

4.2. Market Support: Set-Asides for SMEs in Brazil & India

Business owners not only need financial and business support to succeed, but also require access to markets. In this regard South Africa could vamp up support to small businesses if it looked at setting aside certain types of procurement for SMEs, as a number of countries like South Korea, the US and Japan already do. Recent legislation in Brazil now also requires that certain contracts are set aside for small businesses. Business owners also need access to affordably priced raw materials and in this regard India's NSIC's raw material purchasing programme is one example South Africa could learn from.

The South African government spends billions of rands each year purchasing goods and services on everything from stationary to medical supplies, cleaning and security, which is why so many small businesses want in on the action. Small businesses have the potential to grow if they are able to take hold of a bigger slice of the government's planned R846 billion spend on infrastructure between 2010 and 2012. But in a country dominated by large businesses they will have to fight to get in.

Unlike a number of countries that have set aside huge chunks of their procurement bill for small firms,⁹⁶ South Africa's efforts to procure more from small firms have largely failed. In South Africa some local and provincial governments may have set targets for buying from small business – 40% of spend for the City of Cape Town and 60% for the Gauteng government – but these are these are mere targets, not set-asides backed up by any legislation. Added to this, efforts to put set-asides in place have been torpedoed by the National Treasury over concern that set-asides are unconstitutional. It's why a cabinet-approved plan to allocate 85% of the spend on 10 key goods and services to small businesses never took off and why the Department of Trade and Industry's plan to leverage more local procurement for its infrastructure programme, has also stalled.

India

For some time the Indian government planned to set aside 20% of all public procurement for small businesses. But midway through 2010 it scrapped these plans. The plan was mooted after a high-level MSME Task Force constituted by Prime Minister Manmohan Singh in 2009 proposed reserving 20% of

SMEs made up 17.54% (R\$23.9 billion compared to R\$19.12 billion in 2000) of funding to SMEs in 2009, the lowest percentage in 10 years (the highest touched 31.58% in 2004). However according to BNDES in 2010 from January to June, 36.17% of all funds had gone to SMEs. Historically the participation of SMEs has been at 20% for the bank.⁹⁵

⁹⁶ While the US government's statutory minimum goal for all federal agencies is to allocate 23% of all prime contracts by value to small businesses, South Korea, a country whose miracle economic growth was largely driven by the promotion of small businesses, has had a set-aside policy for small enterprises in place since in 1965.

public procurement⁹⁷ for micro and small enterprises (MSEs), with the Secretary in the MSME Ministry Uday Kumar Varma in October 2010 saying the policy should be “more aspirational than mandatory”.⁹⁸

However the government still reserves the manufacture of certain goods for small firms. Currently 114 items reserved for MSE under 11th plan.⁹⁹ The reservation of products for exclusive manufacture in the small-scale sector¹⁰⁰ was introduced for the first time in 1967 with the reservation of 47 items. This number increased progressively. After the introduction of National Industrial Classification code the list was recast. As a result, the list of reserved items expanded from 504 to 807 in 1978 and up to 836 in 1989. The policy received statutory backing in 1984 under Section 29B of the Industries (Development & Regulation) Act, 1951. The Advisory Committee on Reservation (constituting of the secretary MSME, secretary commerce and additional secretary and development commissioner of MSME) constituted under the Industries (Development and Regulation) Act, 1951 recommends items to be added and deleted from the reserved list including bringing changes in nomenclature. Since 1997 there has been a gradual move to dereservation.¹⁰¹ However though declining, reservation remains as it is seen as one way to help small enterprises compete against medium, large and multinational companies.

On top of reservation of goods and price preference in favour of small businesses on certain goods the government of India buys, foreign banks are mandated to provide 10 percent of all net bank credit to the MSME sector.¹⁰²

Box 3: Raw materials purchasing & warehousing: An initiative by the India's NSIC

Small businesses often face problems competing against larger businesses, which with their sheer weight are able to undercut their smaller competitors by buying in bulk from suppliers and securing discounts. A scheme in India, where a government support organisation buys up and warehouses raw materials allows business owners to procure goods for between 10% to 25% less than the ordinary wholesale price, according to Dr HP Kumar, the managing director of the government's National Small Industries Corporation (NSIC).

The NSIC buys up materials such as steel, aluminium, zinc, copper and paraffin wax from private and public sector companies – such as the Steel Authority of India Ltd, National Aluminium Company and Indian Oil Corporation Ltd - and stores these in 15 warehouses across the country. Thousands of small businesses are making use of the NSIC's warehouses. Demand has been increasing for the programme: distribution of raw materials grew from 229 018 mega tons in 2007/08 to 354 725 mega tons in 2009/10. The organisation plans to open 15 more such warehouses across the country over the next three years.

⁹⁷ At present, the government purchases from the MSME sector come to around Rs400 billion, of the estimated total procurement of Rs6 trillion to Rs7 trillion annually – less than seven percent of government procurement. As government purchases are growing at an annual rate of 10% to 15%, this figure is likely to reach Rs8 trillion in the 2011/12 fiscal year, which means a 20% reservation would come to about Rs 1.6 trillion. The effect on small businesses could be massive, especially as the departments of defence and railways fall under the central government, which also has 240 large companies under it. “This is going to be very very important. This is only what central government can do,” said Fisme general secretary Anil Bhardwaj. The state already has a form of set asides for small businesses as the central government and its public sector units have reserved 358 items for exclusive purchase and its PSUs from the MSEs. There's also a 15% price preference for on these items in favour of small firms. In other words a small or micro firm can quote up to 15% above the quote of a medium or large-sized company and still get the order, as long as the quality and terms of supply are met.

⁹⁸ SME Times, MSME ministry says no to procurement policy, <http://smetimes.tradeindia.com/smetimes/news/top-stories/2010/Oct/26/msme-ministry-says-no-to-procurement-policy25002.html>

⁹⁹ Ntl Planning Commission, Industry report

¹⁰⁰ Medium or large units, including multi-nationals can manufacture reserved items if they have obtained a carry on business licence or accept an export obligation of 50% of their production. As only manufacturing of items is reserved, trading in these items is not a violation of the reservation policy.

¹⁰¹ <http://www.laghu-udyog.com/publications/reserveditems/respol.html>

¹⁰² There is however no specific sub-target for domestic banks, which has to provide 40% of NBC to the priority sector as a whole.

For those who cannot front the required cash, the NSIC also provides the raw materials on credit for up to 90 days, while keeping one-year security or a bank guarantee. The programme is marketed through the organisation's 123 offices.

Kumar admitted that it was not easy to run such a programme as one had to make arrangements with bulk suppliers before agreeing to settle the accounts, set up the warehousing facilities before identifying small business clients. The latter was achieved by offering attractive terms. This required the organisation to work hard to increase its service levels, he said.

Brazil

While set-asides have been put on hold in India, across the world in Brazil set asides are helping to channel billion of reals to small and micro enterprises. The promulgation of Lei Geral da Micro e Pequena empresa (or General Law for small and micro enterprises) in 2006, has transformed government support to small enterprises, by increasing total federal government purchases from small and micro enterprises more than sixfold in just three years – from R\$2.4 billion in 2006 to R\$14.6 billion (R\$49.7 billion total) in 2009.¹⁰³

Under articles 42 to 49 of Lei Geral all government tenders of up to R\$80 000 in value must be granted exclusively to small and micro enterprises and 25% of the contract value of those tenders with a value exceeding this threshold, must be reserved for MPEs. Added to this, under the law, 30% of subcontracts from large and medium businesses are to go to small and micro enterprises. Micro and small enterprises would also be favoured with an allowance for up to 10% difference in price between the small or micro enterprise's price and the medium or large firm's price.

Government purchases from small and micro firms for the first quarter of 2009 compared to the first quarter of 2010 were up 57%, according to data supplied by the ministry's small business forum (Forum Permanente).¹⁰⁴ Added to this the number of suppliers registered with the federal government increased from 185 488 to 210 327 enterprises. In 2009 purchases from micro enterprises made up R\$9 billion, while those of small enterprises made up R5.5 billion. Over half of the purchases from small and micro firms were conducted electronically (R\$11.1 billion of the R\$20.4 billion total).¹⁰⁵

According to Paulo Bernardo, Brazil's minister of planning, budget and management, over 20 million people have been able to raise themselves out of poorest sections of society (from exclusão mínimo to class C). Bernardo said that the ministry had discovered that every R\$1 billion contracted to small and micro enterprises helps generate 7 600 jobs.¹⁰⁶

In spite of Brazil's federal system - which means each of its 5 565 municipalities in Brazil each have to separately agree to pass Lei Geral in their respective municipality – a strategy is in place to win municipalities over to sign the law. The success so far offers a promising lesson on how to gain the co-operation of municipalities in South Africa when it comes to promoting small business development and even the use of procurement set-asides. Let's take a closer look.

Key has been Brazil's small business support agency Sebrae, which has helped foster several initiatives to get municipalities to pass the act in the respective areas and to get involved in supporting SMEs. As of

¹⁰³ Tres Anos da Lei Geral da Micro e Pequena Empresa, Sebrae publication, 2010.

¹⁰⁴ In the state of Sergipe for example the percentage of all state purchases to small and micro firms increased by 500% between 2007 and 2009 – from about six percent of the state government's purchases to over 38% of all its purchases.

¹⁰⁵ Tres Anos da Lei Geral da Micro e Pequena Empresa, Sebrae publication, 2010.

¹⁰⁶ Two government organs oversee points on the law: the Comitê Gestor de Tributação, linked to the Ministry of Finance looks specifically at Simples Nacional and regulating the new points, while the Fórum Permanente das Microempresas e Empresas de Pequeno Porte co-ordinates public policy to support MPEs and evaluates implementation.

October 6, 2010, Lei Geral was active in 2 112 municipalities, which represents 33.82% of the 5 565 municipalities in Brazil.¹⁰⁷

The agency's strategy is first to get the large municipalities to pass the law, as these municipalities have the most businesses and have more unemployed people and social problems than smaller municipalities. Using large municipalities as champions, Sebrae also attempts to gain the smaller municipalities' confidence through collective events and then by offering training courses in capacitating municipalities as agents of development, as well as innovation and technology and skilling officials there on the principles of government purchases.

As many municipalities battle with technical expertise and a lack of infrastructure, public officials there find it difficult to understand the importance of Lei Geral. One course offered to municipalities included a distance learning course for agents on the formation of development agents in their area. The role of these agents is to help strengthen various organisations involved in local economic development, through facilitating co-operation between the various players. Sensitising municipal officials about the important role small and micro enterprises can play in local economic development results in many municipalities voting to instil Lei Geral so that their area can accrue the benefits too. To carry out the training Sebrae partnered with the three existing municipal entities in Brazil that represent municipalities.

Sebrae has also set up the Rede de Prefeitos Empreendedores – an autonomous group of mayors with an entrepreneurial mentality – which is tasked with spreading a culture of public entrepreneurship. Further to this the agency has also developed bi-annual awards (O Prêmio Prefeito Empreendedor) with various categories, for mayors who have been involved in the best entrepreneurial projects in their respective municipalities.¹⁰⁸

Reflective comments: Use e-procurement

The National Treasury probably shares the concern many other governments around the world have with set-asides, namely that putting in place set-asides will result in inflating the costs of procurement. This is, something a country just recovering from the recession can ill afford. Yet, a 2009 empirical study¹⁰⁹ by the University of Tsukuba's Jun Nakabayashi, who looked at Japan's policy of allocating about half of all construction contracts to small firms, revealed that the increase in costs associated with procuring more from small firms was "neutral". Nakabayashi pointed out that set-asides, which had led to 40% more small firms winning government construction contracts, had actually forced larger companies to become more competitive and to bring down their prices.

Nevertheless, the presence of set asides alone may not ensure that more small businesses benefit from public procurement. A 2008 report¹¹⁰ commissioned by the UK government found that South Korea and Australia were successful in getting more small businesses into public procurement because they had developed e-procurement systems which had had the effect of bringing down bidding costs, therefore making tendering more accessible to all. South Africa could learn from this, especially as many government tenders require business owners to put down non-refundable deposit, which according to

¹⁰⁷ "Sebrae incentiva a aplicação da Lei Geral em todo o País" from http://www.agenciasebrae.com.br/audio_int.kmf?cod=2155.

¹⁰⁸ The awards have been running since 2001 and are promoted by Sebrae with support from municipal entities and parliamentarians. In all, 44 mayors have been honoured, with certificates and international travel to see other cases of small business successes around the world. The awards are in their sixth edition. During this time 3 500 projects have been entered for a chance to win. The competition is divided into two phases – state and national. There is one overall winner in each state and in six themes: at the state level: government purchases, removal of red tape, entrepreneurial education and innovation, formalisation of entrepreneurs, passing of Lei Geral and middle and big municipalities. In the sixth edition of 2009-10, 1 300 municipalities with 719 projects, participated in the competition.

¹⁰⁹ Nakabayashi, June, 2009. "Small Business Set-asides in Procurement Auctions: An Empirical Analysis", Global COE Hi-Stat Discussion Paper Series from Institute of Economic Research, Hitotsubashi University.

¹¹⁰ HM Treasury, 2008. "Accelerating the SME Economic Engine - Through Transparent, Simple and Strategic Procurement".

Martin Feinstein of business support organisation Enablis, can be anything from R50 to R5 000, if they want to view tender documents.

The government of South Korea's e-procurement site (see: b2g.gov.kr) has also been successful in reducing the time it takes to pay suppliers – from 14 days to just four hours. This is a lesson South Africa, which in 2009 launched a call centre at the Small Enterprise Development Agency (Seda) to handle late payments from government, can learn from, especially as there is only so much a call centre can do to help speed up payments. Call centre members still have to spend time negotiating with officials to make the payment. An IT system could also simplify the payments process and flag problematic tenders and those where payment still needs to be made.

Handing out support and finance will only go so far to assist new entrants into the market. The government will have to look more carefully at how public procurement can help to drive small business growth in this country. Business owners not only need finance and business support to succeed, but also access to markets. In this regard South Africa could vamp up support to small businesses if it looked at setting aside certain types of procurement for SMEs, as a number of countries like South Korea, the US and Japan already do. Recent legislation in Brazil now also sets asides certain contracts for small businesses. Business owners also need access to affordably priced raw materials. India's NSIC's raw material purchasing programme is one example South Africa could learn from.