of know-how at the firm level, but may also partly be due to more structural issues such as limited access to resources (capital, labour and technology), poor business environment conditions, and inadequate MSME policies and programmes. Of course, not all of these issues can be addressed by labour ministries alone, but rather require an integrated approach that involves other institutional players and private-sector stakeholders involved in MSME policies.

The rest of this section offers an overview of the main drivers of MSME productivity growth at macro, meso and micro levels which policy makers can leverage in their respective constituencies. Although presented individually for the ease of legibility, these drivers affect each other and the way they do so is highly context-specific. A careful analysis of these interactions in a given geographical and sectoral

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<sup>5</sup> In this study, “scalers” are defined as non-micro SMEs (i.e. companies with between 10 and 249 employees) that grow in employment (i.e. employment scalers) or turnover (i.e. turnover scalers) at an average yearly rate of 10% or more for three consecutive years. While scalers (i.e. high-growth firms) are a major source of job creation, it should be noted that MSMEs are also a main source of job destruction.

<sup>6</sup> Labour productivity is up to 10% higher in scalers than in non-scalers in the two years before scaling and in the first two years of the scaling period. Toward the end of the high-growth period, productivity levels align with those of non-scalers.

context is, therefore, key to understanding the main factors affecting the productivity performance of local MSMEs and to designing appropriate policy measures.

### ***MSME productivity and decent work drivers at macro level***

Many issues at the macro/policy level affect MSME productivity growth. This section of the report focuses on four of them: the business environment, enterprise formalization, social dialogue and access to social protection.

#### *An enabling business environment supports MSME productivity growth through different channels*

Barriers in the business environment are particularly influential and can create negative effects on the productivity of MSMEs. MSMEs, compared to larger companies, often find it more difficult to navigate an unfriendly business environment as they lack the specialist high-skilled staff who tends to be required to deal with tangled regulations and/or the political connections needed to bypass the same regulations. As a consequence, burdensome tax procedures and inefficient business regulations create particularly high costs for MSMEs, deterring investments and possibly encouraging informal economic activity. Similarly, inadequate access to market information may leave MSMEs unsure about the appropriate marketing and investment strategies to adopt. On the whole, poor business environment conditions negatively impact enterprise productivity by distorting decisions, lowering capital accumulation, creating uncertainty and promoting and expanding informal market activity.

Against this backdrop, access to finance conditions deserve special attention. Small companies tend to experience more difficult access to finance and worse credit conditions than larger companies, as repeatedly shown by the OECD publication series, *Financing SMEs and Entrepreneurs: An OECD Scoreboard*. The last edition of this publication, for example, sheds light on the impacts of the COVID-19 crisis on MSME finance, showing that lending continued to flow to MSMEs during the pandemic and that credit conditions (e.g. interest rates and collateral requirements) eased significantly. While this has allowed many small companies to survive the crisis, it has also resulted into higher business debt levels that could have a negative impact on the future ability of MSMEs to undertake productivity-enhancing investments (OECD, 2022<sup>[10]</sup>).

#### *Business informality and low productivity levels are closely related*

More than 6 workers out of 10 and 4 enterprises out of 5 operate in the informal economy worldwide<sup>7</sup>. The COVID-19 pandemic has cast further light on the problems associated with a large informal sector, which is a major hindrance to economic and social progress (ILO, 2021<sup>[11]</sup>). For example, informal enterprises have been largely unable to access the support measures introduced by governments to help MSMEs weather the crisis, thus further widening the income gap between formal and informal workers.

The different dimensions and causes of enterprise informality should be carefully analysed to inform tailored, integrated strategies to promote business formalization (ILO, 2016<sup>[12]</sup>). Individual piecemeal measures tend to have limited or no effect. For example, facilitating formalization processes alone, including through bespoke simpler regulations, is unlikely to convince many informal entrepreneurs to formalize (Bruhn and McKenzie, 2013<sup>[13]</sup>). Conversely, more integrated strategies that include information campaigns, regulatory simplification, training and coaching opportunities and access to social protection are more likely to succeed (Jessen and Kluge, 2021<sup>[14]</sup>). In addition, targeting policy interventions to those segments of the informal economy that have a greater capacity to improve productivity – e.g.

<sup>7</sup> In this section the term “enterprise” refers to economic units as defined in ILO Recommendation 204 ([https://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:0::NO::P12100\\_ILO\\_CODE:R204](https://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:0::NO::P12100_ILO_CODE:R204)).

companies that operate at a sufficient production scale and in interaction with formal market activities – can clearly bring better results (Bruhn and McKenzie, 2013<sup>[13]</sup>).

Many factors affect the decision of informal entrepreneurs to formalize, including their social and educational profile, the purpose of their business activity, existing productivity levels, the prevailing labour market and economic context, the cost of doing business and government enforcement capacity. The design and implementation of business formalization policies should therefore be context-specific, with a clear definition of costs and benefits and possible trade-offs. Given that productivity improvements take time to materialise, access to social protection during this transition period is key to maintaining a viable transformative path for informal businesses and workers.

#### *Social dialogue can support productivity-enhancing policies*

Social dialogue between governments and social partners (employers' associations and trade unions) can help build consensus on productivity-enhancing MSME policies. Indeed, social dialogue typically improves coherence in the policy design phase and coordination in the policy implementation phase. Social dialogue, for example, can help policy makers place MSME productivity interventions within wider relevant policy strategies, particularly in areas related to employment and skills, investment, technology transfer, digitalization and enterprise formalization. Social dialogue can also help governments and social partners to look more closely at the relationship between labour productivity and working conditions. For example, within the context of collective bargaining, social dialogue can facilitate the discussion and negotiation of issues such as the trickle-down of productivity improvements into wage increases, the adoption of high-performance workplace practices, and the prevention and resolution of labour disputes.

#### *Access to social protection is associated with productivity gains*

Social protection systems – which include, among others, pension contributions, unemployment benefits, parental leave and sick leave – play an important role by helping people cope with temporary shocks and find a job and by protecting the aging population, with expected positive consequences on productivity growth. Access to social protection is generally associated with participation in the formal economy which, as mentioned above, is associated with higher labour productivity levels than informal market activities.

The positive relationship between social protection and productivity has been the subject of different bodies of research. For example, unemployment insurance has been found to increase labour productivity by encouraging workers to seek more productive jobs (Acemoglu and Shimer, 2000<sup>[15]</sup>); pension benefits have facilitated the introduction of productivity-enhancing solutions at the firm level by acting as incentives in employment contracts (Cornwell and Dorsey, 2000<sup>[16]</sup>); and safety net interventions have been found to support productivity growth by encouraging asset creation, asset protection and resource reallocation (Hoddinott, 2008<sup>[17]</sup>).

### ***MSME productivity and decent work drivers at meso level***

This section describes the relevance of looking at MSME productivity trends and policies from a sector and local perspective. In addition, it discusses access to foreign markets and the upgrading of workers' skills as main drivers of MSME productivity growth at the meso/sector level.

#### *Taking a sectorial approach to support MSME productivity growth and decent work is important*

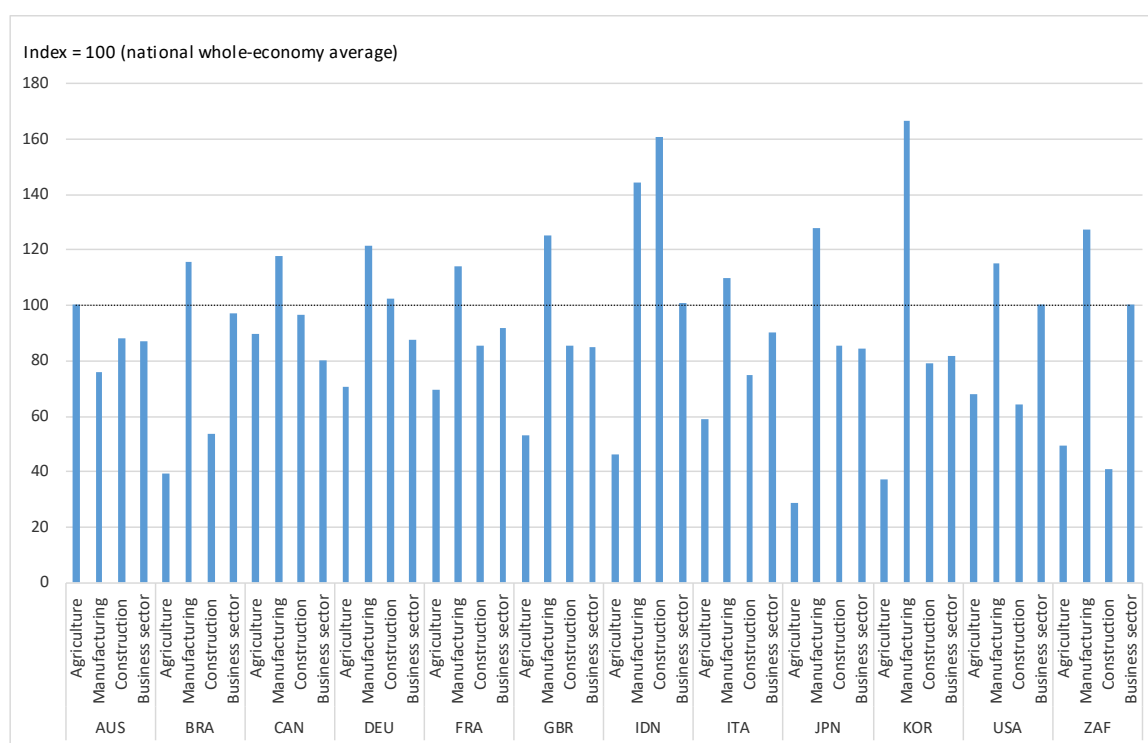
Aggregate productivity and employment statistics hide significant labour productivity differentials across sectors. For example, manufacturing tends to show higher labour productivity and lower labour intensity than agriculture in developing economies, the two (labour productivity and labour intensity) being

inversely related. Conversely, services encompass both high value-added segments (e.g. professional services) and, especially in developing economies, low-productivity informal activities (e.g. street vendors, hawkers). The COVID-19 pandemic, with its asymmetric impact across sectors, has corroborated the importance of industry-based analyses in order to design better-informed MSME productivity policies. The pandemic disproportionately hit sectors such as tourism and retail trade where MSMEs are overrepresented, leading to a larger drop in employment in those sectors and in the MSME business segment as a whole.

Figure 8 presents information on labour productivity levels across given sectors as ratios to the national labour productivity average (whole economy), pointing to significant differences in productivity levels across sectors.

**Figure 8. Sector-based labour productivity levels in selected G20 economies, 2020**

Productivity levels (value added per person employed) as a ratio to the national labour productivity average (whole economy)



Note: Business sector excludes agriculture, real estate activities and non-market sectors. Sector-based labour productivity levels are presented as a ratio of each national average labour productivity (whole economy).

Source: OECD Productivity Statistics database, April 2022.

### *A local lens is complementary to a sector lens for effective MSME productivity policies*

A local lens in the design and analysis of MSME productivity policies is complementary to a sector lens, since there are strong regional variations in business environment conditions and since some regions may have strong sector specialisations that affect employment and productivity growth opportunities for local MSMEs.

The quality of the local business environment is particularly important for MSMEs because, compared to larger companies, they tend to rely more on external sources of knowledge, support and advice to

improve their productivity performance due to lower internal capacities (OECD, 2013<sup>[18]</sup>) (OECD, 2021<sup>[19]</sup>). For example, well-documented regional differences in the availability of finance (Lee and Luca, 2019<sup>[20]</sup>) can curb productivity-enhancing investments in peripheral regions and locations; for instance, in the United States, the closure of local bank branches led to a considerable decrease in small business lending (Hoai-Luu Q. Nguyen, 2019<sup>[21]</sup>). However, the quality of regional governments can mitigate financial constraints and contribute to productivity growth both directly and indirectly, with larger positive effects documented for smaller, younger and less productive companies (Agostino et al., 2020<sup>[22]</sup>) (Rodríguez-Pose et al., 2020<sup>[23]</sup>). Product market regulations also vary significantly by region, which reflects different capacities in local administrations and has direct implications for business activity (OECD, 2016<sup>[24]</sup>)

The design and delivery of economic development policies has become more complex in recent years. It is not uncommon to see three or four levels of government, as well as multiple ministries and government agencies, simultaneously involved in MSME and entrepreneurship policies. Regardless of what governance level policies and programmes originate from, a local lens – from how to tailor policies to local conditions to addressing capacity differences in policy delivery at local level – needs to be taken into account (OECD, 2016<sup>[24]</sup>).

#### *Access to foreign markets and MSME productivity levels are closely related*

While local markets and local business environment conditions influence the growth prospects of most MSMEs, access to foreign markets may prove crucial for the smaller segment of growth-oriented small and mid-sized companies. Direct exposure to foreign competition, knowledge and technology, as well as forward and backward linkages in the context of supply chains, are positively associated with enterprise productivity levels, although the relationship goes both ways. On the one hand, more productive companies are more likely to export or tap into global supply chains. On the other hand, direct exporting or participation in global supply chains gives a further competitive advantage to MSMEs through the abovementioned channels as well as through access to bigger economies of scale (Wengel and Rodriguez, 2006<sup>[25]</sup>) (Gkypali, Love and Roper, 2021<sup>[26]</sup>).

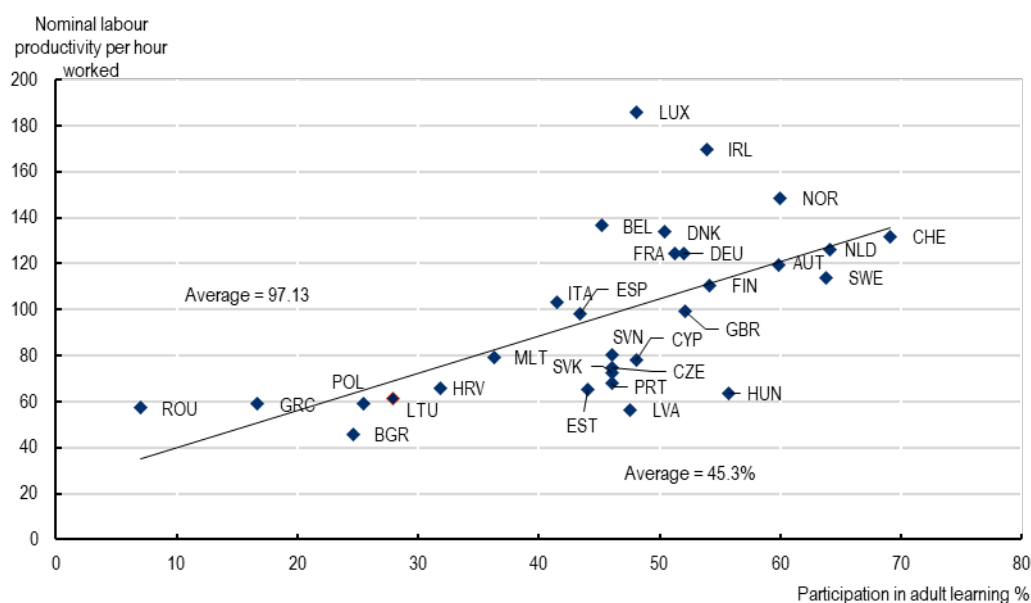
#### *Workforce skills are an important driver of MSME productivity growth*

Workforce skills are a major driver of MSME productivity growth at sector level, since many job-related skills are sector-specific. For example, the OECD finds that structured work-based learning schemes, such as apprenticeships and dual-training programmes, have a strong impact on the productivity of participants, although the correct design of these programmes, for example in terms of duration and time split between on-the-job training and classroom training, is key to maximising benefits for both workers and employers (Kis, 2016<sup>[27]</sup>).

Access to adult learning opportunities are also increasingly important in the context of a rapidly changing economy due to megatrends such as the digital transition, the decarbonisation of the economy and demographic change (OECD/ILO, 2022<sup>[28]</sup>). Adult learning, on-the-job or off-the-job, can prevent the depreciation and obsolescence of skills and facilitate the transition from declining to expanding jobs and sectors (OECD, 2019<sup>[29]</sup>) OECD calculations based on Eurostat data, for example, point to a strong positive correlation between the share of adults who have participated in formal and/or non-formal learning opportunities in the past 12 months and labour productivity levels in the economy (OECD, 2021<sup>[30]</sup>) (Figure 9).

**Figure 9. Participation in adult learning and labour productivity, 2016**

Labour productivity measured as real output per hour worked



Source: (OECD, 2021<sup>[30]</sup>)

However, those who need training the most, train the least: low-skilled workers train less than high-skilled workers and older people train less than younger ones (OECD, 2019<sup>[31]</sup>). This bias also extends to MSMEs, as there is strong evidence that staff in small enterprises train less than in larger companies, although there are strong cross-country differences across OECD economies (OECD, 2020<sup>[32]</sup>). Some of the reasons behind the low participation of MSMEs in training include the lack of dedicated human resources departments, the fear of having trained workers poached by other firms, incomplete information on the quality of available training and on the returns of the training investment, high transaction costs involved in the purchase of training services, or training services simply not being available nearby.

Local governments can play a vital role in creating adult learning systems that contribute to resilient societies and more productive economies. In this respect, the OECD has developed an ambitious programme – the Future-proofing Adult Learning in Cities Programme – to support policy makers and practitioners at city levels in the design, management, and implementation of adult learning policies and programmes that better respond to local needs.<sup>8</sup>

#### *Workforce skills upgrading requires an integrated approach*

Both national and local governments can support the skills upgrading of workers through multiple approaches, such as: awareness-raising campaigns, information and guidance mechanisms, training tax incentives and other subsidies (e.g. vouchers), training levies, job rotation schemes, training networks and rights to training leave (Marchese et al., 2019<sup>[33]</sup>) (OECD, 2021<sup>[34]</sup>). Particularly relevant for MSMEs are training vouchers and training networks. The main hallmark of training vouchers is their ease of access and use, which makes this instrument particularly appealing to time-constrained MSME owners.

<sup>8</sup> For further information on this programme and recent reports, please see: <https://www.oecd.org/cfe/leed/future-proofing-adult-learning-cities/>

On the downside, vouchers have been found unlikely to change the long-term attitude of business owners towards training. As to training networks, they allow MSMEs sharing similar training needs to pool their resources and gain access to training opportunities which they would not be able to afford individually. Training networks, especially when they are managed by a professional broker, can also help in the identification of training needs and suitable training courses, which are another common barrier to workforce training in MSMEs. Using individual learning entitlements to support workers with the greatest need for training has also been an approach successfully implemented in some G20 countries, such as France and Korea (ILO, 2021<sup>[35]</sup>).

A critical factor for the success of these and other similar schemes lies in the active collaboration between governments and employers to examine how training can better support skills utilisation at the firm level. This requires moving away from policy silos and bringing together employment services, policy makers responsible for training policy and innovation policy, business development service providers, and local economic development organisations to determine which policy mix best responds to the training needs of local individual firms and sectors (OECD/ILO, 2017<sup>[36]</sup>). Skills development policies that are integrated with innovation policies, active labour market policies and social protection systems are best placed to promote productivity growth and decent work in MSMEs and to ensure successful and equitable labour market transitions (ILO, 2021<sup>[35]</sup>).

The Manufacturing Extension Partnership from the United States and the Gwangyang HRD programme in Korea provide national examples from G20 countries of how training programmes have been matched with other policies to address sector-specific skills development challenges (ILO, 2017<sup>[37]</sup>). Examples of wider innovation and business development strategies with a strong skills component include the Workforce Training Innovation Fund in Australia and the UK Innovation Strategy. Tailored analysis at sector level, such as the one offered by the ILO Skills for Trade and Economic Diversification (STED) Programme, can also help identify appropriate skills development strategies in specific sectors, in this case those with export potential.

At local level, coordinated interventions, including through the means of local networks and intermediary organisations (see above), have proven particularly successful and highlight the limitations of only national supply-driven skills policies. The experience of the OECD Local Economic and Employment Development (LEED) Programme, for example, has emphasised the role of local partnerships and skills ecosystems that are responsive to local business needs. This includes cooperation among companies, industry bodies and public authorities, dedicated local coordinators and competence centres, as well as local champions able to showcase good company practices to other MSMEs (OECD, 2020<sup>[38]</sup>).

### ***MSME productivity and decent work drivers at the micro level***

From an ecosystem perspective important drivers of MSME productivity growth and decent work creation at firm level consist in the upgrading of managerial skills and the improvement of working conditions. At the same time, the twin transition (digital and green) also offers opportunities which MSMEs need to seize if they are to improve their productivity performance. Finally, stronger gender inclusion, for example through the development of higher quality women's entrepreneurship, is also pivotal to promoting inclusive growth and decent work for all.

#### *Managerial skills are an important determinant of productivity growth*

Managerial skills are an important determinant of productivity growth. At macro-economic level, managerial skills<sup>9</sup> have been found to partly explain the income gap between high-income and middle-

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<sup>9</sup> Managerial skills refer to the ability of entrepreneurs to manage their business well. They include marketing, financial planning, record keeping, inventory control and management, performance monitoring and strategic thinking.



income economies, as the latter have a much larger share of ill-managed companies (Bloom and Van Reenen, 2010<sup>[39]</sup>). At sector level, the OECD finds that skills and diversity in the workforce and management team account on average for about one-third of the labour productivity gap between firms at the productivity “frontier” (the top 10% within each industry) and medium performers, often smaller companies, at the 40-60 percentile of the productivity distribution (Criscuolo et al., 2021<sup>[40]</sup>). At firm level, managerial skills are a good predictor of the use of formal management practices, such as Total Quality Management or Lean Production, which also have a positive impact on productivity (Parker, Storey and van Witteloostuijn, 2010<sup>[41]</sup>). However, returns from formal management practices decline in line with firm size, thus making the non-use of such practices a possible rationale behaviour in smaller enterprises.

Building the capacity of MSME business owners is, therefore, crucial for MSME productivity growth. The ILO’s Sustaining Competitive and Responsible Enterprises (SCORE) Programme has found that the training of MSME managers and workers on workplace cooperation, Kaizen principles<sup>10</sup> and Lean Manufacturing<sup>11</sup> contributes to reducing costs, the number of defects, and the use of energy and other resources in the production process. In addition, this training programme also contributes to better cooperation between managers and workers, fewer workplace accidents and less absenteeism. Up to 50% of enterprises trained by the ILO SCORE Programme reported that these improvements also resulted in productivity gains. Similarly, research on the effectiveness of the ILO’s Start and Improve Your Business (SIYB) Programme, a training course on basic management concepts aimed at micro-entrepreneurs, found that the training improved business resilience to economic shocks (ILO, 2018<sup>[42]</sup>). The importance of management training and advice for MSME productivity growth is further confirmed by additional research on other similar training programmes (Iacovone, Maloney and McKenzie, 2022<sup>[43]</sup>).

The digital transformation is offering governments new instruments to deliver business advice to MSMEs, including through online diagnostic tools and online training platforms (OECD, 2021<sup>[44]</sup>). Online diagnostic tools allow MSME owners to benchmark their business operations against similar firms from the same sector and/or region. As to online training, it holds the potential of reaching many MSMEs that were previously unattended by training services. However, online training also requires minimum levels of digital skills and high levels of self-motivation, which might dampen its impact and point to the need of mixing online learning and in-presence learning especially when hard-to-reach groups are concerned.

Finally, research finds that management training, when it is delivered in isolation, is much less effective than when it is combined with other interventions, such as access to finance at the firm-level and measures to address sector- and macro-level constraints to productivity growth (McKenzie, 2020<sup>[45]</sup>), thus stressing again the importance of an integrated approach to MSME productivity growth.

### *Improvements in working conditions and productivity levels can be self-reinforcing*

Working conditions and productivity levels are closely interconnected at the firm level. For example, (Bloom et al., 2013<sup>[46]</sup>) find a positive relationship between the introduction of occupational safety and health (OSH) practices and quality management processes, on the one hand, and productivity growth in MSMEs, on the other. Other studies have found that workplace cooperation agreements (e.g. through workers’ councils) (Morikawa, 2010<sup>[47]</sup>) and improvements in the working environment (work-life balance and worker health) also positively affect productivity growth at the firm level (Saint-Martin, Inanc and

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<sup>10</sup> Kaizen is a Japanese term meaning “change for the better” or “continuous improvement.” It is a Japanese business philosophy regarding the processes that continuously improve operations and involve all employees. Kaizen sees improvement in productivity as a gradual and methodical process.

<sup>11</sup> Lean manufacturing is a production process based on an ideology of maximising productivity while simultaneously minimising waste within a manufacturing operation. The lean principle sees waste as anything that doesn’t add value that the customers are willing to pay for.

Prinz, 2018<sup>[48]</sup>). Collective bargaining agreements at firm level have also been found to lead both to higher productivity growth and to better working conditions (Garnero, Rycx and Terraz, 2020<sup>[49]</sup>). ILO research has also examined the role of collective bargaining in reducing the gap between productivity growth and wage growth and put forward policy advice to share productivity gains between employers and workers and avoid labour disputes (Hayter, 2011<sup>[50]</sup>).

There is also evidence that good management practices bring better results when many of them are implemented at the same time, rather than individually or one by one (Hirsig, Rogovsky and Elkin, 2014<sup>[51]</sup>). For example, the positive effect of improving working conditions on enterprise performance is stronger when management, business and human resource practices are aligned (May, Lau and Johnson, 1999<sup>[52]</sup>), when companies also invest in building workers' skills and reward performance (Huselid, 1995<sup>[53]</sup>), and when jobs are characterized by a variety of tasks (Vandenberg, Richardson and Eastman, 1999<sup>[54]</sup>). Efforts to improve MSME productivity and decent job creation should therefore focus on coordinated measures, such as helping MSMEs to improve their management practices as well as ensuring that well-functioning collective bargaining mechanisms are in place.

### *Digital technologies may open up new opportunities for productivity growth in MSMEs*

Digitalisation offers a range of opportunities for MSMEs to enhance their productivity levels through lower operation and transaction costs, reduced information asymmetries, greater capacity for product differentiation and dissemination, business intelligence and automation (OECD, 2021<sup>[19]</sup>). While MSMEs typically lag behind larger companies in the take-up of digital technologies, the COVID-19 pandemic has been a major turning point, with between 25% and 60% of SMEs across OECD countries increasing the adoption of digital technologies, from online sales to smart working solutions (OECD, 2021<sup>[55]</sup>). Similarly, data gathered in a joint research initiative by the OECD, Facebook and the World Bank (Future of Business Survey) show that between 25% and 62% of MSMEs (with a Facebook page) across OECD countries increased the digitalisation of their business in 2020 (OECD, 2021<sup>[55]</sup>).

Digital adoption is more likely to have a positive impact on firm-level productivity when it is combined with complementary investments in skills upgrading and reforms to improve the business environment (e.g. access to finance and sufficient IT infrastructure) (ILO, 2021<sup>[56]</sup>). For example, a recent paper by the OECD shows that the use of online platforms in hotels, restaurants and retail trade, all sectors with a strong presence of MSMEs, has led to strong productivity gains at the firm level. Importantly, these effects have been larger where online platforms are well-developed, pointing to the simultaneous importance of IT infrastructure and Internet penetration in the wider population (Bailin Rivas et al., 2019<sup>[57]</sup>).

However, two caveats are important. Firstly, a major productivity paradox is that increasing investments in ICT and digitalisation over the last decades have not translated in corresponding productivity growth rates. The extent to which widespread MSME digitalisation will result in narrower productivity gaps by firm size and aggregate productivity growth is, therefore, uncertain. Secondly, the risk that certain forms of digitalisation, such as automation, come with job losses, especially among low-skilled workers, cannot be dismissed and require adequate policy responses, for example with respect to upskilling and reskilling opportunities for workers affected by the digital transition, whether they work in MSMEs or large companies.

### *The green transition also offers productivity-enhancing opportunities for MSMEs*

The transition to a more environment-friendly production process can boost firm-level productivity by reducing operational costs through the improvement of energy efficiency. However, in the short-term, the green transition also imposes upfront costs which many MSMEs may find difficult to finance. "Sustainable finance" (or "green finance"), including green bonds, green loans and green loan

guarantees, can play a key role in easing the green transition for many MSMEs<sup>12</sup>. In addition, increasing awareness and knowledge about the effective costs and benefits of the green transition among MSMEs, including possible access to new markets consisting of more conscientious consumers, can prove important to convince more entrepreneurs that there is indeed a business case for the green transition.

However, it should also be recognised that certain environmental practices do not systematically provide decent jobs. For example, millions of people in developing countries work in the circular economy and waste management industry under informal and poor working conditions (O'Connor, 2021<sup>[58]</sup>). This illustrates the importance of addressing both the environmental and social implications of the green transition, pointing to the need for a “just transition” in which affected workers and companies are adequately supported and opportunities for decent work are fully taken into consideration.

### *Women’s entrepreneurship is key to inclusive growth and decent work*

Women entrepreneurs face higher barriers than men in setting up and running a business, which typically results in the creation of less productive companies, often in low value-added activities, which are less able to generate adequate revenues and good jobs. Common barriers to growth for women entrepreneurs include holding more household responsibilities than men, lower access to finance and training opportunities, and less extended professional networks.

Different policy interventions can support women’s entrepreneurship, including training and mentoring, enhanced access to finance, including equity finance, and access to technology (OECD/EU, 2017<sup>[59]</sup>). Special emphasis should also be placed in helping women enter sectors, such as high-tech sectors, where they are underrepresented, as well as supporting women-owned business with an internationalisation potential to enter foreign markets. Online platforms collecting different business-relevant resources can also increase women’s awareness about entrepreneurship as a career option. The European Union’s WeGATE and the ILO-UNWOMEN platform *Red de Mujeres Empresarias de Europa, América Latina y el Caribe* provide two good examples<sup>13</sup>.

## Conclusions and policy leads

This joint ILO-OECD report has presented evidence on the relationship between MSME productivity, inclusive growth and decent work. Labour productivity growth is a key long-term driver of income growth. Emerging and developing economies where labour productivity has grown the most over the last 35 years are also those where poverty rates have dropped the most. However, the link between labour productivity growth and income growth cannot always be taken for granted, as the recent experience of certain high-income economies shows.

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<sup>12</sup> In 2021, the OECD launched the “OECD Platform on Financing SMEs for Sustainability”, which has the threefold goal of: i) strengthening knowledge-sharing and collaboration on SMEs’ access to sustainable finance; ii) advancing analytical research on the topic of SME sustainable finance; iii) promoting networking and policy dialogue to enhance the design and implementation of policies on SMEs’ access to sustainable finance. For further information, see: [OECD Platform on Financing SMEs for Sustainability](#).

<sup>13</sup> See <https://business-women-network-ganarganar.lim.ilo.org/>

Labour productivity levels in MSMEs are only a fraction of those in larger companies. In addition, there is evidence that productivity gaps by firm size have widened in many OECD countries possibly due to increased market concentration. Productivity gaps by firm size contribute to income inequalities and are, accordingly, something policy makers have a powerful incentive to address. In this respect, it is important that policy makers bear in mind that MSMEs are a very heterogeneous group, which calls for adapted and tailored MSME productivity policies.

Increasing productivity levels across the whole spectrum of MSMEs requires a comprehensive approach that leverages the main MSME productivity drivers at macro, meso (i.e. sector) and micro (i.e. firm) levels. The “Productivity Ecosystem for Decent Work” framework, which is presented in the central part of the report, aims to do this by helping policy makers to identify and take action on the main drivers of MSME productivity growth in a systemic manner. Typical development actions in this approach include regulatory reforms at macro level, supply chain development and workforce skills upgrading at meso/sector level, and managerial skills upgrading and workplace cooperation at micro/firm level.

The following points offer broad policy recommendations (i.e. policy leads) on what G20 governments can do to enhance MSME productivity and improve working conditions, bearing in mind that concrete recommendations can only be context-specific and require an appropriate analysis of local conditions and policies.

## Box 2. Policy leads on MSME productivity-enhancing policies

### **Macro-level**

- Ensure that product markets are open to competition in order to reduce product market rents and facilitate the transmission of productivity gains into wages.
- Maintain a sustained process of simplifying and improving an enabling business environment with regulatory frameworks that are coherent and encourage MSME productivity.
- Introduce an employment policy framework that offers adequate social protection and upskilling and reskilling opportunities to workers in MSMEs, including those transitioning from the informal to the formal economy.
- Keep national economies open to global trade to let domestic MSMEs benefit from access to foreign knowledge and technology and participation in global supply chains, both of which are key drivers of MSME productivity growth.

### **Meso level**

- Develop an integrated approach to workforce skills development that is tailored to industry needs and is built upon consultation between employers’ and workers’ organisations.
- Take a local and sector lens in MSME productivity policies, tailoring national policies to local conditions and adapting them to local capacities in policy delivery.
- Encourage social dialogue to ensure that MSME productivity policies are informed by and address the needs of employers and workers.

### **Micro level**

- Support the upgrading of managerial skills through training, mentoring and coaching services, including through the establishment of a national network of recognised business development service providers. Also, consider adapting management skills programmes to the enterprise target, favouring short free courses for micro and small enterprises in traditional

sectors of the economy and longer fee-based courses for growth-oriented MSMEs.

- Encourage social dialogue at firm level to ensure that workers understand and implement new productivity-enhancing practices introduced by managers and adequately benefit from productivity gains through higher wages.
- Support the uptake of digital technologies in MSMEs through awareness-raising and information campaigns, training and technology assistance, access to finance and support for the development of MSME-tailored solutions.
- Facilitate MSMEs' green transition by reducing barriers that prevent adoption of green business practices and processes, and by emphasizing and capacitating MSMEs to seize the business case associated with green transitions.
- Promote women's entrepreneurship, including in higher value-added sectors where they are underrepresented, through training, access to markets, and the development of professional networks.

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