

Reducing SMEs informal economy through institutionalization: the MNC-academia-SMEs business model (Disminuyendo la economía informal de las PyMEs por medio de la institucionalización: Modelo empresa multinacional-academia-PyMEs)

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Abstract. The informal sector has been growing throughout the last century in emerging economies. Particularly in Latin America, both a long-term instability in economic and political environments, and a continuous migration from rural to urban areas; have triggered the appearance of unregulated businesses and employments. Small and Medium-sized Enterprises (SMEs) operate informally in one or more business processes, in order to reduce costs and maximize profits. Leaving aside tax evasion and illegal labor, such SMEs often have low technology and an unskilled work force; which threatens its survival in highly competitive environments. The purpose of this paper is to highlight the impact of the Multi National Corporation (MNC) and the Academia in the formalization of SMEs. This is aimed through a collaborative model for the institutionalization of operational and managerial knowledge within SMEs. Qualitative results indicate that improvements are triggered by a self-conscious awareness of the value derived from institutionalizing best business practices.

Palabras clave: economía informal, institucionalización, PyMEs

Resumen. En economías emergentes, el sector informal ha crecido continuamente durante el último siglo. Particularmente en América Latina, entornos de inestabilidad política-económica, así como una migración continua de las áreas rurales a las urbanas; han propiciado la aparición de negocios y empleos no regulados. Las Pequeñas y Medianas Empresas (PyMEs) operan informalmente en uno o más procesos de negocio, con el fin de

reducir costos y maximizar utilidades. Más allá de evadir impuestos y leyes laborales, dichas empresas cuentan con baja tecnología y mano de obra poco calificada, lo cuál amenaza su supervivencia en entornos altamente competitivos. El propósito del presente artículo de investigación es el resaltar el rol que la Empresa Multinacional y la Academia juegan en la formalización de las PyMEs. Esto es realizado mediante un modelo colaborativo para institucionalizar el conocimiento administrativo y operativo de la PyME. Resultados cualitativos indican que las mejoras están sujetas a la transformación en la visión de negocios derivada de la institucionalización de mejores prácticas.

Introduction

Throughout the last century, an excessive urban growth relative to the level of economic development in emerging countries, often referred as hyper-urbanization, gave rise to alternative ways of assuring incomes, resulting in informal businesses. Such businesses, often incurring in tax evasion and illegal labor, are excluded from the benefits and rights incorporated in the laws and administrative rules. Moreover, such businesses are unregulated by the institutions of society; although legitimized for their operation (Castells and Portes, 1989; Feige, 1990; Portes and Schaufli, 1993).

Actors in an informal economy could be individuals; SMEs; as well as legally operating MNCs that perform unregulated transactions (Godfrey, 2011). In that sense, the informal sector has reached considerable proportions throughout the last decade. Webb et al. (2009) estimated that informal economy activities account for approximately 17 percent of the Gross Domestic Product (GDP) in developed economies and approximately 40 percent of GDP in developing economies. In addition, according to the International Labour Organization, further referred as ILO (2010), in developing countries particularly, the informal economy accounts for between 35 and 90 per cent of total employment, and is not confined to traditional rural and urban informal sectors. However, the existence of a large variety of informal sectors limits a global measurement of its implications (Feige, 1990; Webb et al., 2009; Godfrey, 2011).

There have been several efforts to reduce informality in business practices, mainly through government policies and incentives. However, such programs are rooted in fiscal objectives rather than competitiveness or regional growth. Through an institutionalized perspective (Meyer and Rowan,

1977; Dimaggio and Powell, 1983), informal businesses could migrate into legitimate and legal practices imported from MNCs, with competitiveness and sustainability as ultimate objectives.

Several models involving the MNC have been found in relation to the enhancement of competitiveness and sustainability. However, most of them are mainly focused on the improvement of MNCs' performance through its supply chain, rather than on the achievement of regional growth. The purpose of this article is to highlight the role of the MNC and the Academia in the institutionalization of best business practices within SMEs (clients and suppliers) for the creation of regional development and quality of life. This is pursued by the MNC-Academia-SMEs model, which transfers operational and managerial knowledge within SMEs pertaining a value chain.

Literature review

Informal economy

The emergence of an informal economy has been traced from an accelerated rural-urban migration and the labor surplus generated in third-world countries since 1950. In the post war years, half of Latin American population lived in rural areas and was employed in agricultural activities; forty years later, the proportion changed to almost three out of four living in urban areas. However, such rapid growth derived in excess labor supply and insufficient infrastructure for accommodating a continuously growing population (Portes and Schauffler, 1993). In addition, long-term instability in Latin America, expressed in terms of volatility of Gross Domestic Product (GDP), has been diffused through the labor market, affecting employment, incomes, and wages (Tokman, 2007). Thus, both an excessive urban growth relative to the level of economic development often referred as hyper-urbanization; and the volatility of Latin American economies have resulted in alternative ways of assuring incomes, through informal businesses.

There are a variety of definitions regarding the concept of informal economic activities. Economists define it in terms of economic activities conducted by unregistered firms or by firms hidden from taxation; while sociologists define it in terms of activities unregulated by the institutions of

society, in a legal and social environment in which similar activities are regulated (Castells and Portes, 1989; LaPorta and Schleifer, 2008; Godfrey, 2011). Therefore, such activities are considered as excluded from the benefits and rights (i.e. financial credits and social security) framed by the law (Feige, 1990). However, there has been a stream of literature considering informality as an illegal or underground activity with a crime-related conception. According to Chowdhury (2005), political instability, rule of law, corruption, and irregular payments are the fundamental characteristics of the informal economy. Similarly, Venkatesh (2006) defines informal, underground, or “off the books” economic activity as characterized by either illegal practices (products or processes) or illicit exchanges. Nevertheless, this paper will adopt the definition of informality as pertaining socially legitimate economic activities not properly taxed or aligned to labor laws.

According to Chowdhury (2005), employment in the informal sector is more of a necessity than a choice, due to the low demand of labor in the formal sector. The ability to survive through the generation of an income depends on the probability of employment in an unregulated sector. This could be illustrated by 30% of Latin American urban EAP employed informally according to data from the ILO with up to 60% in the least developed countries of the region (Portes and Schauffler, 1993). However “informal-sector” workers are poor workers with few productive resources (Tokman, 2007). Amaral and Quintin (2006) state that such workers are younger, have less education, and earn less than their counterparts in the formal sector.

The economic goal of informal enterprises is to ensure personal survival, rather than accumulating profits. Moreover, family members are the main labor force; low capital is used; and often activities outside the law are conducted. Thus, informality has been characterized as presenting low entry barriers to entrepreneurship in terms of skills and capital requirements; family ownership; small scale of operation; outdated technology; and unregulated and competitive markets (Portes and Schauffler, 1993; Tokman, 2007).

Actors in an informal economy could be not only self-employed individuals; but also legally operating MNCs and SMEs that perform unregulated transactions (Godfrey, 2011). According to De Soto (1989), informal economic activity has expanded in response to non-flexible market

conditions. Informal provision of goods and services has resulted in a feasible method for reducing costs in many industries.

The effects of the informal sector on the economies are mainly related to low tax collection due to evasion, as well as the existence of workers with a lack of healthcare or retirement plans (OCDE, 2009). Informal activity could be measured in terms of employment or production. According to Webb et al. (2009), informal economy activities account for approximately 17 percent of GDP in developed economies and approximately 40 percent of GDP in developing economies. Particularly in Mexico, the informal sector represented 33.6 percent of GDP in 2003, which accounted for 47.8% of home incomes and 36% of total revenues (INEGI, 2003). According to the ILO (2005), 46.7% of workers were employed in the informal economy in Latin America in 2003. Moreover, the associated societal costs are also significant, such as an estimated USD \$250 billion in revenues lost by uncollected taxes and the regulation, inspection and enforcement of counterfeit goods or unlicensed services; in addition to 750,000 lost jobs, as reported by the U.S. Department of Justice (Fadahunsi & Rosa, 2002).

The informal economy proves difficult to define; measuring its scope and impact presents a problem as well, both for emerging and developed economies (Feige & Urban, 2008; Webb et al., 2009; Godfrey, 2011). Informality is seldom recorded, thus representing a difficulty for measurement, due to diversity in levels of analysis. In addition, it covers illegal, breaking-the-law activities; and a-legal, unregulated activities. Therefore, such economy is socially and economically embedded in a specific context (Williams and Winderbank, 2005).

Informal activities could represent an obstacle for productivity and business growth. Individuals and enterprises operating in this sector often omit reports on economic activities in order to avoid the law; thus, lacking access to customers, financing, formal training, and property rights (OECD, 2009). According to Chowdhury (2005) the role of the government must be the development of policies intended to alleviate poverty and improve urban income distributions, in order to reduce informal businesses.

However, government policies in most Latin American countries are based on fiscal schemes, such as Mexico's *Programa de Combate a la Informalidad* (The Informality Combat Program). This program was launched and implemented by the Secretaría de Hacienda y Crédito Público (Ministry of

Finance and Public Credit) through the Servicio de Administración Tributaria SAT (Tax Administration Service Department) in October 31, 2011. The way in which the government sought to eliminate informal business practices was through the *Impuesto a los Depósitos en Efectivo* (Cash Deposit Tax, consisting in 3% tax retention over a fixed amount of cash deposits), which had the dual purpose of collecting taxes and detecting citizens who were not registered or who did not report all their income in 2009 (Secretaría de Economía, 2009). More recently, online billing and complementary procedures required when conducting transactions involving large figures have been implemented.

There have been studies focused on the origin and consequences of the informal economy. Amaral and Quintin (2006) state that informal employers rely on self financed funds and operate with a reduced and unskilled labor capital; opposite their counterparts in the formal sector. However, when unregulated financing costs exceed those related to fixed expenses, registration fees, and taxation; managers turn to the formal sector, obtaining more capital and higher productivity levels.

Institutionalization

A shift from informal business practices into a regulated regime could be explained by a change in institutional boundaries. Efforts from interest groups regarding the legislation of new technologies and services could lead into the alignment of formal institutions with certain groups' norms, values, and beliefs (Webb et al., 2009). The MNC could be the main driver for institutional changes which impact on supply chains and even on industrial configurations.

Firms aim to resemble the most competitive and sustainable in the market. Such homogeneity could be explained through the institutional theory (Selznick, 1948; Meyer and Rowan, 1977) particularly with respect to isomorphism, defined as the homogenization of firms through the adoption of institutionalized practices. Coercive isomorphism, as formerly exemplified, is caused by direct or indirect pressures exerted on organizations by other organizations (public and private) upon which they are dependent (Pfeffer and Salancik, 1978); and by the cultural context in which the organization is

immersed. Such pressures may be felt as force, as persuasion or as invitations to join in collusion (DiMaggio and Powell, 1983).

Another mechanism for firm homogenization is mimetic isomorphism, resulting from standard responses to uncertainty. In this case, a firm institutionalizes certain practices as an emulation of other firm's success. When organizational technologies are poorly understood (March and Olsen, 1976), when goals are ambiguous, or when the environment creates symbolic uncertainty, organizations may model themselves on other organizations. Such isomorphism may occur unintentionally, indirectly through employee transfer or turnover, or explicitly by organizations such as consulting firms or industry trade associations. Specifically, the Academia plays an important role in such isomorphic processes (DiMaggio & Powell, 1983).

The third mechanism for isomorphism is defined as normative, referring to the adoption of practices as dictated by professional organisms and educational entities in order to maintain a competitive or sustainable business level. Both the MNC and the Academia contribute to the establishment of a determined professionalization level pertaining an industry or sector. Although it is the duty of SMEs to catch-up the required level for achieving competitiveness and sustainability; the Academia in collaboration with the MNC should assist SMEs on the process of achieving the required capabilities through education.

Of all the isomorphic mechanisms discussed, MNCs have exerted coercive action on SMEs to achieve institutionalization through certified processes within the supply chain. Often, MNC's from developed economies demand mechanisms that assure quality regarding supplied products in emerging economy contexts. However, these SMEs, although formally operating according to government statutes in the best scenario, lack the capabilities for adoption and implementation of new standards and procedures in order to comply with MNC's requirements. Therefore, SME's competitiveness and sustainability in emerging economies could only be enhanced by the MNC's active role as the engine for regional development.

Models such as the triple helix model, including the MNC, the Academia and the Government (Leyersdorf and Etzkowitz, 1996; Benner and Sandstro, 2000); the MNC-Micro entrepreneurship model (Chelekis & Mudambi, 2010); and the MNC-government model (Luo, 2004) have been conceived around MNCs' flagship role in regional growth. Although there is a

regional development from the mentioned models, such business schemes are mainly focused on the improvement of MNCs' performance through its supply chain. Nevertheless, Prahalad's Base of the Pyramid Model (Prahalad, 2005) could be considered as centered on profits from BOP markets and their quality of life improvement, but not necessarily in the reduction of informal businesses.

The MNC-Academia-SMEs business model presents an approach for creation of regional development and quality of life, which could lead to the reduction of informal businesses. This model institutionalizes SMEs through the transmission of operational and managerial education from the collaboration of MNCs and the Academia.

Proposed business model

The 21st century compromise of the MNC at emerging economies is centered upon the sustainable growth of SMEs, in a more extensive way other than traditional technical support and coerciveness. Thus, the MNC enhances institutionalized best business practices in collaboration with Academia (Business Schools and Business Accelerator) to enhance the institutionalization and growth processes of SMEs (clients and suppliers) by focusing on managerial education, operational development and technology, and financial support. Therefore, sustainable business conditions that assure long-term business operations are attainable.

The methodology used in this research paper is qualitative, rooted in a case study. The impact of the tripartite model is measured in terms of performance improvement, determined through open interviews and second-hand information.

MNC-academia-SMEs business model

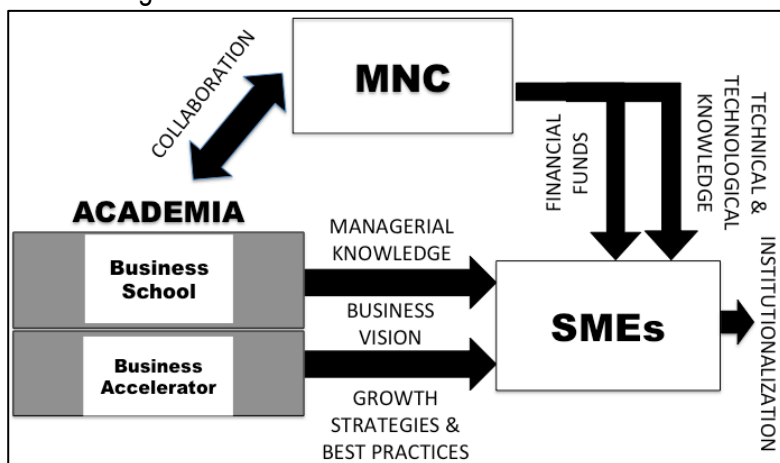
In emerging economies, firms are forced to adapt and survive to technological, market or institutional changes (Dobrev and Carroll, 2003). Particularly, SMEs are vulnerable due to poor business visions, low value-added products, and scarce market knowledge (Portes and Shauffner, 1993). Concerning MNCs, they have greater possibilities to achieve sustainability

due to the control and possession of critical resources (Pfeffer and Salancik, 1978) and political ties (Hoskisson et al., 2000). Although MNCs could succeed in new markets and achieve innovative capabilities with an impact on their respective industries, they have a strong dependence on clients and suppliers, most of them being SMEs. Therefore, MNC's competitiveness is embedded upon the enhancement of business sustainability among the value chain. By the provision of technical and technological knowledge, the Multinational Corporation commits to enhance such sustainability among client SMEs. This scheme is completed in collaboration with a Business School for the transfer of managerial knowledge and best practices to SMEs' networks.

Rules of operation

Initially, the MNC selects SMEs through a program of best manufacturing or service practices, by the following criteria: value added products, exporting capabilities, idle capacity and financial profile. In order to fulfill the mentioned purpose, the MNC could design a specific SME selection program, intended to enhance the development of its supply chain through best business practices. Therefore, the MNC acquires a deeper knowledge of the SMEs participating in the program (Figure 1).

Figure 1. *MNC-Academia-SMEs Business Model*



Institutionalization & SMEs

The next stage is centered upon education and development of managerial skills, with the collaboration of a Business School in the design and development of an Executive Program in Management. According to Hynes and Richardson (2007), entrepreneurship education must go beyond the Academia into the industry, where managers could benefit and participate in such educational process. In the same trend, Hynes and Richardson mentioned that universities must transform into entrepreneurial institutions, in order to anticipate to the needs of employers and firms; positively impacting on communities. Therefore, the assurance of a direct transfer of knowledge from institutions to the industry is fundamental for the enhancement of regional growth.

Through the Executive Program in Management, directors and general managers of SMEs are intended to acquire and improve management skills in order to structure and institutionalize their organizations. In addition, these business executives, from different regions of the country, could establish network relationships into the conformation of potential alliances, collaborative ventures, and associations. In the model, a Business School provides management skills to SMEs executives, as well as a structured vision of business. However, there is the need to implement the acquired knowledge and vision in the SME through the Business Accelerator.

The third stage in the tripartite model is the business acceleration of the participating SMEs. At this step, the Business Accelerator provides the specialized knowledge from consultants, academic professors and coaches in a multidisciplinary scheme to impulse the transformation of companies with high market potential in new sustainable businesses. Some of the areas covered in this stage are related to the development of business models, markets, products, business relationships, alliances, and financial options.

Case study

In Mexico, a leading corn wheat manufacturer has been involved in the tripartite model (López Lira, 2013). Initially, technical and technological knowledge was transferred to small and medium-sized clients pertaining to its value chain. Furthermore, in a collaborative scheme, a Business School imparted an Executive Program in Management to 135 participants from such

SMEs. However, such firms had not reached the business acceleration stage at the time the case study was performed.

A qualitative study performed on a representative group of participating SMEs indicated positive results. SMEs' executives reported benefits such as controlled inventories; reduced product breakages; efficient invoicing systems; specified job descriptions; updated sales reports; among others. SME's managers adopted new strategies such as diversification of products and markets, while others focused their efforts on employee training and less rotation through robust selection processes. Marketing strategies were found in selected cases where brand image was critical for business sustainability. Similarly, a few SMEs incorporated a strategy of technological updating, in order to have operations at a greater scale.

More than basing their strategies on profits, SMEs' executives transformed their business paradigms by focusing on human capital as the most important factor for success, including clients, suppliers, and employees. Facilities were remodeled, and job descriptions were specified towards a joint achievement of goals and objectives from all organizational member. The mentioned findings are the foundations for subsequent performance improvements; and thus, the tripartite model could be empirically validated. An overall perspective could summarize findings as specific improvements triggered by an acquired sense of awareness about actual business practices and the willingness of SMEs to pursue performance improvement through institutionalized business practices.

Summary and conclusions

The benefits that the MNC could achieve by participating in this model are several. First of all, an ordered growth of the market could be conceived from the reduction of informal businesses, resulting in more feasible market scenarios for the MNC. In addition, the business school could facilitate a dialogue among SMEs regarding pricing strategies to diminish price wars and disloyal competence, which ultimately affect the MNC. Moreover, a close collaboration between the institutionalized SMEs has lead into increased credibility and co-opetition, the phenomenon in which firms engage in simultaneous cooperation and competition with each other (Brandenburger and Nalebuff, 1996; Lado, Boyd, and Hanlon, 1997) emerges.

Regarding quality norms, particularly relevant in the food sector, MNC's requirements and policies have been assured through institutionalized business practices. Additionally, a long-term commitment of both suppliers and clients is acquired, due to the perceived benefits (economical, technological and operational) derived from their participation in the program.

Another benefit is the incorporation of a Corporate Social Responsibility of the MNC related to the sustainability of SMEs, with the collaboration of Business Schools. It implies an improvement in social welfare and quality of life through regional employment; a better education for organizational members; and the reinforcement of moral values within communities. Finally, the enhancement of market continuity through client and supplier satisfaction rounds it up.

Concerning SMEs, sustainable business conditions from formal operational practices have been spotted. Through institutionalized processes, firms have the opportunity to outperform competitors by establishing value-added strategies to reduce disloyal practices. This could be translated into value added products or services; on-time payments, possibility of applying for additional funds; operative control and strategic planning, development of leadership abilities; increase in the efficiency of market strategies; new products; innovation, and alliances among them.

Additionally, SMEs have the mechanisms for increasing productivity levels through the implementation of quality tools and lean manufacturing methodologies transferred by the MNC. Through institutionalization and ordered growth, SMEs could aim for a competitive position in a changing global market. In addition, these formal SMEs could adapt and allocate their resources to strategic objectives (i.e. delivery, flexibility, cost reduction, asset usage, or quality) in order to achieve sustainability.

Continuous learning and specialization is imperative regarding SMEs participating in this model. Through the collaboration of Business Schools, managerial and operational knowledge is assimilated by SMEs in accordance to organizational capabilities. Such combination between existing and new organizational knowledge is the start for new market and technological opportunities. With these actions, Business Schools are then directed beyond the provision of education and the promotion of business leadership among

the alumni into the enhancement of quality of life and regional wealth through SMEs as part of their commitment to sustainable development in society.

Finally, SMEs' institutionalization has been nurtured by external networks that strengthen SME's market presence; either by collaboration efforts with similar business or within the value chain. As a result, the creation of common knowledge systems, new resource combinations, and research development has arisen.

In the 21st century, the MNC in collaboration with the Academia will play a preponderant role in the enhancement of regional wealth and quality of life. SMEs' managerial education and business development should be aimed in emerging economies in order to create sustainable growth and reduce the proliferation of business by necessity rather than by choice. Thus, the MNC-Academia-SMEs business model has become a feasible alternative for competitiveness and sustainability in emerging economies through institutionalized business practices.

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