Small and Medium-Sized Enterprises in Ecuador: Evolution and Challenges

Abstract

The main objective of this article is to analyze the evolution of Ecuadorian Small and Medium-Sized Enterprises (SME), their contribution to the national economy, institutional framework, and internal operating characteristics. To this end, the focus is on companies related to the manufacturing sector in Ecuador. The main periods of the analysis are: i) the 1990s, ii) 2000-2008 and iii) 2009-2019; however, the decades of the 1970s and 1980s have been included in the first part of the article for their relevance. Literature review is the main data collection methodology, and the databases used are from official sources. Data from the Banco Central del Ecuador (BCE, Central Bank of Ecuador), the Instituto Nacional de Estadística y Censos (INEC, National Institute of Statistics and Census), regulations and research around the SME sector have been used. The main findings are that SMEs are crucial within the Ecuadorian industrial fabric, because of its specialization in products that contribute to satisfying basic needs, but also because they provide parts and supplies to other companies. The quantitative contribution of SMEs, however, has been declining over time, both in number of establishments, staffing, and production, which reveals the increasing relevance of large industries. In this process, the institutional framework has had an influence in the evolution of SMEs, with certain strengths and weaknesses in terms of supporting the development of SMEs. In turn, in regards to internal operation, it becomes apparent that despite some improvement, there has not been significant progress during the period under analysis. In short, this work contributes to the larger discussion about the relevance of SMEs in Ecuador, their history, and whether there might be grounds for public policies to support their development.

Keywords: Small and Medium-Sized Enterprise; Small and Medium-Sized Industry; Ecuador

Corresponding author: e-mail: wilson.araque@uasb.edu.ec
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1. Introduction

In Latin America, there is a significant contribution from small and medium-sized industries in terms of employment and production, which is linked to the development models implemented by the countries in the region (CEPAL 2013; Peres and Stumpo 2002). The same can be said about the Ecuadorian case. However, we have yet to know the history, evolution, environment, and characteristics that have influenced their dynamism and survival over time. The article focuses the analysis on companies related to the manufacturing sector in Ecuador.

The main objective of the study is to understand the evolution of Small and Medium-Sized Industries (SME, or PYMI for its initials in Spanish) in Ecuador. In this document, an SME is characterized according to the number of workers, due to the availability of information, and taking as reference Comunidad Andina de Naciones (CAN, Andean Community of Nations) Decision 702 of 2008,¹ which was formally adopted by the country through the Código Orgánico de Producción, Comercio e Inversiones (COPCI, Organic Code of Production, Commerce and Investment) and later in Executive Decree 757 of 2011.

The methodology used in this document is based on a documentary review; data from the Banco Central del Ecuador (BCE, Central Bank of Ecuador), the Instituto Nacional de Estadística y Censos (INEC, National Institute of Statistics and Census), regulations and research around the SME sector were used in this process. In this analysis, the main characteristic of this study is the use of timeframes, which organizes the presentation of the evolution of SMEs into three

¹ According to Resolution 702, SMEs (PYMIs) are defined by two variables: the personnel employed and the gross value of sales. In terms of the personnel employed, a small business has up to 49 workers and medium businesses have up to 199 workers (CAN 2008). The use of sales or personnel employed does not have a statistically significant difference (Rivera 2018).
main periods: i) the 90’s, ii) 2000 -2008, and iii) 2009-2019. It should be noted that the first part of the article includes the 70s and 80s because they are important for background.

The document is structured as follows: the second section presents the study methodology; the third section analyzes institutional characteristics related to SMEs, highlighting the laws and organizations related to the sector; the fourth section presents some characteristics of the evolution in the study of the sector over time; the fifth section establishes the importance of the industry within Ecuador and the contribution of SMEs to the country, highlighting their contributions in the number of establishments, personnel employed, and production; the sixth section indicates the operating characteristics of the SME sector, its progress, and challenges. Finally, the seventh section presents the conclusions of the document.

2. Methodology

As a technique for data collection, this paper uses the analysis of historical documents that, as part of historiography—a key space of the historical profession (Ayala 2014b)—focuses on identifying, reviewing, and studying specialized literature, studies, and research already generated by public and private, national and international organizations throughout the economic history of Ecuador. These contain a significant component such as the history of the evolution and transformation of the fabric of production.

Considering that history, from the viewpoint of the time variable, is a fairly wide space, this study takes timeframes as a method to help the approach to reality, based on the specific organized analysis of duly classified data collected (Ayala 2014a). The investigative effort has focused on three periods starting in 1990 since, due to the occurrence of certain historical events, these become references for understanding the economic history of SMEs. However, in
the institutional segment, an earlier period is included; the decades of the 70s and 80s, as a necessary background to understand the sector.

The periods chosen for the historical study of SMEs are the following:

- 1990 to 1999, a period of searching for an economic opening, given that between the 60s and 80s, Ecuador took as reference a model of inward industrialization promoted by the Comisión Económica para América Latina (CEPAL, Economic Commission for Latin America).
- 2000 to 2008, implementation of dollarization as the monetary model of Ecuador.
- 2009 to 2019, evolution of the economy, from an economic boom, with restrictions on private productive development—emphasis on the presence of the State in all spaces—to a final scenario of economic austerity.

3. Institutional Evolution and Change in Regard to Small and Medium-Sized Industries (SMEs)

In the analysis of the institutional framework related to SMEs, the definition established by Institutional Theory is considered, for which institutions are the norms, regulations, and actions of people and entities that set conditions and/or limit the behavior of involved social actors (North 1991; DiMaggio and Powell 1999). In contrast, organizations are groups of people who act on the basis of a structure and guidelines to achieve a specific purpose or objective, thus, “formal organizations are generally understood to be systems of coordinated and controlled activities that arise when work is embedded in complex networks of technical relations and boundary-spanning exchanges” (Meyer and Rowan 1977, 340). With this perspective, this section identifies laws and regulations, public and private entities, business associations, and organizations directly related to SMEs in Ecuador, whether with a regulatory, representative, or academic approach to the sector. As previously stated, the timeframe of analysis in this
section presents four periods since, from the institutional perspective, the 70s and 80s are relevant as background. In each period, certain facts that determined changes in the economic situation and the administration of the country are presented as points of reference, and graphs of relevant economic variables that reflect the context of these situations are also presented.

**FIGURE 1.** Average Annual Price of Oil 1972 - 2019, by Type, in 2015 Dollars

![Graph of Average Annual Price of Oil 1972 - 2019](image)

Note: Deflated series using the United States Consumer Price Index - Adapted from British Petroleum. 2020.
Source: Observatorio de la Energía y Minas de la Universidad de las Américas 2020.

The periods are: i) the 70’s and 80’s, ii) the 90’s, iii) 2000-2008, and iv) 2009-2019. An important reference in all these stages is oil and its price variation, which, since 1972, has been a determining factor in the country’s economy, so that below (figures 1 and 2) the evolution of the oil price and the variations in GDP and GDP per capita are presented. This information and its specific relevance is taken up in each period.
FIGURE 2. Percentage Change in GDP and GDP per capita (1970-2019)

Note: GDP per capita based on data from years of Population Censuses and with projections in intercensal years.
Source: Own elaboration with BCE and INEC data.

The evolution of GDP per capita in constant monetary values, shown in figure 3, also allows us to visualize the economic situation described in the aforementioned stages, specifically, growth in the 1970s, stagnation in the 1980s, the crisis at the end of the 90s and growth from 2004 to 2014-2015, when the decline in oil prices began to impact the economy (Figure 1) and the further deterioration in growth (Figure 2).
FIGURE 3. GDP per Capita Evolution 1970-2019 (2007 Dollars)

Note: GDP per capita based on data from years of Population Censuses and with projections in intercensal years.
Source: Own elaboration with BCE and INEC data.

3.1 The 70s and 80s

In Ecuador, the manufacturing industry began to have relevance in the 1960s, as it was considered an alternative for growth and economic development in light of the crisis of the agro-export model. This gained momentum from 1972, mainly due to the application of the import substitution model, which had started in the 1960s, and due to the availability of resources from oil exports, channeled as credits or fiscal stimuli. This was complemented by the creation of the Andean group, through the signing of the Cartagena Agreement in 1969, in which Venezuela, Colombia, Ecuador, Peru, Bolivia, and Chile came to participate, with an initial vision of integration, geographical planning of manufacturing production and a community market (Insotec 1986, 19). However, the crisis of the 80s occurred, known
internationally as the debt crisis, a period in which the terms of trade deteriorated, external investment declined significantly and export growth was slow (Samaniego 1993).

The effect of oil resources and the import substitution model is shown in Figures 4 and 5, the first of which shows the evolution of the GDP of various sectors of economic activity. In the case of the Manufacturing Industry, significant growth can be seen in the 1970s; it should be noted that oil extraction and refining data has been consolidated in a single item and oil refining has been removed from the Manufacturing Industry, in order to visualize the growth and contribution of other manufacturing activities. With this consideration in mind, the stability of the manufacturing industry not related to oil in contributing to the economy is presented (Figure 5). In recent years it has contributed the most and has always been among the top two or three industries, with an average of 11.9% between 1965 and 2017. Figure 4 confirms the growing evolution that manufacturing had from the oil boom; between 1965 and 1972 the average growth rate was 4.8% while between 1973 and 1981 (before the new crisis) it was 8.4%. In any case, in this period, “industrialization, urbanization, the expansion of the middle classes, and the strengthening of the State profoundly changed Ecuadorian society” (Larrea 2000, 89).
**FIGURE 4.** GDP Evolution in Several Economic Sectors, 1965 - 2017, in 2007 Dollars

Note: Oil Refining has been removed from manufacturing industries, to be added to Oil Extraction, in order to portray the contribution of the Manufacturing Industry independent of oil.
Source: Own elaboration with BCE data.

**FIGURE 5.** GDP Contribution Structure between 1965 and 2017 (in %)

Note: Oil Refining has been removed from manufacturing industries, to be added to Oil Extraction, in order to portray the contribution of the Manufacturing Industry independent of oil.
Source: Own elaboration with BCE data.
The legal framework to promote small industry was generated in 1965 with the Small Industry and Handicraft Promotion Law, which had several modifications in the 70s, aimed at better serving the sector. Specific regulations were issued for the application of the law, the promotion of the sector, the categorization and qualification of companies' access to a differentiated salary, and access to special credit lines such as Fopinar and Fondos Financieros. In 1975 the Centro Nacional de Promoción de la Pequeña Industria y Artesanía (CENAPIA, National Centre for Promotion of Small Industry and Handicraft) was created. It gives way to the formation of inter-ministerial committees to support the sector and reorganizations to better meet the needs of companies (Fernández 1990, 48-annex 1). Additionally, at this stage, the Industrial Development Law is issued and organizations such as the Centro de Desarrollo Industrial (CENDES, Industrial Development Centre), Corporación Financiera Nacional (CFN, National Financial Corporation), Ministerio de Industrias, Comercio e Integración (MICEI, Ministry of Industry, Commerce, and Integration) are created and “as complementary measures, amendments are made to the tariff system, seeking to protect the production of the existing industry and the tax system in order to promote investment and capital accumulation in the industry” (Insotec 1986, 43).

In the business associations sphere, as of 1969, provincial small industry associations were formed; in 1971 a national federation of these associations was organized, in 1979 it was approved that the associations be considered as chambers of production and they were renamed Cámaras de Pequeña Industria (Small Industry Chambers); and in 1982 amendments were approved so that the federation of associations be called Federación Nacional de Cámaras de
Pequeña Industria (FENAPI, National Federation of Small Industry Chambers) (Insotec 1986, 81). From the private sector, in 1980 Instituto de Investigaciones Socioeconómicas y Tecnológicas (INSOTECS, Socioeconomic and Technological Research Institute) was created at the initiative of business owners and technicians related to SMEs (some of this entity’s activity is described in section 4.2). It started researching to support proposals for the benefit of the sector, with support for Small Industry Chambers’ development through training for entrepreneurs who held management positions in Small Industry associations. The result of INSOTECS’s actions is, in part, to influence the chambers of the provinces with greater economic development, to develop services and mechanisms so that their members could have better levels of competitiveness, “among them the following can be mentioned: credit guarantee corporations, savings and credit cooperatives, fair and exhibition corporations, training institutes, sectoral technical assistance programs, etc.” (Lanusse 1993, 41).

The model of promotion and protection within a closed market, applied since the 1960s but promoted since the 1970s thanks to oil resources, along with “restrictive economic policy measures have meant a great [negative] weight for the industrial sector due to the [excessive] dependence of the sector on domestic demand” (Samaniego 1993, 122), which ultimately led to a lack of productivity and quality by local companies and a lack of options and convenient prices for consumers.

3.2 The 90s

“Since the late 1980s, but especially since 1990, a series of measures were adopted in Ecuador to modernize the State's management and favor the country's insertion into international markets” (Hidalgo 1999, 10). There were changes related to fiscal management, monetary
policy, labor policy, financial policy, foreign trade, and also in public institutions related to the productive sector (Insotec 1996, 9). Up to 1994, the tax reform introduced in 1990 gradually dismantled all the exemptions that the development laws had established. Tariffs were reduced, subsidies were removed that were intended to favor the development of the industrial sector but that, in reality, ended up being harmful due to not having considered a temporary validity term from the beginning. Figure 4 shows that in the 90s the growth rate of the manufacturing industry decreased. Ecuador transitioned to an *outward* development model promoting the export sector.

Over the first five years of that decade, several government entities that had been created in previous years as instruments of the state to promote industrial development under the previous scheme, were closed or restructured. Among those that were closed were CENAPIA, CENDES, Comisión Ecuatoriana de Bienes de Capital (CEBCA, Ecuadorian Commission of Capital Goods), Fondo Nacional de Preinversión (FONAPRE, National Pre-Investment Fund). The following were restructured: Ministerio de Industrias, Instituto Ecuatoriano de Normalización (INEN, Ecuadorian Institute for Standardization), Servicio Ecuatoriano de Capacitación (SECAP, Ecuadorian Training Service), Consejo Nacional de Ciencia y Tecnología (CONACYT, National Science and Technology Council), and CFN.

But also as part of the national productive transformation process, government bodies were created such as the Consejo Nacional de Modernización del Estado (CONAM, National Council for State Modernization) which, among its main objectives, sought to restructure the operation of state entities. Thus, the goals were to present said entities as direct contributors to the strengthening of the economic opening of the country towards a global context. The intensive development of information and communication technologies (ICT), began to demand a more innovative profile from the country’s production fabric, with a highly adaptive capacity to new
challenges. It is clear that, in the case of SMEs, corporate guilds had their role in joining this transformative process (Lanusse 1993, 38).

In this context, the Minister of Industry in office in 1992, according to words transcribed in Lanusse's document (1993, 44), expressed no interest in introducing sectoral (industrial) policies and even less for specific strata (small industry), but Ministry maintained lines of credit and technical assistance programs. From the private sphere and with the support of international cooperation (Germany, Switzerland, Canada, USA, Inter-American Development Bank – IABD), two institutions, which began their activities in the 1980s, continued with programs aimed at the SME sector (Hidalgo 1999, 71). These institutions were INSOTEC (with research, dialog, support for business associations development, generation of proposals, and some direct services to companies: technical training and assistance) and Swisscontact (technical assistance, training, support for credit guarantee programs).

In the second part of this decade, there was a deep political crisis, even with the promulgation of a new constitution in 1998, which in terms of trade liberalization gave a predominant role to the private sector (Ayala 2012). During this period there were five changes of President between 1996 and 2000, as a result of the implementation of certain unpopular measures and the lack of respect for the constitutional order, which was influenced by the difficult economic situation, whose main causes were the war with Peru in 1995 and the decrease in the price of oil (see Figures 1 and 2). This led to high inflation rates, high interest rates (which distorted the investment priorities of individuals and companies), devaluation of the national currency (MICIP 2002, 20), a deposit freeze in march 1999, and, faced with the risk of hyperinflation, the national government opted for a currency change to the dollar.
An important characteristic to consider is that, in Ecuador, the representation of small industries is in the Cámaras de Pequeña Industria, while the medium-sized industries are instead affiliated with the Cámaras de Industrias (Industry Chambers) which also group the large ones. The latter are “those that most influence and weigh on the decisions made in matters of economic and social policy” (Lanusse 1993, 39). The limited influence of the small industry can be explained by the fact that they do not represent strong economic groups, there are internal divisions in FENAPI, but also that “they continue to analyze the current situation with schemes and approaches that were typical of the oil boom times and that can be associated with a concept of a protective and paternalistic state” (Lanusse 1993, 39).

3.3 2000 to 2008

As stated above, this period begins with the implementation of the dollar as the official currency in Ecuador in January 2000. This occurred due to the serious economic situation of the last years of the nineties. In any case, during the first years of this period, the framework of economic opening and export promotion was maintained, without an explicit industrial policy and much less one aimed towards small industry. Symbolically this was reflected in maintaining the new name that had been given to the Ministerio de Industrias (Ministry of Industries) in previous years, when it was renamed as Ministerio de Comercio Exterior, Industrialización y Pesca (Ministry of Trade, Industrialization and Fisheries), together with the issuance of the Foreign Trade and Investments Law (issued in 1997), which led to the creation of Consejo de Comercio Exterior (COMEXI, Exterior Commerce Council) and Corporación para la Promoción de Exportaciones e Inversiones (CORPEI, Export and Investment Promotion Corporation). In addition to this, several projects with international support (USAID, GTZ, CBI-Holland, ALADI), all with emphasis on exports, were executed. Unfortunately, in a similar
way to what happened in other Latin American countries, “institutions typically focus on their own goals without coordinating and implementing policies with other institutions” (Urmeneta 2018, 83).

The first six years of the 2000s were focused on how to strengthen the monetary model of dollarization and recover what was lost, in productive terms, by the financial crisis at the end of the previous decade. At this stage, there is a consolidation of the new monetary model, in which “the growth of the Ecuadorian economy has improved […] due largely to high oil prices, increased remittances, the depreciation of the dollar, low international interest rates” (BCE 2010, 72).

In this first half of the decade, a more active role of local governments in productive development is observed; a good example of this is what has been done by the Municipio de Quito (Municipality of Quito) and the Consejo Provincial de Pichincha (Provincial Pichincha Council), in order to generate spaces for competitive improvement of the local economy. In this line of action, an instance that stands out is Conquito—the agency for the economic development of Quito (Araque 2010). Something similar happened in Ambato (with Corpoambato Corporation) and in Cuenca (with Acudir Agency), initiatives that were later replicated in other cities.

Also noteworthy are the efforts made to strengthen the technical education system for company workers, through the action of the so-called Consejo Nacional de Capacitación y Formación (CNCF, National Training and Education Council), which was proposed to replace the SECAP in promoting this type of service for the private sector. Unfortunately, the implementation model was modified in the second half of the decade, the expected results were not achieved,
and it became a failed project. However, with the access to the Presidency of Ecuador by Rafael Correa in 2007, a change of vision begins in the development model that will finally be based on the guidelines of the new constitution promulgated in 2008.

At the level of the small industry guilds, in this period one of the most important chambers, that of Pichincha (Quito), had a fracture that affected the influence of SMEs in public policies, since the national association, FENAPI, was also affected. When the situation was resolved, the guild was weakened anyway. Since the end of the 90s, the main private entities that support SMEs (INSOTEC and Swisscontact) had expanded their scope of action to the provision of direct services to microenterprises, as a result of the importance that this segment was taking in public policies and international cooperation. But there was also a change in focus in order to encourage small industry chambers to generate their own business service initiatives or that they be undertaken by those chambers, after a boost from the aforementioned entities. For instance, in the case of INSOTEC, an entity was created to provide training services to the textile clothing industry, with support from the IADB and the participation of the Municipio de Quito (Municipality of Quito) and Cámara de Pequeña Industria de Pichincha (CAPEIPI, Small Industry Chamber of Pichincha); the latter institution was left in charge of the entity once the project with the IADB was completed. Additionally, INSOTEC promoted the creation of the aforementioned local development agencies: Conquito, Corpoambato, and Acudir. In the case of Swisscontact, there was important work to strengthen savings and credit cooperatives, some of them started in the provincial chambers of small industry, and to promote professional training programs (they supported the creation of the above-mentioned CNCF and generated other initiatives), additionally they supported local development agencies in various provinces.

3.4. 2009 to 2019
With the new development plan, the Plan Nacional del Buen Vivir 2009 - 2013 (National Plan for Good Living), issued after the re-election of Rafael Correa due to the validity of the new constitution of 2008, a strategy towards an internal and sustainable economy is proposed “through a process of selective import substitution, promotion of the tourism sector and strategic public investment [...] the foundations are laid to build a domestic industry and produce substantial changes in the energy matrix [...] In this period, the protection of generating sectors that are intensive in work and employment will be a priority” (SENPLADES 2009, 96).

Economically, thanks to the high price of oil, GDP maintained positive growth rates until the beginning of 2015, although at a decreasing rate. In 2015 - 2016 the economy decreased, the following year of it showed slight recovery and then it fell again and became stagnant (see figure 2).

A change of the productive framework was proposed in the development plan—inserted within the Agenda para la Transformación Productiva presented in 2010 (Ministerio de Coordinación de la Producción, Empleo y Competitividad. 2010)—but it did not materialize in terms of achieving its main objective, which was to reduce the Ecuadorian economy’s dependence on products such as oil and other traditional non-oil products as much as possible. The idea was to develop an innovative industry, with sophisticated products, with greater added value, capable of being sold in the different markets of the world. As part of this Agenda—which generated great expectations in the national productive sector—at the end of December 2010, the COPCI was approved; however, it would be of little use if a long-term strategy was not adopted to insert the national production fabric in a real way into the international context, which meant changes to the focus of the productive and commercial policies of the current Administration.
(Luna 2014, 26), which did not happen because the government maintained an anti-business discourse.

At this stage, some initiatives to support the SME sector were generated, but always under the control of the State. International cooperation was centralized and controlled, which made some initiatives from private foundations and even from the corporate guilds themselves extremely limited. The protection of national production, through tariffs on imports, favored some sectors, but affected others and ultimately harmed the final consumer by not providing the option to choose higher quality. This return to import substitution, without a clear definition of its temporary duration, determined an approach between the government and certain leaders of small industry, micro-enterprises, and the social and solidarity economy. Figures 3 and 4 show that the growth rate of the manufacturing industry and the economy, in general, has resumed. Due to the aforementioned policies and the new oil price bonanza (Figure 1), the average growth rate of manufacturing was 4.8% between 2009 and 2014, while in the 1990s it had been 1.4%.

At the guild level, the government managed to formally divide the small industry sector (which also happened in other areas of national institutions). Only a few provinces remained in FENAPI, while the others formed a national chamber, close to the government. Despite this and the calls for agreement and dialogue to define policies, one of the representatives of the sector close to the government (interview with the Executive Director of CAPEIPI, in November 2017) recognized that they had little actual influence on the final decisions made by the government. Ultimately, as in other Latin American countries, “the absence of a clear analytical framework has favored the shift of policy emphasis towards objectives focused on reducing poverty and increasing employment, causing export competitiveness and development
objectives to lose relevance. The segment of medium-sized enterprises runs the risk of being marginalized within the support policies” (CEPAL 2013, 57).

The slowdown in the economy as of 2015 (figures 2 and 3), due to the decrease in oil prices, the strong earthquake of 2016 and the wrong economic policies (excessive debt, lack of control over spending, lack of an emergency fund, regulations unattractive for private and foreign investment, lack of stability regarding tax regulations) affected the support initiatives that the government had proposed.

4. Evolution of Analysis of the Sector in the Historic Periods Referenced

In 1965, through the issuance of the first Small Industry and Handicraft Promotion Law, the legal life of this sector formally begins, establishing in the codification and reform issued in 1973, that “Small Industry is considered to be that in which there is a predominance of machinery operation over manual activity; it is devoted to transformation activities, including casting, raw materials or semi-finished products, into final or intermediate articles” (EC 1973, art. 5) and reference is made to a certain investment value in fixed assets, excluding land and buildings, a value that has changed over time.

For research and analysis purposes, some public and private institutions have taken the number of employees as a reference and on some occasions, the sales value or the level of investment have accompanied that reference. Sometimes it has happened that, in the same period, two government institutions have had different definitions. With the issuance of Executive Decree 757 in 2011 (EC 2011, art. 106) a single definition was established. The historical use of the number of employees, as the main reference, originates from the fact that the information from
the INEC was easier to process, especially in previous years when digital support was scarce, but also for ease of comparison with other countries with similar situations.

4.1 Initial State Research into the Sector

In the 1970s, the public entities related to productive development: CENAPIA, CENDES, FONAPRE, and CEBCA, were the ones that generated information about and for the small industry sector, especially the first of those, whose direct objective was focused on small industries. It can be stated that this information was descriptive of the sector and supportive to the entrepreneur, for example, with certain investment profiles. However, the scope of action of all these entities covered other topics (training, technical assistance, marketing support) so the study of small industry was limited.

4.2 Research from the Private Sector, INSOTEC 1980-2005

Due to the limitations stated about the need to know the sector and its needs in-depth, in 1980 INSOTEC was created on the initiative of a group of small industry entrepreneurs and technicians connected to this issue, for the purpose of contributing to Ecuador’s economic, social, technological and educational development, with an emphasis on small industry requirements, for which it had the support of the Konrad Adenauer Foundation. Lines of research, support for business associations development, proposals, and policy dialogue for the sector were generated and, later, also direct action projects.

Between 1980 and 2005 there was relevant INSOTEC activity with studies on small industry of a general, descriptive type, focusing on productive subsectors by branch of activity, on issues of technology, human resources training, policies for the sector, and occasional environmental
issues, for specific geographic regions, cities or provinces, but also for the country as a whole, on current issues and time-sensitive issues.

Support along these lines was received from other cooperative entities such as IDRC of Canada, the Inter-American Foundation, IADB, USAID, CAF, OAS (Organization of American States). Nearly 100 publications and internal documents were generated at the request of the small industry chambers or state agencies or to guide these institutions’ courses of action, and those of INSOTEC or other entities.

In the aforementioned years, especially until 1995 when the institutional framework created under the import substitution approach was dismantled (which was partially justified because some of these entities became a bureaucratic burden instead of supporting the productive sectors), there was also some research activity on the sector by CENAPIA and SECAP. As of the year 2000, with the new institutional framework and the role of local governments, other research initiatives on the sector were generated, e.g. in the capital of the country with the CONQUITO Corporation; this was also done in some chambers of small industry, but not with the same volume and significance as INSOTEC’s efforts.

4.3 SME Observatory and its Influence from 2010

The gap left by INSOTEC from approximately 2005, when it became an entity providing direct services to companies, was compensated for in September of 2010 by the creation of the Observatorio de la PyME (also “SME Observatory”) of Universidad Andina Simón Bolívar, sede Ecuador (UASB-E). This made it possible to strengthen the institutional framework with the presence of an organization that, from the realm of research and generation of information,
supports all the actors who, from different perspectives, are interested in the situational improvement of such a key sector of the national production fabric as SMEs.

With the launch from the UASB-E’s SME Observatory, as a key element of the University’s strategic action was “breaking down the walls that, for years, have prevented the generation of a fluid and interconnected true link between universities and the other actors that integrate and coexist in a society” (Araque 2019).

Something to be highlighted in the operation of the SME Observatory is that, from its beginnings, it took the tenets of systemic thought and action as a major philosophical referent, thereby allowing the work to be oriented towards the collection, analysis, and socialization of information ranging from macro variables to micro information regarding the sectoral and organizational behavior of entrepreneurs and MSMEs. Additionally, to achieve an integrated understanding of the sector, information of a social, political, technological, legal, and cultural nature is processed and disseminated (Araque 2019).

The Observatory’s strategic model of operation is summarized in seven thematic courses of action: discussion spaces on the problems of entrepreneurship and SMEs; activities on the exchange of knowledge and domestic and international experiences related to entrepreneurship; windows into business reality intended to motivate entrepreneurs; specialized training programs in the field of entrepreneurship and business creation; training programs for entrepreneurs and small enterprises; bibliographic production specialized in entrepreneurship and the productive sector; spaces for the development of research and the generation of information on entrepreneurship and SMEs (Observatorio de la PYME UASB-E 2014).
5. Contributions of SMEs to the Country’s Socioeconomic Development

In this section, the analysis focuses on companies related to the manufacturing sector in Ecuador. To do this, the importance of small and medium-sized industries in the Ecuadorian economy is analyzed, based on their contributions in the number of establishments, employed personnel, and production. The data used comes from the BCE’S National Accounts and the INEC’s Manufacturing and Mining Survey.³

5.1 The 90s

The 1990s are characterized by the economic opening of the Latin American region and the liberalization of markets, which had repercussions on the countries’ industrialization processes, affecting the participation of the industry within total production (Geymonat 2020). It comes after a lost decade for Latin America due to economic and social deterioration, driven by the fall in oil prices, the external debt crisis, and the fall in investment.

This fact affected Ecuador, with a brake on the industrialization process that took place in the seventies, generating instability in the behavior of the national industry (Durán and others 1992); along these lines, the evolution of the manufacturing industry had some limitations during the eighties (Samaniego 1993). During the nineties, the contribution of the manufacturing industry to GDP averaged 12% (removing the processing of oil products), where for 1990 the share was 12.4%, with slight drops and a close of 11.7%. Thus, there was a certain

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³ The data that comes from the BCE’S National Accounts uses base year 2007 as a reference. The data that comes from INEC’s Manufacturing and Mining Survey uses data available from the 1998 to 2015 surveys. It must be noted that, standardizing with the figures presented above, manufacturing has excluded the manufacture of oil-related products in order to ensure the analysis is not influenced by the oil-related industry, which has a different dynamic.
stability in the share of the manufacturing industry during the 1990s (Araque 2002), as presented in the following figure.

**Figure 6.** Manufacturing Industry’s Contribution to the GDP 1990-1999 in Constant Prices (2007=100)

The structure of the Manufacturing Industry according to the number of establishments reflects the importance of SMEs in the national industrial fabric. In the 1998-1999 period, on average, Small Industry represented 66% of all establishments, Medium Industry 25%, and Large Industry 9%. That is, nine out of 10 industries are SMEs, as shown in the following figure.
**FIGURE 7.** Structure of the Manufacturing Industry by Business Size 1998-1999

Source: Own elaboration with INEC data.

Regarding the employed personnel, during the nineties, SMEs contributed about 49% of the total. Small Industry generates employment for 19% of all workers, Medium Industry 30%, and Large Companies 51%. With this, one out of every two workers works in an SME, as presented in the following figure.

Taking into account production, SMEs contribute 40% of the total. Small Industry contributes 11%, Medium 29% and Large Businesses 60%; Thus, this indicator is where SMEs have the lowest share, as shown in the following figure.
**Figure 8.** Employment by Business Size 1998-1999

Source: Own elaboration with INEC data.

**Figure 9.** Production by Business Size 1998-1999

Source: Own elaboration with INEC data.
5.2 2000 to 2008

The new century in Ecuador begins after a social and economic crisis that affects the well-being of the population, with the presidential overthrow of Jamil Mahuad in January, the product of “economic deterioration, a social crisis, and a popular uprising” (Larrea 2008, 215). This period is characterized by the change of official currency in the country, dollarization, which brings economic stability, although there is still political instability within the State. The contribution of the manufacturing industry to GDP in the 2000-2008 period remains on average at 12% (removing the processing of oil products). It begins in 2000 with a 12.1% share, reaching its lowest point in 2004, due to an increase in the share of the oil sector, and is at 12.2% in 2008. In that sense, during this period, there was relative stability in the share of the manufacturing industry in GDP, as shown in the following figure.

**Figure 10.** Manufacturing Industry’s Contribution to the GDP 2000-2008 in Constant Prices (2007=100)

Source: Own elaboration with BCE data.
The main components of the manufacturing industry show dynamic behavior within their shares in the sector. Over the period, the five main subsectors are; food processing and manufacturing (32.1%), the manufacture of chemical substances and products (10.6%), the manufacture of textile products, clothing, leather manufacture, and leather articles (9.6%), the manufacture of metal products, furniture, machinery and equipment (8.8%), the manufacture of paper, printing and paper products (7%).

**Figure 11. Structure of the Manufacturing Industry by Business Size 2000-2008**

During this period of the new century, the importance of SMEs is slightly reduced in terms of the number of establishments, personnel employed, and contribution to production. This is related to a concentration process of large companies, which have higher rates of profitability and stability within a competitive environment such as that of the manufacturing industry, reducing volatility in terms of their entering and leaving the sector, where in this country “when a company matures it achieves a relevant share in the market” (Coello 2017, 66).
With this, the importance of SMEs within the manufacturing industry is close on average to 88% of all establishments, which represents a slight decrease of 3 percentage points in comparison to the previous decade. Small Industry on average represents 61% of all establishments, Medium Industry 27% and Large Industry 12%, as shown in the following figure.

In reference to employed personnel, during the 2000-2008 period, SMEs contributed close to 40% of the total, which represents a decline of 9 percentage points in comparison to the 1990s. With this, Small Industry on average generates employment for 14% of total workers, Medium Industry for 26%, and Large Companies for 60%, as shown in the following figure.

**Figure 12. Employment by Business Size 2000-2008**

![Employment by Business Size 2000-2008](chart)

Source: Own elaboration with INEC data.

Concerning production, in the 2000-2008 period, SMEs represent around 30% of the total, with a reduction of 10 percentage points in comparison to the nineties; Small Business contributes
9%, Medium-Sized Businesses 21%, and Large Business 70%, as shown in the following figure. This reflects improved productivity in larger establishments.

**FIGURE 13.** Production by Business Size 2000-2008

Source: Own elaboration with INEC data.

5.3 2009 to 2019

Latin America had significant economic growth and improvement in social indicators, reducing gaps and increasing the provision of services related to well-being. This fact was promoted by an economic bonanza due to the increase in the prices of primary products, called commodities, generated by a period of world expansion and growing demand from China. In 2008 Ecuador passed the latest Constitution of the Republic, within a favorable economic environment, driven by high oil prices. Similarly, during this period there was political stability, with the same party at the helm of the national government. The manufacturing industry’s contribution during this period is close to 11.8% (removing the processing of oil products), with a slightly lower share of GDP than in previous decades. It begins the year 2009 with a contribution of 12.0%, reaches its lowest point in 2016, and stands at 11.7% for the year 2017. Thus, the share of the
manufacturing industry within the national production remained relatively stable, as shown in the following figure.

**FIGURE 14.** Manufacturing Industry’s Contribution to the GDP 2009-2017 in Constant Prices (2007=100)

Source: Own elaboration with BCE data.

In accordance with the previous paragraph and as has been presented in previous sections, it can be said that since 1975 manufacturing has been among the three sectors of economic activity (Figure 5) with the highest contribution to GDP and since 2010 it has been the sector that contributes the most, in contrast to the oil extraction and refining sector which, despite having had the highest share in several periods, has declined in others and, as of 2010, the average contribution to GDP is 10.6%. Something similar has happened with the trade sector which, since the year indicated above, has contributed 10.2%.

In this period five major subsectors of the manufacturing industry are; food processing and manufacturing (33.2%), manufacturing chemical substances and products (10%), manufacturing of non-metallic mineral products (9.1%), manufacturing of metal products,
furniture, machinery, and equipment (8.9%), manufacturing of textile products, clothing, manufacture of leather and leather goods (7.7%), revealing some changes in comparison to the prior period.

According to the number of establishments, the participation of SMEs within the structure of the manufacturing industry is close to 83%, which is an important percentage but reflects a reduction in its contribution when compared to the two previous decades. In the 2009-2015 period, on average, Small Industry represents 52% of all establishments, Medium Industry 31%, and Large Industry 17%, as shown in the following figure.

**FIGURE 15.** Structure of the Manufacturing Industry by Business Size 2009-2015

![Bar chart showing the structure of the manufacturing industry by business size from 2009 to 2015.](chart.png)

Source: Own elaboration with INEC data.

If we take employed personnel as a reference, SMEs contribute 29% of the total, which is a reduction of 11 percentage points in comparison to the previous period. Small Industry generates employment for 8% of all workers, Medium Industry for 21%, and Large Companies for 71%, as shown in the following figure.
Finally, the share of SMEs within production has also reduced its magnitude, contributing 23% of the total, being 7 percentage points lower than the previous period, where on average Small Business contributes 6%, Medium-Sized Business contributes 17% and Large Businesses contributes 77%, as shown in the following figure.

The information in the three previous figures and the comparison with prior periods reflects the concentration of companies within the manufacturing industry, favoring the larger ones since there has been a growing trend of their share in terms of the number of establishments, employed personnel, and production (Coello 2017). In addition to improvements in productivity, this occurs due to market power, which creates entry barriers and has been enhanced by accumulation processes (Solano, Camino and Alvarado 2017). This process is associated with greater efficiency of large companies and greater liberalization of the economy that could affect the survival of smaller companies (Aguiar 2013).
However, despite the above, the contribution of SMEs to the development of Ecuador’s provinces as a whole should be recognized, since large companies are mainly in the economic attraction poles, while in intermediate and small cities it is the SMEs that generate employment and income for the population. Thus, according to the Directorio de Empresas—Company Directory (INEC 2019)—, the number of companies per 10,000 inhabitants tends to be higher in smaller provinces. Another important issue is that traditionally (Hidalgo 1999) the Sector Specialization Coefficient shows that SMEs carry out activities related to satisfying basic needs (food, clothing), to providing inputs for households (cleaning and simple chemical products, wooden furniture), but they are also suppliers of other companies with inputs and parts (chemical products, general metal products, and some electrical machinery).

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4 For a specific subsector it is calculated as the ratio between its share in the value added of SMEs and the share of the same subsector in the value added of the total industry. If the result is greater than 1, it means that SMEs have a specialization in that subsector and, the larger the result, the greater the specialization.
6. Characterization of the Evolution of Internal Operations in Small and Medium-Sized Enterprises (SMEs)

The internal functioning of Ecuadorian SMEs throughout the three periods of this study shows a series of evolutionary characteristics that have adapted to certain national and international historical milestones, as described in the previous sections. As in other countries, the share of SMEs in industrial development processes is seen as “the hope of growing dynamism” (Cardozo 2005, 118). In the Ecuadorian case, even industrial development policies have tended to remain stable in the national development plans of the 1970s and early 1980s (Insotec 1987).

Among the main effects felt at the beginning of the 1990s was the lag in institutional matters accumulated in the country as a result of having operated based on a productive model of industrialization that, rather than promoting exports - a key requirement for a secure opening—prioritized the substitution of imports using tariff barriers to prevent the entry of products from foreign markets. This legal framework and public policies rather had an anti-export bias and an oversizing of the state role that, in the end, limited SME's competitive potential (Fernández 1990).

With the changes in institutions and policies detailed in section 3, among the positive effects of this decade was the improvement in exports of non-traditional products, where small and medium-sized companies played an important role together with the support that was offered by the CFN, CORPEI and non-governmental organizations at the time, through programs such as the Promoción de Exportaciones Agrícolas no Tradicionales (PROEXANT, Promotion of Non-Traditional Agricultural Exports). In any case, the Small and Medium Industry sector had an orientation to increase its presence more in the local market, hence the export levels
registered did not reach more than 5% of the total establishments (Universidad Eafit, Insotec and CAF 1996) and only four out of ten Ecuadorian SMEs had knowledge about the key factors behind the management of foreign trade. For this reason, the scant trend towards internationalization, despite government efforts to open the economy to new markets with products other than oil and other traditional ones such as bananas, coffee, and cocoa, was held back by SMEs internal operations; their behavior limited the possibilities of insertion in foreign markets.

For example, significant weaknesses were found in fields such as the creation of competitive advantages, due to the lack of concern for incorporating good organizational practices aligned with competitive improvement requirements such as; quality, productivity, and innovation. In terms of quality management, there was a trend towards little widespread use of certification processes through international quality standards. During this decade only 13% had been concerned about using ISO 9000 series standards (Universidad Eafit, Insotec and Caf 1996). Therefore, as expected, “the quality standards of their products are relatively low, if not deficient, in the absence of genuine competition, both internal and external” (Lanusse 1993, 32).

Regarding the concern for innovation as a permanent practice to face the challenges of a changing and increasingly globalized market, there was a trend of high weakness, since only 14% of SMEs indicated that they were doing any kind of investment in research and development; this is later reflected in scant product innovation - about 4 out of every 10 SMEs tend to make changes in what they produce - and in processes, only 21% tend to make efficiency-oriented improvements (Universidad Eafit, Insotec and Caf 1996). This weak quality and innovation behavior ended up influencing the value registered in terms of productivity,
which, in the Ecuadorian case, shows a heterogeneous behavior when comparisons are made between different company sizes, while in countries like Colombia productivity is more homogeneous when companies of different sizes are compared (Araque 2002).

Finally, in the last year of the 90s, with the freezing of the population's deposits and the serious crisis of the financial system, which, as expected, had an impact on the lack of money circulating and caused a drop in consumption, the SME sector was one of the most affected, despite its flexible capacity for productive adaptation. This macroeconomic blow even dismantled the availability of workers who began to migrate in large numbers to countries such as Spain, Italy, and the United States.

During the next historical period—from 2000 to 2008—chosen as the object of study for understanding the evolution of Ecuadorian SMEs, began with a series of economic policy decisions that sought to stop the rampant inflation and devaluation that was destroying the currency in effect in Ecuador up to that date, the Sucre, and determined the adoption of dollarization as the monetary model. This macro decision had a direct impact on the behavior of meso- and micro-realms; where companies, specifically SMEs, felt the effects of the change in the monetary model in their cost structure and in the price-setting process. This began to cause havoc over time, above all in those SMEs oriented towards exports, faced with the impossibility of a monetary devaluation to improve the competitive position of national products in international markets, they saw an increase in the price of their export products in relation to those of other countries; testing adaptive and creative flexibility that generally characterizes a company classified within the size of SME.
In the context of that time and concerning the operation of SMEs in the financial field, a need that remained unmet in that period was that of specialized financial products for the sector. Thus, a healthy structure of business finances was hindered, since the definition of terms, interest rates, and amounts—on the part of public and private financial institutions—was established without considering the real profile of small and medium-sized companies’ productive needs. Therefore, oftentimes, that profile matched the reality of micro-enterprises - with products such as microcredit - or that of large companies - with products such as corporate credit. This excluded small and medium-sized enterprises from access to financial products specialized for their productive and business needs (Araque 2010). The aforementioned is ratified in the report prepared by OECD (2019) on policies for SME development in which it stated that “Ecuador has one of the lowest scores in the LA7 in the dimension of access to finance, which finds that it is particularly important to address financial education initiatives and strengthen procedures for dealing with bankrupt businesses” (OECD 2019, 394).

Something important to highlight is that, as of 2007, a change of focus took place in government matters, with the inauguration of Rafael Correa as President of the Republic, in terms of supporting the country's productive actors. Great emphasis was placed on strengthening the SME sector and what began to be made visible and known as the Social and Solidarity Economy. At this historical moment in the country, the National Development Plan also recognized the importance of supporting SMEs. Unfortunately, at the time of putting written plans into action, a series of obstructing distortions appeared, linked, above all, to the implementation efforts regarding Ecuador’s productive policies.

Regarding the third period (2009 to 2019) of this historical study of Ecuadorian SMEs, despite the fact that a large amount of money circulated in the domestic economy as a result of the new
oil boom—2011 to 2014—the real strengthening of industrial production—which includes SMEs—unfortunately, remained as merely good intentions written in the National Development Plan. Hence, according to the Quarterly Survey of SMEs of the Observatory of Universidad Andina Simón Bolívar, national SMEs’ concerns with making new investments, growth, and innovation were left on hold until support to strengthen the sector improves.

Thus, during this period, in the end, certain indicators have remained largely unchanged within the evolution process of domestic small businesses. For instance, the export trend remains similar to that registered in the mid-1990s—between 2017 and 2019—exporter SMEs accounted for around 5% of total SMEs (Observatorio de la PYME UASB-E 2019). This can be explained by the fact that—according to a study on the internationalization of Latin American SMEs in the European market, carried out by CERALE (2017)—in countries with weak economies, such as Ecuador, SMEs depend more on export support programs to achieve internationalization. Additionally, Ecuadorian SMEs indicate that what they most require is access to information and communication technologies, information on foreign markets, and validity of free trade agreements, among a list of eleven factors (CERALE 2017, 34).

Incidentally, free trade agreements with the USA and Europe was one of the issues opposed by the government that was in power between 2006 and 2016.

Along the same lines of identifying issues in which there is stagnation, in the use of operating capacity—measured by the hours of daily work and by the weekly days worked—the trend for 2019 is similar to that recorded at the beginning of 2000: 8 hours a day and 5 days a week, which indicates the underutilization of operating capacity, generating a drop in productivity levels (Lanusse 1993). On innovation issues, the OECD report determines that “the industrial strategy of Ecuador […] notes the particularly important role of innovation in the diversification
and productivity efforts of the country. However, there are few support schemes for innovation in SMEs and start-ups, compared to other countries” (OECD 2019, 395), corroborating the weakness and need for coherent policies in the country.

Finally, this last period in the history of SMEs - amid periods of prosperity and scarcity of state resources as drivers of economies with profiles similar to the Ecuadorian - can be defined as a segment in the economic history of Ecuador where perceptions and pro-growth actions of sectors such as small and medium-sized industry were put into the maintenance category; the expectations were that the conditions of the political, economic, social and legal environment would change and, thus, perception would stimulate growth in investments by business owners. This trend is reflected in SMEs pro-investment passivity—between 60 and 70% of businesses indicate that they have not invested (Observatorio de la PYME UASB-E 2019). This means they have kept their internal productive structure without major changes, despite the positive perception of sectoral variables such as ease of access to production factors - nearly 90% view access to raw materials and machines and equipment as positive - (Observatorio de la PYME UASB-E 2019). On the other hand, a negative perception - which influences passivity for productive investment - is observed in the behavior of macro variables such as; the country’s general economic performance, legal certainty, the business and investment climate, and the political climate (SME Observatory UASB-E 2019). The uncertainty observed in SMEs is understandable because “Ecuador has yet to develop a complete SME policy, including the design of programs for direct SME and entrepreneurship support, such as Business Development Services (BDS). Because the country’s strategies are geared to capital-intensive industries, they contain few specifics on BDS for SMEs and entrepreneurs” (OECD 2019, 395).
7. Conclusions

Within the three periods analyzed, the Manufacturing Industry sector reveals one of the greatest contributions to Ecuador’s GDP, with an average 12% share (removing the processing of oil products). This share has remained relatively steady, with a slight, though not significant, reduction. Since 1975, manufacturing has been among the three sectors of economic activity with the highest contribution to GDP, and since 2010 it has been the largest contributor, in contrast to the oil extraction and refining sector which, despite having had the largest share in several periods, has declined in others and, as of 2010, the average contribution to GDP is 10.6%. Something similar has happened with the trade sector which, since the year indicated above, has contributed 10.2%.

The structure of the manufacturing sector, according to the companies’ size, makes it possible to highlight the contribution of SMEs to Ecuador's social and economic development; on average, SMEs have contributed 87% of the number of establishments, 37% of staffing, and 29% of total production. In this sense, considering the Sector Specialization Coefficient, it contributes with products that help to satisfy basic needs (food, clothing), to provide inputs for households (simple cleaning and chemical products, wooden furniture), but it also provides other companies with supplies and parts (chemical products, general metal products, and some electrical machinery), to which is added their contribution in generating employment in the provinces of lower economic development. However, their relative share has been decreasing over time, in favor of large companies, as a result of a process of improved productivity and greater concentration of market power by large companies and because of the lack of coherent public policies for SMEs, as recognized in the OECD report (2019).
In the periods analyzed, the operational performance of SMEs reveals structural situations that, for years, have been highlighted as opportunities for integrated improvement of the sector, but which in practice have remained unfortunately unchanged. As an example, the exporting trend of SMEs has varied little over the past 20 years, despite a series of programs and projects to this end, which have been promoted from several public and private entities, domestic and international, but which unfortunately have not been accompanied by proper international trade policies—for example, by not promoting free trade agreements with the main commercial partners.

In the end, the greater or lesser availability of state resources, in an economy that is highly dependent on oil prices, and the lack of stability and priority in terms of policy and support mechanisms, has affected the drive of SMEs. Yet, this sector has shown its ability to be flexible to adjust to ever-changing and negative conditions, in addition to its ability to innovate - perhaps not at higher levels—in light of adverse circumstances. From the perspective of their contribution to the economy as a whole, we may highlight the important presence of SMEs throughout the country, which contribute jobs and fulfil the basic needs of the population, because the main economic activities where SMEs have relevant participation are in the food, beverage and clothing sectors. Thus, it is a catalyst for development within the country. We should not ignore the role of the sector as an important part of production chains, where it has a role as a supplier of parts and intermediate raw materials. SMEs are a relevant participant in the domestic economy, which requires clear and coherent policies and support mechanisms, with medium- and long-term vision to promote entrepreneurship and innovation while avoiding overprotection.
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