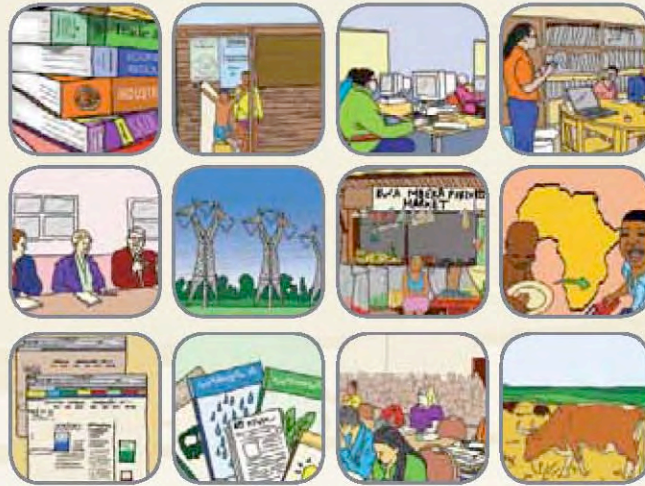


# TIPS

TRADE & INDUSTRIAL POLICY STRATEGIES



HOW SOUTH AFRICA CAN BOOST SUPPORT TO SMALL BUSINESSES:

LESSONS FROM BRAZIL AND INDIA

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January 2011

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## Abbreviations

ALIs	Agentes Locais de Inovação (Local Innovation Agents)
APLs	Arranjos Produtivos Locais (Local productive arrangements)
Assocham	Associated Chambers of Commerce and Industry (India)
BBSDP	Black Business Supplier Development Programme (South Africa)
BEE	Black Economic Empowerment
BIC	Business Innovation Centres (EU)
BNDES	Banco Nacional de Desenvolvimento Econômico e Social (Development Bank of Brazil)
BRIC	Brazil, Russia, India and China
Busa	Business Unity South Africa
Cerne	Centro de Referência para Apoio a Novos Empreendimentos (Reference centre to support new enterprises)
CGTMSE	Credit Guarantee Trust for Micro and Small Enterprises (India)
CII	Confederation of Indian Industries
Cipro	Company and Intellectual Property Registration Office (South Africa)
CNI	Confederation of National Industries (Brazil)
CNPq	O Conselho Nacional de Desenvolvimento Científico e Tecnológico (Brazil's National Research Council)
CPPP	(The) Community Public Private Partnership Programme (South Africa)
CRD	Credit Risk Database
Dempi	Fiesp's small and medium department (Brazil)
DTI	Department of Trade and Industry (South Africa)
ECDC	Eastern Cape Development Corporation (South Africa)
EIP	Enterprise Investment Programme (South Africa)
Emia	Export Market and Investment Assistance
Fampe	Fundo de Aval às Micro e Pequenas Empresas (Guarantee fund for micro and small enterprises)
Fiesp	Federação das Indústrias do Estado de São Paulo (Industry Federation of the State of São Paulo)
Fisme	Federation of Indian Micro and Small & Medium Enterprises
GDP	Gross domestic product
Gem	Global Entrepreneurship Monitor
Geor	Gestão Orientada para Resultados
GTP	Grupo Trabalho Permanente (Permanent Work Group)
HACCP	Hazard Analysis and Critical Control Points
IBA	Institute of Business Advisors (South Africa)
Ibsa	(The) India, Brazil and South Africa (Initiative)
IDC	Industrial Development Corporation (South Africa)
IID	Integrated Infrastructure Development
IPAP	Industrial Policy Action Plan (South Africa)
Ipea	Institute of Applied Economic Research (Brazil)
KVIC	Khadi and Village Industries Commission
LBSCs	Local Business Support Centres (South Africa)
MAC	Manufacturing Advice Centre (South Africa)
MDA	Marketing Development Assistance (India)
MDIC	Ministério do Desenvolvimento, Indústria e Comércio (Ministry of Development Industry and Commerce)
MPEs	Micro e pequenas empresas (micro and small enterprises)



MSEs	Micro and small enterprises
MSMEs	Micro, Small and Medium Enterprises
Namac	National Manufacturing Advisory Centre (South Africa)
Nectar	Núcleo de Empreendimentos em Ciência, Tecnologia e Artes (Centre for Enterprises in Science, Technology and the Arts)
NEF	National Empowerment Fund (South Africa)
NIEs	Newly Industrialising Economies
NMCC	National Manufacturing Competitiveness Council
NPA	Non-performing asset
NRF	National Research Foundation (South Africa)
NSIC	(The) National Small Industries Corporation (India)
NYDA	National Youth Development Agency (South Africa)
OEM	Original Equipment Manufacturer
PBE	Programa Brasil Empreendedor (Programme Enterprising, Brazil)
Prime	Programme First Innovative Business (Brazil)
PUC	Pontifical Catholic University - Rio University
R&D	Research and Development
SAB	South African Breweries
SAE	Secretaria de Assuntos Estrategicos (Secretariat of Strategic Affairs)
SAMAF	South Africa Micro Finance Apex Fund
SARS	South African Revenue Service
SBDC	Small Business Development Centers (US)
Seda	Small Enterprise Development Agency (South Africa)
SEZs	Special Economic Zones
SICDP	Small Industry Cluster Development Programme (India)
Sidbi	Small Industries Development Bank of India
Sinvest	Sindicato das Industrias do Vestuario de Pernambuco (Industry syndicate for clothing businesses of Pernambuco)
Spil	Support for Industrial Innovation (South Africa)
SPVs	Special Purpose Vehicles
SPX	Sub-contracting and Partnership Exchanges
SSI	Small-Scale Industries
TEA	Total Early Activity
TePP	Technopreneur Promotion Programme (India)
Thrip	Technology and Human Resources for Industry Programme (South Africa)
UCT	University of Cape Town
Unido	UN Industrial Development Organisation

# 1 Introduction

In its efforts to craft a new economic growth path and assist small businesses, South Africa could do well to look to emerging economies such as Brazil and India, which have attracted much attention in their recent efforts to create greater and more equitable economic growth. There is much South Africa can learn from these two countries, with gross domestic product (GDP) growth in India edging towards 10% a year and with Brazil ranked as one of most entrepreneurial countries in the world according to the 2009 Global Entrepreneurship Monitor (Gem) Report.

Policymakers, consultants, bureaucrats and all those that serve small businesses in South Africa have become increasingly aware that more needs to be done to support small businesses if the country is to address widening inequality and persistent poverty as well as unemployment and job losses.<sup>1</sup> It is also crucial to build a society that can create wealth more effectively, particularly with South Africa heading towards a dangerous dependency on state benefits with the number of social grant beneficiaries having risen sevenfold in just 10 years, from two million in 1999 to 14 million in 2009.<sup>2</sup>

The promotion of small businesses is one way the government could tackle South Africa's current and future economic challenges. In particular, the growth of small businesses could help reduce the population's dependence on state-funded grants, while boosting job creation and creating equitable growth. However, numerous factors such as a lack of business and financial management skills impede the growth or setting up small enterprises. In the meantime serious developmental opportunities are being foregone: according to researchers Finmark Trust's Finscope 2010 survey, small businesses could create 2.5 million jobs by 2020. Added to this Finmark believes that the government could take about 500 000 people off social grant schemes if it supported small businesses more actively.<sup>3</sup>

## Why Brazil and India?

While Brazil and India both have larger populations and land areas than South Africa, the three emerging do share some similarities in that all three are grappling with similar development issues, including a lack of quality education, a shortage of quality infrastructure and a low share in international trade. The three countries are also part of the India Brazil South Africa (Ibsa) initiative, set up in 2003, which aims to act as a forum to share various developmental and economic learnings and experiences. Nevertheless, Brazil is particularly similar to South Africa in that the two countries are among the most unequal in the world.

There is therefore a case for contrasting South Africa with Brazil and India. One reason to look to India and Brazil rather than to the Newly Industrialising Economies (NIE) of Southeast Asia as many developmental economists prone to do, is that the NIE model is not directly comparable to the policy context of South Africa. For instance, Alan Hirsch<sup>4</sup>, deputy director-general in South Africa's Presidency, points out that although the ANC began looking East, shortly before the end of apartheid, with the intention of modelling South Africa's growth on the export-led strategies of Southeast Asian countries, these countries were more authoritarian and had more skilled managers than South Africa, making it difficult to apply lessons there in South Africa.<sup>5</sup> More recently, international growth performances

<sup>1</sup> See Business Report, 9 October 2009. Also, a report by the OECD in July 2010 also noted that among emerging economies such as Turkey, Chile, Russia, Mexico and Brazil, South Africa had made the least progress in reducing poverty (see Business Report, July 9, 2010).

<sup>2</sup> See Ann Bernstein and Anthony Altbeker, "Rapid growth the only way to rid SA of stubborn poverty", in Business Day, 31 August 2010.

<sup>3</sup> Trevor Kaseke, Finmark Trust research specialist, quoted in "Millions of small businesses operate in dark", Business Day, 21 September 2010.

<sup>4</sup> Hirsch, Alan, *Season of Hope: Economic Reform under Mandela and Mbeki*, University of KZN Press, Scottsville, 2005: p118-119.

<sup>5</sup> This is although lessons were applied around policy focusing on innovation, education, private-public partnerships, industrial-sector targeting combined with geographic targeting, export promotion and training.

suggest that there are new lessons to be had from Brazil and India as part of the group of emerging economies labelled the Bric (Brazil, Russia, India and China) countries.

Several key differences across the three emerging economies stand out, however. For instance, Brazil is ranked as the sixth most entrepreneurial country in the world, according to the 2009 Global Entrepreneurship Monitor (Gem) Report, with a total early stage activity (TEA)<sup>6</sup> rate of 15.3%<sup>7</sup>, while South Africa is ranked a lowly 35<sup>th</sup> out of 54 countries with just one in 17 people involved nationally in starting or running a business (compared to one in seven in Brazil). In India about one in nine people are involved in starting or running a new business (with a TEA rate of 11.5%), according to figures from the Gem Report in 2008 when the country last took part in the Gem survey. During that particular year India was ranked at 15 out of 43 countries.<sup>8</sup>

Turning to Brazil again, policymakers in the world's eighth largest economy it seems are preparing for an entrepreneurial explosion. Though the country's entrepreneurs may still struggle to access capital and battle with red tape when starting a business, macro economic conditions have made it easier to start and run a business, particularly with GDP growth expected to touch five percent this year. Brazil also already escaped the worst of the 2008 global recession (with GDP growth of 0.2% in 2009, compared to South Africa's -1.8% and India's 6.8%) and following GDP growth averaging 3.7% between 2000 and 2008. This follows a decade or more where Brazil battled with a notorious inflation problem, growing at just 1.7% between 1990 and 1999.<sup>9</sup>

Meanwhile in India a task team by the Prime Minister Manmohan Singh is looking at various proposals to boost financial and business support to small businesses. Also on the agenda is the possible re-engineering of those public institutions that support small businesses. This follows a period where India's economic growth averaged at a little over 6% a year since 1991, when the country began implementing market reforms and gradually doing away with its infamous licensing regime which once choked entrepreneurialism. Like Brazil, this country too is betting on an explosion in the number of entrepreneurs.

## How is small business defined in these countries?

The governments of India, South Africa and Brazil each make use of their own unique definition when classifying an enterprise as a small or micro business. For example in India the Micro Small Medium Enterprise (MSME) Act of 2006 defines a small or micro business by the value of its fixed assets depending on whether the firm is based in the manufacturing or services sector. Like this a manufacturing firm is classed as a small business if the investment in plant and machinery is between Rs2.5 million and Rs50 million, while a firm in the services sector is defined as a small business if its investment in equipment falls between Rs1 million and Rs20 million.

In Brazil, a small and micro enterprise is defined by its annual turnover (up to R\$2.4 million), while the country's small business support agency, Sebrae, goes further by also defining a retail and construction business according to the number of employees they have.

In South Africa the governments makes use of a combination of annual turnover and number of employees to define an enterprise as small, micro, medium or large. Generally speaking a small business is defined as an enterprise which has 50 or fewer employees. Businesses are further defined as small, medium, micro or large according to their turnover by sector.

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<sup>6</sup> Gem's TEA rate measures the percentage of all those in the population involved in either setting up a business or running an enterprise which is up to three-and-half-year old.

<sup>7</sup> Equivalent to 18.8 million people, according to the 2009 Gem Report.

<sup>8</sup> 2008, 2009 Gem Report for Brazil. The last Gem country report on India was carried out in 2001.

<sup>9</sup> Figures from Brazil's Institute of Applied Economic Research (Ipea) quoted in Wikipedia ([http://en.wikipedia.org/wiki/Economy\\_of\\_Brazil#cite\\_note-28](http://en.wikipedia.org/wiki/Economy_of_Brazil#cite_note-28)).

More information on how small business is defined in each of these respective countries is provided in tables produced in Appendix 1 of this report.

## What is the aim of this report?

The aim of this study is to inform policymakers and the government, particularly South Africa's Department of Trade and Industry and its Department of Economic Development, on key learnings from fellow emerging nations India and Brazil when it comes to improving business support, market access and access to finance for small businesses.

To date there has been no reported studies on small business schemes in India and Brazil. This study aims to bring to light what may possibly be the best emerging countries against which South Africa can compare itself to.

The focus of the report is on those business owners in the formal sector starting out as well as those that employ between 10 and 50 employees. The focus is defined by the fact that these have been shown to make the most significant contribution to employment as we illustrate in this report.<sup>10</sup>

## Structure of the report

Following this introduction the report takes a brief look at the basic characteristics of small businesses in India, Brazil and South Africa – including a look at the respective business environment in each country and the size and performance of the sector and the ability of small firms to create jobs in each of these countries. A chapter follows on the policies that each of the three countries has in place to support small businesses. Some comments are also made on the architecture of support each government has set up with which to assist small businesses.

The bulk of the report is then taken up in Chapter 4 in looking at various support schemes South Africa could learn from as these are applicable in India and Brazil in the areas of: financial support, market support and business support. This report then concludes.

Much of the information in this report is gleaned from many interviews with various heads of small business associations, various government officials and policymakers who oversee small businesses and business owners themselves in South Africa, Brazil and India (see a full list under References). The interviews were conducted during visits to India (between March and April 2010) and Brazil (during August 2010) as well as via many telephonic discussions and email exchanges with various experts in each of the respective countries.

## Key findings

The report focuses on the various policies, government support schemes as well as the environment in which small businesses operate in each of the three countries under focus. In general policies and schemes to support small businesses appear to be working best in Brazil and less successfully in India and South Africa.

The report posits a number of reasons for this in the section on policies. These include better monitoring mechanisms, specific targets driven from the top and a more simplified support architecture in the case of Brazil compared to that of India and of South Africa.

The report also makes several other key findings, these are that:

- The state needs to co-ordinate its support better by simplifying its architecture of government agencies and departments that support small businesses.

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<sup>10</sup> According to Neil Rankin from Wits University 73% of employed people in South Africa work for firms with fewer than 50 employees for instance.

- The South African government's finance agency Khula can put its ailing credit guarantee scheme back on track by learning from India's Credit Guarantee Trust for Micro and Small Enterprises (CGTMSE).
- South Africa must get buy-in of businesses and banks if it intends to set up a credit rating subsidy scheme similar to that run by India's National Small Industries Corporation (NSIC).
- South Africa can learn from an innovative card implemented by Brazil's Development Bank and which helps improve access to finance for small businesses, while promoting local production.
- The National Treasury in South Africa should reconsider set-asides for small businesses based on the experience of Brazil, it must also look at adopting IT systems to streamline the procurement system.
- The Small Enterprise Development Agency (Seda) can learn a number of key things from Brazil's small business support agency Sebrae's innovative and professional practices.
- The experience of Brazil is evidence that incubators can play an important part in building innovative businesses and develop regions, but that their ability to drive job creation is limited.
- Clusters face many challenges in India, but the South African government should not overlook the importance of focusing support on existing clusters rather than creating new ones from scratch. It should support these existing clusters by helping them to build strong business associations to drive these clusters and construct effective monitoring mechanisms to ensure cluster support delivers optimal business support to small businesses.

## Way forward

It is important that South Africa benchmarks its support organisations, programmes and general architecture of support, against peer countries such as India and Brazil. Though specific lessons are provided under each support scheme looked at in this report, in general there are five key learnings for South Africa from India and Brazil. Chapter 5 includes a more in-depth discussion of these key learnings, which are:

- Craft a national entrepreneurial vision based on measurable targets and which has backing from the President.
- Build more forums based on partnership with the private sector.
- Simplify the government's support architecture.
- Put effective real-time monitoring mechanisms in place.
- Better capacitate government agencies.

## 2 Small Businesses in India, Brazil and South Africa: Basic characteristics

South Africa may have an environment which appears to be more conducive to opening and running a business than that of India and of Brazil where businesses have to deal with huge amounts of red tape, but these two countries make up for it by having inhabitants that are more entrepreneurially-minded than those of South Africa. This chapter takes a brief look at the overall business environment in which small firms operate in their respective countries, the size and performance of the sector and what role small enterprises play in job creation in each of these countries.

### What is the business environment of each country like?

The explosion in entrepreneurship in both India and Brazil is taking place notwithstanding the high levels of red tape businesses that these two countries still face when starting up. For instance, according to rankings from the World Bank's Doing Business 2011 report, Brazil ranks 127 and India at 134 on the ease of doing business, while South Africa is ranked far higher up at 34 out of 183 countries (Table 1).

**Table 1. Ranking on Doing Businesses in India, Brazil and South Africa (2010, 2009 & 2006)**

	Brazil	India	South Africa
Overall (2010)	127	134	<b>34</b>
Starting up (2010)	128	165	<b>75</b>
Procedures to start up (2009)	15	12	<b>6</b>
Procedures to start up (2006)	<i>18</i>	<i>13</i>	<i>8</i>
Time in days (2010)	120	29	<b>22</b>
Time in days (2006)	<i>152</i>	<i>33</i>	<i>31</i>
Employing workers (2009)	138	104	<b>102</b>
Getting credit (2010)	89	32	<b>2</b>
Closing a business (2010)	132	134	<b>74</b>

Sources: Data for 2010 from World Bank (2011); data for 2006 from World Bank (2007).

In Brazil, entrepreneurs face mountains of red tape, administrative barriers, uncertainty over constantly changing regulations, difficult regulations – for example on setting up new businesses, on employment and working overtime and on minimum wages.<sup>11</sup> Starting a business takes about 16 procedures – more than double the six steps required in South Africa and more than the 13 required in India. It can take almost six times longer to start a business in Brazil (120 days) than it does in South Africa, and four times longer than the average 30 days needed in India. Yet despite this Brazil still produces entrepreneurs at a rate of almost double that of South Africa, according to the 2009 Gem Report.

<sup>11</sup> Jonathon Ortman a US entrepreneurship expert and Senior Fellow, Kauffman Foundation, in an (undated) article called "Government and Education efforts to further entrepreneurship in Brazil", available at: <http://www.publicforuminstitute.org/nde/sources/reports/Brazil-2005.pdf>

When it comes to looking at how the three countries fare when it comes to the competitiveness of their respective marketplaces, data in the World Economic Forum's Global Competitiveness Report 2010-2011 (Table 2) reveals that the three have very similar levels of competitiveness.

**Table 2. Ranking on selected Global Competitiveness measures (2010 based on 183 countries)**

	Brazil	India	South Africa
Overall	58	<b>51</b>	54
Business costs of crime, violence	123	<b>67</b>	137
IP protection	89	66	<b>27</b>
Ethics, corruption	111	80	<b>67</b>
Infrastructure	<b>62</b>	86	63
Quality of primary education	127	<b>98</b>	125
Hiring and firing practices	131	<b>89</b>	135
Venture capital availability	60	<b>31</b>	39
Access to loans	65	<b>39</b>	41
Extent of market dominance	46	<b>26</b>	43
State of cluster development	<b>23</b>	29	39
Company spending on R&D	<b>29</b>	37	40
Utility patents per population	61	59	<b>43</b>

Source: Global Competitiveness Report 2010-2011.

The report reveals that all three countries have similar level of infrastructure development. In turn, while both Brazil and South Africa suffer from high crime rates, a poor quality of education, restrictive hiring and firing practices and similar high levels of market dominance by large firms, India and South Africa share similar levels of access to finance and similar spending on research and development. Nevertheless, despite South Africa being an easier place to start up a business according to the World Bank survey, the country's favourable business climate is undone by the disastrous consequences of Apartheid (1948-1994).<sup>12</sup>

## How have small businesses performed?

The small business sector is significantly larger in both Brazil and India than it is in South Africa. Brazil's 16 million small and micro enterprises contribute about 20% of Brazil's GDP and employ 60 million people or 56% of the urban workforce in the formal sector, according to Brazil's small business support agency, Sebrae.<sup>13</sup> According to statistics on Sebrae's MPE Data<sup>14</sup> there were 5.89 million registered small and micro enterprises and 10.34 million informal small and micro businesses in Brazil in 2008.

<sup>12</sup> Apartheid effectively stifled entrepreneurship in the country, by making it illegal for black people to run or own a business outside of homelands. Bantu education also left black people with poor skills, while the Group Areas Act banished blacks to the unproductive areas of homelands and to townships kilometres outside of the centre of towns and cities. Black people also could not own property in locations or anywhere else in urban areas, which affected their ability to take out loans (Hirsch, 2005).

<sup>13</sup> [http://www.info.sebrae.com.br/br/rumo\\_lei\\_geral/index.htm](http://www.info.sebrae.com.br/br/rumo_lei_geral/index.htm)

<sup>14</sup> [www.mpedata.com.br](http://www.mpedata.com.br)



**Table 3. Comparative Statistics on Small Business, South Africa, Brazil and India**

	<b>South Africa (2007)</b>	<b>Brazil (2008)</b>	<b>India (2006/07)</b>
Total small businesses	2.4 million	16 million	26.1 million
Registered firms	595 000	5.9 million	1.6 million
Informal businesses	1.4 million	10.4 million	24.6 million
GDP contribution	27% - 34% (micro, small, medium)	20% (micro and small)	8% (only MSMEs)
Percent of the workforce	56%	56.1%*	90% <sup>15</sup>

Notes: - \*Of the workforce in the formal sector in urban areas

- South Africa's statistics include small, micro and medium-sized firms; Brazil's statistics include only small and micro-sized firms; India's statistics are as according to the definition of MSMEs: Medium, Small and Micro-Enterprises as per India's classification of small businesses.

Sources: Review of trends on entrepreneurship and the contribution of small enterprises to the economy of South Africa, 2000 – 2006 (Seda); MPE Data (Sebrae) and the Quick Results of the 4th All India Census of MSMEs (MSME Ministry, India)

In India the 26 million small enterprises that qualify as Micro, Small and Medium Enterprise (MSMEs) under the 2006 MSME Act, according to the 4th All India Census of MSMEs (2006/07),<sup>16</sup> produce 8% of the country's GDP.<sup>17</sup> Of these firms, 1.5 million are in the formal sector, with 24.6 million in the informal sector. MSMEs employ 59.7 million people, of which just 9.5 million are employed in small enterprises operating in the formal sector.

Figures on the number of small businesses in South Africa remain sketchy with no official repository for data on the number of small enterprises. Noting this constraint, FinScope's 2010 South Africa Small Business Survey reveals that there are close to six million small businesses in the country and nearly 5.6 million small business owners. These enterprises are extremely small however: 67% employ no more than the owner themselves. In total, 300 000 businesses, or 6% of all entrepreneurs, employ five or more people. A further 1.5 million or 27% employ one to four people. And just 17% of small business owners run registered businesses.

According to statistics in the Department of Trade and Industry's Annual Review of Small Business 2006-2008, South Africa had 2.43 million small enterprises in 2007. Of these 595 000 were in the formal sector and 1.39 million were in the informal sector. A further 59 000 people above 65 years old were running a business and a further 431 000 were involved in subsistence farming. Small and micro enterprises contribute between 27% and 34% of South Africa's GDP.

Has the small business sector grown in all three countries in recent years? The answer is yes. In fact the small business sector has expanded at a similar rate in Brazil as it has in South Africa. However it is not easy to evaluate how the sector has fared in India relative to South Africa or Brazil because of changes in the classification of small businesses in 2006 by India, particularly as the new definition widened the number of businesses that could be classified as small, micro or medium.

<sup>15</sup> <http://www.thehindu.com/news/states/tamil-nadu/article78585.ece>

<sup>16</sup> More recent figures are not available for India: the 4th All-India Census of MSMEs was launched in May 2008 and its field work was only completed in March 2009.

<sup>17</sup> These figures are from <http://smetimes.tradeindia.com/smetimes/news/top-stories/2009/Sep/01/sick-msmes-increase-marginally-says-4th-msme-census60059.html>. However While India conducts a census every four years by its Ministry for Small Businesses, the small business's share of India's GDP is likely to be higher however as the MSME definition does not account for many small farmers and larger small businesses. According to some, MSMEs could account for 10% or less of all small firms (interview Fisme secretary general Anil Bhardwaj).



Turning to Brazil, the number of small businesses in the South American country's formal sector increased by about 28% between 2000 and 2008 – from 4.1 million to 5.7 million enterprises, this when the economy was growing on average at 3.7% a year.<sup>18</sup> This is similar to South Africa, where the number of small businesses in the formal sector grew by 27% between 2004 and 2007 (from 422 000 to 536 000 registered enterprises) according to the Department of Trade and Industry (the dti).

Despite the growth South Africa experienced in the number of small businesses between 2004 and 2007, the sector appears to have been hit hard by the recession in 2008 and 2009. Anecdotal evidence of this appears in the 2009 Global Entrepreneurship Monitor (Gem) report, which revealed that the percentage of South Africans involved in early-stage entrepreneurial activity slid from 7.8% to 5.9%, as the number of start-ups compared to 2008 declined by 40%. Similar numbers on the effect of the recession on small businesses in India and Brazil are not readily available.

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<sup>18</sup> "Micro e pequenas empresas empregam mais da metade dos trabalhadores formais", Aqui PE, 31 August 2010: <http://www.agenciasebrae.com.br/noticia.kmf?canal=207&cod=10596251>

**Box 1: On Small Businesses Data**

Policymakers in South Africa need to focus on improving the collection and collation of statistics on small businesses in order to target more innovative, high-growth and knowledge-intensive businesses, which have been shown to create more sustainable jobs in the long term.

A lack of clear and accurate statistics is a major stumbling block to South Africa developing more effective policies and support schemes for small enterprises. On this, small business researchers SBP noted, in 2009, the need to improve data on the small-business sector: "We don't know how many small businesses there are, how many people they employ, or what the sector contributes to GDP. Because of the paucity of data, it's hard to say what works. You can't have evidence-based policy in the absence of evidence."<sup>19</sup>

Nowhere is the need for statistics clearer than when it comes to determining the effects the recent recession had on small businesses. The Minister of Trade and Industry Rob Davies commented in 2009<sup>20</sup> that, other than a few reports based more on anecdotal evidence than on hard facts, there were no concrete data on the impact the recession has had on small businesses. Mike Schussler of Economists.co.za said it was difficult enough to even get an accurate number on how many small businesses there were simply in survival mode. No one tracks the number of small businesses in the country, he pointed out. He believes Statistics SA, Cipro and the SA Revenue Service (Sars) should make more information on small businesses available. Said Schussler: "One of the ironies is we want to get the SME sector going, but we don't have any statistics on it."<sup>21</sup>

South Africa's statistics are typically derived from a variety of sources. Those from Seda are gleaned from annual labour force surveys, the Company and Intellectual Property Registration Office (Cipro) and the survey of employers and self-employed conducted between 2001 and 2005<sup>22</sup>.

In contrast, the Indian government carries out a census of its small-business sector every five years. This looks at, among other things, the number of businesses that are struggling as well as those forced to close their doors. The Statistics and Data Bank Division of the Office of the Development Commissioner of Micro Small and Medium Enterprises (MSME) collects, compiles and disseminates statistical information on various economic parameters such as the number of MSMEs in India, how many people the sector employs and fixed investment and production in the micro, small and medium enterprise sector. The census falls under a centrally sponsored scheme called "the Collection of Statistics". Based on the primary data collected through census and sample surveys, the time-series estimates on above economic parameters are maintained for use in the policy formulation and planning.<sup>23</sup>

In Brazil, the country's small business support agency Sebrae launched a website in August 2010 called MPE Data (SME Data), [www.mpedata.com.br](http://www.mpedata.com.br), which carries statistics, official studies and facts about the world of small business. The site contains statistics on the number of SMEs in Brazil, their location, the degree of informality and the number of workers. The site uses Sebrae's own data and that of the Instituto Brasileiro de Geografia e Estatística (IBGE), the Departamento Intersindical de Estatística e Estudos Socioeconômicos (Dieese), the Receita Federal do Brasil e dos ministérios do Trabalho e Emprego, do Desenvolvimento, the MDIC and the Planning and budgeting ministry. According to the manager of strategy of Sebrae Francisco Cesarino, the information is updated every two weeks<sup>24</sup>.

**How have small firms fared in creating jobs?**

While small businesses have been observed to create the most number of jobs in Brazil and South Africa, in India the average number of people employed in each small business has steadily increased in recent years.

<sup>19</sup> SBP, 2009, "Accelerating small business growth in South Africa: A roundtable discussion".

<sup>20</sup> In an interview with Business Day in 24 November 2009.

<sup>21</sup> "Lack of Statistics stymies score on recession impact", Stephen Timm, Business Day, 16 February 2010.

<sup>22</sup> Review of Trends on Entrepreneurship and Contribution of Small Enterprises to the Economy of South Africa, 2000-2006, Seda.

<sup>23</sup> MSME Ministry's Annual Report 2009/10.

<sup>24</sup> Sebrae disponibiliza dados, estatísticas e estudos sobre pequenos negócios, 31 August .2010 : <http://www.agenciasebrae.com.br/noticia.kmf?canal=207&cod=10596251>

Small and micro enterprises create the most jobs in Brazil. Over a longer time horizon, studies have shown that between 1995 and 2000 96% of new jobs in Brazil were created by enterprises with fewer than 100 employees. The result is that 1.4 million jobs were added in this period (an increase of 26% while large businesses in comparison created less than 30 000 new places, with an increase of only 0.3%). In May 2010 micro and small businesses were responsible for 71.3% of the 298 041 jobs created that month, with micro-businesses of up to four employees contributing 48% of the total jobs created that month and small businesses which employ between 20 and 99 employees being responsible for the creation of 13.8% of new positions.<sup>25</sup> Brazil's state-owned Development Bank, BNDES, expects that 2.2 million jobs (up from 995 000 in 2009) will be created in the formal sector in 2010 and that 52.3% of these will be created by small and micro firms.

In South Africa between 1985 and 2005, 90% of all new jobs were created by small, micro and medium firms<sup>26</sup>. According to Neil Rankin from Wits University 73% of employed people work for firms with fewer than 50 employees<sup>27</sup>.

In India small enterprises are slowly growing in terms of the number of employees they take on. The average number of people employed by small, micro and medium enterprises has increased from 4.48 employees in 2001/02 to 6.24 in 2006/07<sup>28</sup>.

It is clear that small businesses play a major part in all three economies. Not only do they employ the highest proportion of the workforce in each country, but in at least the example of Brazil and South Africa they create the most number of jobs. It brings home the importance of policies in all three countries to promote small businesses.

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<sup>25</sup> Minister of Labour's Cadastro Geral de Empregados e Desempregados (2010).

<sup>26</sup> Finscope Small Business Survey Report, 2006.

<sup>27</sup> Quoted in the 2009 Gem Report.

<sup>28</sup> 4th All India Census of Micro, Small and Medium Enterprises.

### 3 Small business policies in South Africa, India and Brazil

With the opening up of domestic markets to world trade, many countries have resorted to promoting and supporting their respective small-business sectors to ensure local firms are able to compete against the added competition that an increase in global trade has introduced. A number of developing countries have also passed small business policies in a bid to forge more equitable economic growth in their respective countries. All three countries considered in this report have specific policies aimed at small business owners. While South Africa's small business policy is principally informed by the 1995 "White Paper on national strategy on the development and promotion of small business in South Africa", Brazil and India both passed legislation in 2006 aimed at boosting their small business sectors.

Each of the three countries has also developed institutions and agencies to support small businesses, with access to financial and business support. While an institutional make-up for each of the three countries is included in the appendix, it is worth pointing out here that in comparison to Brazil, India and South Africa have extremely complex government support matrixes (see Appendix 2 for diagrams and details). In South Africa the government's main funds and agencies are distributed across four different departments. While in Brazil one funding agency (BNDES) supports small business, South Africa has an array of funds (the NEF, Khula, NYDA, Samaf and the IDC) which creates problems when it comes to strategic co-ordination and also risks diluting the effectiveness of funding to small businesses.

#### South Africa

- Policy founded on 1995 White Paper.
- Merger of institutions in 2003 creates Seda.
- BEE encourages rent-seeking behaviour, rather than entrepreneurial behaviour, from black entrepreneurs.
- Schemes policies have had limited impact, little awareness of support organisations.

South Africa's 1995 White Paper outlined, among other things, the need for the government to create an enabling legal framework, facilitate access to information and advice, boost procurement from small firms and to improve access to finance and affordable physical infrastructure. The drafting of the white paper led to the 1996 National Small Business Act and the launch in the same year of Khula Enterprise Finance Limited, a government agency to finance small businesses and Ntsika Enterprise Promotion Agency to dispense non-financial support.

But in 2003 after calls to create a "one-stop" body where small businesses could get assistance from reputable sources, the government decided to do away with Ntsika, by merging it with the Community Private Partnership Programme and the successful manufacturing advice centre (MAC) programme<sup>29</sup>, to form the Small Enterprise Development Agency (Seda) in 2004 – to dispense market support and business advice to business owners.

#### MARKET ACCESS

The government's key focus with regards to small business has been on supporting black entrepreneurs, which the 1995 White Paper pointed out were the most marginalised group during apartheid. Two policies, aimed at helping more black people to become active in the economy and to aid small business owners, have been developed: the 2000 Preferential Procurement Policy Framework Act and the Black

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<sup>29</sup> "Macs lauded by Minister", December 28, 2003 <http://www.businessowner.co.za/Article.aspx?Page=23&type=29&Item=2346>

Economic Empowerment (BEE) codes of good conduct.<sup>30</sup>

The BEE codes, which came into effect in 2008, award points to businesses, based on seven elements, namely the percentage of black ownership, black management, black staff, black staff trained, procurement from black suppliers, business or financial assistance to black small businesses, corporate social investment. Under the BEE codes businesses with an annual turnover of above R35 million can score 15 points on the BEE scorecard if they spend 3% of their net profit on Enterprise Development. For those business with a annual turnovers of R35 million and below, the target is 2% of net profit<sup>31</sup>.

Yet to date there has been no study carried out on the impact BEE or preferential procurement has had on small business promotion. Presently the South African government hopes that large and medium firms will step in to assist small businesses by adopting enterprise development as a means to score BEE points. While this would go some way to expanding support and finance for small businesses, the BEE codes' strong emphasis on black ownership has inadvertently created a rent-seeking behaviour among wealthy or skilled black business people, in effect curbing entrepreneurship among this group.<sup>32</sup>

Instead of using their skills or capital to start their own businesses, many have instead chosen to buy into existing large, often listed, companies. Black ownership may only form one of seven codes on the BEE codes of good conduct, but it is often perceived by companies to be the quickest and most visible way to transform. Companies with high BEE scores can win business with government. According to Nazeem Martin, managing director of small business financier Business Partners, this not only acts as a deterrence to entrepreneurship, but it means that the number of wealthier and perhaps more creative black businessmen are drawn away from starting productive, innovative enterprises<sup>33</sup>. This has a direct effect on limiting manufacturing and high-growth companies, thus in effect further threatening to de-industrialise the country. BEE also threatens the tax base from growing, putting more strain on the country and its already 14 million welfare recipients<sup>34</sup>.

## BUSINESS SUPPORT

According to small business researchers SBP, despite numerous initiatives over the last 15 years aimed at both high end enterprise development, and the encouragement of micro enterprises, government support agencies and initiatives "have been less successful than intended", adding that this could also be "inferred from the institutional re-jigging". SBP concludes that the impact and achievements of the government's initiatives have "fallen disappointingly short of aspirations". The small business research organisation points out that since 2009 there has been a large-scale acknowledgement from those inside as well as outside of the government that the significant funding and support initiatives for small businesses have not had the desired effect in growing the sector.<sup>35</sup>

On top of this awareness of government support has remained limited in the country: a 2007 report by Centre of Entrepreneurship at the University of Cape Town's (UCT) Graduate School of Business revealed that in Gauteng just 13.5% of entrepreneurs had heard of Seda and 1.3% had accessed the agency. In the Western Cape awareness of Seda stood at just 10%, with 0.5% having visited a Seda branch there. Added to this in the recent FinScope 2010 South Africa Small Business Survey only 3% of entrepreneurs reported that they had heard of Khula, while 10% said they had heard of National Youth Development

<sup>30</sup> When it comes to selling to the government, the Preferential Procurement Policy Framework Act of 2000 provides that, depending on the value of a government tender, 10% or 20% of the points awarded to a bidder be for the percentage of ownership in the bidding company of women, blacks or disabled people. The act is presently being aligned with the Black Economic Empowerment (BEE) codes of good conduct, which currently only apply to businesses bidding for work from the private sector.

<sup>31</sup> Bignews, August 2007.

<sup>32</sup> This is the view of Moeletsi Mbeki in *Architects of Poverty: Why African Capitalism Needs Changing*, Picador Africa, 2009.

<sup>33</sup> Interview with Nazeem Martin, Business Partners, September 2010.

<sup>34</sup> Business Times, September 12, 2010.

<sup>35</sup> SBP, 2009. "Small Business Development in SA: Time to Reassess".

Agency (NYDA) and 4% said they had heard of Seda. Only one percent of small businesses reported that they had visited Seda or NYDA branches.

## CONCLUSION

South Africa's small business policies have done little to create effective support agencies to help support business owners to start up and grow their business. Added to this awareness of many of the government's support schemes also remains very low.

Much of this is as a result of the government's lack of co-ordinated strategies aimed at small business and a government support architecture (see Appendix 2) which is both clumsy and confusing – both to business owners and to government officials themselves. The government simply has too many agencies trying to assist business owners, which are in turn spread across two different departments – in turn confusing government officials.

Added to this the country's BEE legislation has acted as a deterrent to skilled black people starting their own businesses. The government should take active steps to get entrepreneurs to steer away from such rent-seeking behaviour by recrafting BEE legislation so that it incentivises and supports black entrepreneurs that want to start up or expand their own businesses, rather than incentivise those that want to buy a slice of an existing business.

## India

- India has long promoted small businesses through a reservation policy for manufacturing of certain goods.
- In 2006 it passed the MSME Development Act, but some say it has had little effect.
- Because of institutional issues the government has made little impact in supporting small businesses.

Much of the Indian government's support schemes and policies for small businesses were introduced after 1991 in a bid by the state to cushion small firms as the state gradually does away with its policy of reserving certain goods for manufacture by small enterprises.

Small business promotion in India however is not new and dates back to 1967 when the government enacted India's Small-Scale Industries (SSI) Reservation Policy which sets aside certain manufacturing activities exclusively for small firms. At its height in 1978 the government's list of reserved goods for small firms contained 504 products. With the gradual removal of reservation since 1991, the small-business sector is facing much greater competition than before.

More recently in 2000 the Government of India announced a comprehensive policies package to strengthen small businesses. The package provided for easier access to credit, availability of collateral free loans up to Rs2.5 million capital subsidy for technology upgradation and improved infrastructure<sup>36</sup>.

Though primary responsibility for the development of small business remains in the hands of the state and Union Territory Governments, the central government has always shown an interest in supplementing the efforts of the various states. At the national level, the Ministry of Micro, Small and Medium Enterprises (formed after the merger of Ministry of Agro and Rural Industries and Ministry of Small Scale Industries in 2007) serves as the central authority which assists the states in their efforts to support small businesses. The Ministry is empowered by the 2006 MSME Development Act which aims to boost support and promotion of small businesses. Among other things the act makes it easier for business owners to register their business, allows for the setting up of facilitation councils to deal with late payments owed to small firms and provides for the crafting of preferential procurement policies by government for small enterprises.

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<sup>36</sup> <http://www.lubindia.org/ssi/what-is-ssi.php>

The Government of India has a number of support schemes for small businesses, including schemes aimed at increasing the competitiveness of small firms, making it easier to access finance, export and helping firms to acquire new technology. However business owners and small business associations offer a mixed account of how the Indian government has fared when it comes to supporting small businesses. Of note is the fact that the awareness of government schemes is very low. A study by consultancy Milagrow Business & Knowledge Solutions shows that only between 20% to 30% of micro, medium and small enterprises are aware of various government initiatives. This is somewhat similar to the situation in South Africa (see above section).

Milagrow's Rajeev Karwal believes part of the problem is that the MSME ministry plays only a minor role in the Indian central government and is often subjugated by the various industries ministries in central government. Most of these ministries are dominated by big businesses. The MSME ministry, he says, is "lacking in teeth"<sup>37</sup>. Anil Bhardwaj, secretary general of the Federation of Indian Micro and Small & Medium Enterprises (Fisme) echoes this view. Bhardwaj commented that the largest drivers for the growth of small businesses have been the changes to the economic framework in the 1990s and the country's young sizable population, not the government's support schemes for small enterprises.<sup>38</sup>

## MARKET ACCESS

The 2006 MSME Development Act introduced a new definition for small businesses (MSMEs) which the government applies to determine which enterprises can benefit from its support schemes, but critically, it also introduced a system by which small businesses waiting on payments from corporates or public-sector organisations can approach facilitation councils to settle outstanding debts. However, according to some, the act has made little if no difference to small enterprises in India; and in the words of the general secretary of Fisme Anil Bhardwaj, it is "basically a promotional act" which "doesn't have any teeth".<sup>39</sup>

Added to this, not all the facilitation councils have been set up so far. Only 13 of the country's 35 states and territories had set up one as of March 2010. However, the uptake of cases to the councils is affected by business owners staying away from the councils, fearing that though they may be able to recover their outstanding money by taking an entity to a council, that entity will simply never want to do work with them ever again. This problem also applies to payment delays: a trained engineer, Chander Goel, who owns Goel Engineers, said public sector companies and large companies took a minimum of three months to pay him. He has already stopped supplying one public-sector company because they were taking too long in paying him. He said that whereas under the MSME Act one can complain when payments are not made within 60 days, this was not "a practical solution". "When you make a complaint, next time you are not going to get the business," he said.<sup>40</sup>

## BUSINESS SUPPORT

The National Small Industries Corporation (NSIC) which has been tasked by government to support small businesses was also criticised, including most notably by a leading small-business financier running a government-backed fund and by Milagrow's Karwal. Karwal points out that the NSIC has made next to no impact in supporting small businesses, other than in its warehousing of raw materials programme (See Chapter 4 on schemes).

Dr HP Kumar, the NSIC's chairman and managing director, however disagrees. He says the corporation has made an impact and has been "highly successful" in assisting small enterprises. He points out that the amount of total manufacturing sector output contributed by MSMEs and the fact that these entities

<sup>37</sup> Interview with Rajeev Karwal, New Delhi, March 2010.

<sup>38</sup> Interview with Anil Bhardwaj, New Delhi, March 2010.

<sup>39</sup> Interview with Anil Bhardwaj, New Delhi, March 2010.

<sup>40</sup> Interview with Chander Goel of Goel Engineering, New Delhi, March 2010.



contribute 40% of exports, is evidence of this. Added to this, the sector has raked up growth of 12% to 13% in recent years. Kumar's view is that the sector needs further support, not protection or reservation or direct grants and subsidies, but rather support through programmes like the government's scheme which subsidised ISO 9001s, to build the capacity of small businesses.<sup>41</sup>

However new developments in India could introduce changes to small business support and the business landscape. In August 2009 after a meeting with 19 small business associations with Prime Minister Manmohan Singh, the prime minister constituted a task team in September that year to look into ways of boosting support to small businesses. The associations highlighted a number of things, such as the problem of obtaining finance from banks, the need for a focused procurement policy, the need for prompt payment of small businesses and simplification of labour laws. The task force subsequently submitted its report to the Singh (in January 2010). An expert group was formed by the government to look at recommendations for the promotion and development of micro, small and medium units. The group is headed by Planning Commission Member (Industry), Arun Maira.<sup>42</sup>

## CONCLUSION

The various problems India faces in the area of business support and as a result of its less than satisfactory institutional landscape are being dealt with following the task force meeting to ensure a further boosting of small businesses. One of the recommendations that has emerged from the resulting report to target at least 20% of the central government's purchases, from micro and small enterprises (MSEs), has however since been done away with (see section on market support in the Chapter 4).

Currently, the Development Commissioner (MSME) is the focal point for all policy matters, the formulation of various promotional and developmental schemes as well as channelling certain incentives and subsidies to the MSME sector; the Small Industries Development Bank of India (Sidbi) is the principal financial institution for financing and related promotional and development work for small businesses, while the National Small Industries Corporation Limited (NSIC) has been set up to facilitate MSMEs in procurement of raw material and helping in marketing of their products. The idea is that the proposed independent body could use the existing structures of these organisations after making appropriate changes in their charter and mandate.<sup>43</sup>

India's support for small businesses has been less than impressive, in a country also marred by high corruption (see Appendix 5). This may well play a part, along with the country's confusing and clumsy government support architecture for small businesses (see Appendix 2 for details).

## Brazil

- Strong policies, driven by measurable targets set by the country's planning ministry and backed by recent laws have seen Brazil make marked progress in supporting small businesses.
- However, business owners still battle with red tape and to access finance.
- Idea to set up small business ministry receives support.

In contrast to South Africa and India, Brazil's small business policies appear to have made some impact. Backed by strong reference to the support of small business in its national plans, the South American country is working overtime to boost support to small businesses, from informal street traders to more established small businesses.

The Brazilian government's policy on small businesses is contained principally in Lei Geral, a law passed in 2006 which has simplified taxes for small and micro firms and boosted government procurement among other things.

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<sup>41</sup> Interview with HP Kumar, New Delhi, March 2010.

<sup>42</sup> Yahoo News India: <http://in.news.yahoo.com/20/20100303/372/tbs-govt-constitutes-expert-group-for-ms.html>

<sup>43</sup> Indian government press releases: <http://pib.nic.in/release/release.asp?relid=57553>



A recent addition is the Empreendedor Individual (Individual entrepreneur) law, approved in 2008, which aims to help informal one-man-show entrepreneurs (who do not have a share in any other business and who have an annual income of up to R\$36 000) to formalise and to therefore have access to social benefits such as pension and medical aid and workman's compensation. To simplify the registration of these types of entrepreneurs wanting to benefit from the law, the Ministry of Development Industry and Commerce (MDIC), which oversees the development of small businesses, launched an internet portal in 2009 where entrepreneurs looking to formalise can sign up. The law also reduces the number of steps and pieces of information (41 to seven) an entrepreneur is required to follow to register and offers them lower taxation.<sup>44</sup>

The promotion of small businesses forms an important part of the federal government's four-year Pluriannual plan, at a time when Brazil is increasingly debating the role small enterprises can play in creating equitable growth. Under the Brazilian constitution, each newly-elected government must submit a multi-year plan, or Plano Plurianual, to guide public policy. The plan outlines major objectives, challenges, and guidelines for the government as well as programmes and actions for the achievement of these objectives. An important emphasis in the 2008-2011 plan is the need to strengthen innovation in Brazil if the country is to grow and meet its goal of regional and social inclusion. Another is to target 3.8 million small and micro businesses by 2011 with loans.

The goals in the Plano Plurianual 2008-2011 for MDIC concerning small businesses<sup>45</sup> name 65 actions distributed in four challenges: continuing to implant Lei Geral in more municipalities, the participation of micro and small enterprises in the local and international market, improvement of management and the increase in capacity of innovation in these enterprises and incentivising them to join associations and co-operate.

One of the measurable goals is to ensure that by 2011, 65.42% of all jobs in the formal sector are created by small, medium and micro enterprises. In 2008 the Brazilian government exceeded this target, with a figure of 65.21%. The projection for 2011 is to reach a target of 68.24%. Another goal is to increase the percentage of micro and small enterprises involved in exporting, with a goal to have 8.58% of all small and micro firms exporting by 2011. In 2008 the figure reached 6.58%.

The plan also sets various goals for assisting small businesses to commercialise, gain access to the international market, for research on clusters and for financing SMEs through specific programmes of Caixa, Banco do Amazônia and Banco do Brasil.

A recent development in 2010 was the suggestion to create a small business ministry by the country's outgoing President Lula. Policymakers will have to wait and see what will come of this.

## SUCCESS & PROBLEMS

The Brazilian government, it appears, is not doing too badly on disbursing finance to small businesses. Of the five government funds mentioned in the evaluation report for MDIC under the Plano Plurianual 2004-2007, two exceeded their target in loans lent out and amount of finance lent out, with a further two falling just short of meeting their respective lending target.<sup>46</sup>

However an assessment by the Ministry of Planning, Budgeting and Management of MDIC's goals in the last Plurianual (2004-2007)<sup>47</sup> revealed that very few of the government's goals to promote small enterprises, were achieved. It found that the MDIC was hindered in achieving some of the goals because of the difficulty in obtaining from the fiscus certain statistics needed to measure the government's performance in assisting small businesses. Measures have since been amended for the 2008-2011 plan.

<sup>44</sup> Tres Anos da Lei Geral da Micro e Pequena Empresa, Sebrae publication, 2010

<sup>45</sup> Relatório de Avaliação do Plano Plurianual 2004-2007: MDIC Caderno 18, 2009.

<sup>46</sup> For example, the state's Banco do Brasil handed out 1.6 million loans to medium, small and micro firms, slightly below the target set of 1.8 million. But it exceeded the R\$25.9-billion target for finance handed out, disbursing R\$31.8 billion in 2008.

<sup>47</sup> Relatório de Avaliação do Plano Plurianual 2004-2007: MDIC Caderno 18, 2008

There were nevertheless some successes in the last plan, including the setting up of the Permanent Forum for Micro enterprises and small business (Fórum Permanente das Microempresas e Empresas de Pequeno Porte e da Portaria) in 2007, which has enabled members from the private sector and the government to discuss problems related to the SME sector and to together develop solutions.

What is notable is that Brazil's planning ministry is already preparing for the effect an increasingly entrepreneurial workforce will have on the economy. Roberto Mangabeira Unger, a Harvard University lecturer and former chief minister of the Secretariat of Long-term Planning between 2007 and 2009, believes the Brazilian economy is moving from a wage-based economy to a entrepreneur-based economy.<sup>48</sup> Unger's ascertain is that with its hefty labour laws and institutions mainly geared to serving big businesses, Brazil is not sufficiently prepared to face this new challenge.

The move towards an entrepreneur-based economy has all sorts of consequences for the country. With many one-man businesses and contractors having formalised their operations through the Individual Entrepreneur law, questions have already been raised about whether many of these businesses are actually businesses at all, or whether the business owners were really just employees masquerading as contractors. The problem is that if these business owners register under the law they access special conditions which bypass labour laws. Employers could therefore be encouraging employees to register to get past the country's strict labour laws.

The Presidency's Secretariat of Strategic Issues (Secretaria de Assuntos Estratégicos) is currently evaluating the performance of the various government policies aimed at SMEs which have been put in place in the last 10 years (including Lei Geral, clusters and the Individual Entrepreneur law). So far many in the private sector are generally positive about the government's SME policies. José Dornelas of Empreende, which provides business training and consulting services to business owners, believes the state had come to see supporting small and medium enterprises (SMEs) as a way to develop the country. And Dr Joseph Couri the president of employer's association Simpi, which represents businesses with 50 or fewer employees and has 100 000 members, pointed that Brazil is working "rapidly and intensely" to solve problems faced by SMEs.<sup>49</sup>

Milton Bogus, the director of the micro, small and medium department (Dempí) at Federação das Indústrias do Estado de São Paulo (Fiesp) said with the passing of Simples Federal (the country's new tax for small business through Lei Geral in 2007) it was possible that small businesses with a turnover up to R\$2.4m to be taxed less and be prioritised government procurement of up to R\$80 000, among other advantages. He said one unfavourable aspect of the current Simples Federal is that the turnover for SMEs is set very low though this has been amended to increase the turnover threshold to R\$3.6 million.

Despite these changes, small businesses in Brazil still battle to obtain finance and lower interest rates from banks and funders. There are still too many procedures to open and close a business in Brazil. The 2009 Gem Report on Brazil also suggested that, among other things, state agents should provide incentives to create angel funding networks.<sup>50</sup> The report also suggested that the government should set up and rigidly apply indicators to evaluate its vast number of entrepreneur support programmes. Many interviewees that Gem spoke to in compiling its 2009 report on Brazil, indicated that heavy bureaucracy and red tape were key reasons why many Brazilian entrepreneurs opted to remain in the informal economy. Incorporating a start up requires 15 procedures, three times more than in the US.

Noting the above, according to Gem's 2008 report on Brazil, a collection of experts from each specific participating Gem member country, rated Brazil's government policies as more favourable (-0.48) than those of South Africa (-1), Russia (-0.7), but behind policies of Chile (-0.2) and South Korea (about 0.2). Brazil's support for incubators and science parks was the main reason for the South American country's more favourable rating when compared to other rated emerging economies.

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<sup>48</sup> Interview with Nabil Moura Kadri, a chief of cabinet in the Secretaria de Assuntos Estratégicos, Brasília, August 2010.

<sup>49</sup> Interview with Joseph Couri, São Paulo, August 2010.

<sup>50</sup> Angel investors provide equity, grants or capital to businesses, usually those that are starting up. Many of these investments are done on an informal or ad hoc basis.

Many such as Dornelas, support the idea mooted by Lula to set up a Small Business Ministry. However Nabil Moura Kadri, at the Secretariat of Strategic Affairs (SAE), though backing the need for more government support to small businesses, in contrast feels that setting up a ministry may not be the best way to assist the sector. He believes what may transpire instead will be a special secretary linked to the presidency, rather than a full ministry. He believes that co-ordination and evaluation is lacking when it comes to effective SME policies. Therefore, a separate unit is required that is dedicated to SME policies.

## CONCLUSION

Despite some challenges specifically regarding the red tape small businesses face, the Brazilian government has achieved many successes in promoting small businesses. The country's Presidency has set clear and measurable goals contained in the country's overarching development plan (Plano Plurianual) and regular reviews of these targets by Brazil's Presidency are undertaken. The targets in the overarching plan allow for a co-ordinated support system among the various government departments and small business support agencies. This is something both India and South Africa could do well to learn from.

## Conclusion on Policies

India and South Africa, whose policies have made little impact on small businesses, can learn much from Brazil in the way that it devises its small business policies which are backed by measurable targets set by its planning ministry. Also, South Africa's planning must centre more around not only targets but a long-term vision about what the country wants in terms of how its economic ownership should look like, as in the case of Brazil which is already planning for a shift from wage-based employment to a more entrepreneurial-based system.

There is also a need to simplify the government's architecture of support for small businesses. All too often when complaints are made of insufficient support to small businesses, the South African government simply sets up yet another agency or department, which only makes it more difficult to co-ordinate policy and programmes. Instead of growing bigger, the government must look to become smarter in the way it assists small businesses.

South Africa can also learn from Brazil in the way the South American country prioritises the building of partnerships. Brazil has a number of groups that focus on small business policies: the Permanent Forum on Micro Enterprises and Small Businesses, the Working group on clusters and the presidential group on small businesses. All of these contain members drawn from both the private sector and government. South Africa could learn from this to form a national consensus. Partnerships offer a plausible way to do this.

## 4 Featured Schemes

This chapter focuses on a number of government schemes, as well one private-sector initiative, which the South African government can draw key lessons from to boost support to small businesses.

The chapter is structured into three main sub-sections which detail various Brazilian and Indian schemes to assist with financial support, market support and business support for small enterprises. Where applicable these are contrasted to such support in place in South Africa.

The author selected the below schemes from a number of government support schemes in Brazil and India which are aimed at small businesses. For a list of some of the most prominent of these schemes, as well as some of the South African government's most important SME support schemes, see Appendix 3.

### 4.1. Financial Support

This section on financial support covers three schemes that South Africa can learn from, namely: how Khula can boost lending by learning from India's Credit Guarantee Trust Micro Small Enterprise (CGTMSE) to boost lending through credit guarantees, how to improve access to finance from India's experience with credit ratings and how to improve access to finance and promote localisation: the experience of Brazil's development bank BNDES.

#### CREDIT GUARANTEE SCHEME: KHULA VS CGTMSE (INDIA)

- Banks shun the Khula guarantee scheme due to high default rate, poor quality of applications and a claims process marred by red tape.
- Near failure of Khula's guarantee scheme has led Khula and policymakers to develop Khula Direct
- India's CGTMSE offers various lessons to Khula in improving the performance of its guarantee scheme.

#### Overview

With the Minister of Economic Development Ebrahim Patel's announcement in March 2010 that his department would be looking at how to increase funding to small businesses, his officials would do well to look East, at an impressive credit guarantee scheme in India.

While in the 2009/2010 financial year Khula Finance Limited, the government's small business finance agency, handed out a mere 53 credit guarantees through its Credit Indemnity Scheme valued at R30.26 million, India's Credit Guarantee Fund Scheme for Micro and Small Enterprises (CGTMSE) in the same financial year disbursed 149 867 guarantees, valued at Rs68.72 billion (valued at about R10.7 billion in December 2010).

The CGTMSE has shown impressive growth in recent years. Just two years ago the scheme handed out 30 000 credit guarantees. The nearly 150 000 it gave out last year is equal to the total number of loans disbursed in the previous eight years of the scheme's existence. This impressive vault in lending took place at a time when not a single employee at the scheme received performance incentives.

Interestingly, staff are spurred on by the CGTMSE's fifth chief executive OS Vinod who joined the scheme at the end of 2007. He sends SMS alerts out to his team each morning to motivate them. Each alert contains a breakdown of the number of guarantees handed out the previous day and the total for the financial year so far. Vinod is aiming higher and believes the scheme can reach 300 000 guarantees a

year by the end of the 2010/11 financial year.<sup>51</sup> So why is he so confident and how has the scheme which recently joined the 16 member Asian Credit Supplementation Institution Confederation, been able to lend out so many credit guarantees?

Khula was set up in 1996 as the government's small business finance agency. Khula does not lend directly to business owners, but through banks and a network of retail finance intermediaries. The agency has various products, including its credit indemnity or guarantee scheme also launched in 1996. The scheme is aimed at business owners who lack sufficient collateral to access traditional bank finance.

Khula's guarantee scheme disburses amounts of between R10 000 and R3 million, covering between 50% and 90% of the loan amount, depending on the amount of security a business puts up for the loan

The Indian scheme guarantees up to Rs10 million (R1.5 million), covering between 75% and 85% of a loan. The first Rs5 million of a loan is covered by a 85% guarantee, while the second Rs5 million is covered by a guarantee of 50%. The initial ceiling of guaranteed loans stood at Rs2 million when the scheme first started. This had been lifted to Rs5 million and then to Rs10 million on request from the World Bank. The CGTMSE uses only primary security such as a project or a contract.

About 83% of the guarantees taken out through the Indian scheme last year were for amounts under Rs500 000 (R77 000). Businesses in India's more literate states<sup>52</sup> take out the highest number of credit guarantees.

However unlike Khula which obtains most of its funds from its balance sheet, the scheme is backed by a corpus of Rs25 billion (valued at about R4 billion in December 2010), of which Rs5 billion is from the Small Industries Development Bank of India and Rs20 billion from government – committed over the last 10 years. So far the corpus stands at Rs19 billion with a further Rs6 billion still to be committed. This compares to the mere R330 million that Khula was capitalised by when it was set up in 1996.

So how has the CGTMSE managed to scale up lending so significantly?

Amid the depressing performance of Khula's credit guarantee scheme, the CGTMSE provides a glaring example on how a credit guarantee scheme should operate – not only on how to drive up lending numbers, but also on how to settle claims quickly. A look at the Indian scheme's performance also reveals just how bad South African entrepreneurs are at paying back loans: Khula's default rate on its guarantee scheme between 2005/2006 and 2009/2010 came to 42.15% of the total loan amount, with 80.1% or 1 381 loans in those five financial years being defaulted upon. In India the equivalent figure, in terms of the total value of loan defaulted on, was 2.5%.

If Khula and other development finance institutions fail to attend to the re-payment problem as a matter of urgency, any government attempt to increase lending to small businesses – such as the latest, Khula Direct – set to begin piloting at the end of 2010, will make little impact and could run up millions in bad debt. Khula guarantee scheme has long been dogged by under-performance. What is notable is that in its over 14-year existence, the number of guarantees given out by Khula has never topped 800. The highest number of guarantees ever handed out was 797 in the 2001/2002 financial year.<sup>53</sup>

In a 2005 AGM, the then Minister of Trade and Industry, Mandisi Mphahlela, admitted that Khula's impact was limited. Just days after the AGM, then finance Minister Trevor Manuel was quoted as saying that the R1.4 billion that the government had earmarked for small businesses was not reaching business owners.<sup>54</sup> Then in 2009 lending through the scheme, hit an all time low. In June that year Absa, which

<sup>51</sup> Interview with OS Vinod, Mumbai, April 2010.

<sup>52</sup> These are Uttar Pradesh and Kerala. Both also have the highest coverage with a high number of branches participating. The scheme's chief executive OS Vinod points out that Kerala is one of the most literate states which encourages awareness of the scheme. The worst performing areas are the poor north-eastern states.

<sup>53</sup> "Few benefit from government finance agency", Bignews Oct 2005: <http://www.businessowner.co.za/Article.aspx?Page=23&type=27&Item=2901>

<sup>54</sup> "Few benefit from government finance agency", Bignews Oct 2005, <http://www.businessowner.co.za/Article.aspx?Page=23&type=27&Item=2901>.

had once long outperformed other banks in the scheme, reported a 62% decline in the number of Khula guarantees disbursed, as banks tightened up lending with the then onset of the global financial crisis. At the time an Absa spokesperson<sup>55</sup> reported that more than a third of Absa Small Business impairments for 2008 were made up of Khula-backed business, which had led to “drastic strategy changes”<sup>56</sup> in order to decrease impairments. An assessment by Absa of applications from 2005 until May 2008 revealed that the quality of applications was poor on Absa’s as well as on Khula’s side, which the bank believed was the reason for the high percentage of impairments.<sup>57</sup>

A quick comparison (see Table 4 below) between Khula’s credit guarantee scheme and the CGTMSE reveals just how bad things have become at Khula.

Khula’s default rate on its guarantee scheme between 2005/2006 and 2009/2010 was a whopping 42.15%, with 80.1% or 1 381 loans in those five financial years being defaulted upon. The worst performing year was 2009/2010 when the amount in defaults (R98.8 million) came to over triple the amount in guarantees given out that year (R30.26 million), far worse than the 85% rate of impairments raked up in 2008/2009. In terms of number, during those 2006 to 2010 financial years, Khula gave out 1 710 credit guarantees – with almost half (996) through Absa. In comparison, the CGTSME gave out 271 012 guarantees during the same period.

Added to this the CGTSME’s default rate between 2005/2006 and 2009/2010 was a mere 2.5% – with the worst of the years (2005/2006) touching just 6.4%. And while Khula’s default rate soared to an astronomical 313% in 2009/2010, the Indian scheme in the same year recorded an all time low in defaults with a rate of just 1%!

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<sup>55</sup> Busi Mngomezulu

<sup>56</sup> At the time Absa changed the applications process and centralised assessment, placing a limit of R100 000 in finance for start-up businesses – despite the guarantee scheme offering up to R1 million in finance. It also took the decision at the time not to finance certain high risk industries (“Absa decreases its Khula guarantees”, Bignews, July 2009).

<sup>57</sup> “Absa decreases its Khula guarantees”, Bignews, July 2009.



**Table 4. Khula Vs CGTMSE on loans and total credit guarantees given out between 2006 and 2010 and default rate<sup>58</sup>**

<b>Total guarantees per annum per Bank (amount)</b>						
	2005/06	2006/07	2007/08	2008/09	2009/10	Total
Standard Bank	15,611,849	29,809,259	22,093,629	14,105,000	2,348,000	83,967,737
Absa Bank	146,088,114	110,191,553	126,483,544	50,577,587	2,407,120	435,747,917
Nedbank	19,078,544	49,024,505	27,976,280	48,824,013	22,885,482	167,788,823
First National Bank	39,958,524	78,605,300	64,236,100	9,075,513	2,622,000	194,497,437
<b>Total Khula</b>	<b>220,737,031</b>	<b>267,630,617</b>	<b>240,789,552</b>	<b>122,582,113</b>	<b>30,262,602</b>	<b>882,001,914</b>
Total CGTMSE (rands, 09-12-2010)	659,497,959	1,012,491,372	1,508,021,882	3,216,389,772	10,460,927,703	16,857,328,688
<i>Total CGTMSE (rupees)</i>	<i>Rs4,276,729,000</i>	<i>Rs6,567,748,000</i>	<i>Rs9,784,870,000</i>	<i>Rs20,868,585,000</i>	<i>Rs67,872,607,000</i>	
<b>Total number of taken up guarantees per annum per Bank</b>						
	2005/06	2006/07	2007/08	2008/09	2009/10	Total
Standard Bank	28	65	28	16	4	141
Absa Bank	335	284	275	97	5	996
Nedbank	58	86	53	82	37	316
First National Bank	46	110	79	15	7	257
<b>Total Khula</b>	<b>467</b>	<b>545</b>	<b>435</b>	<b>210</b>	<b>53</b>	<b>1710</b>
Total CGTMSE	12 190	26 744	29 415	52 796	149 867	271 012
<b>Value of Reported Defaults</b>						
	2005/06	2006/07	2007/08	2008/09	2009/10	Total
Standard Bank	5,350,550	7,092,517	8,513,614	13,741,018	7,897,092	42,594,791
Absa Bank	41,869,774	25,898,726	40,048,820	58,969,123	37,394,322	204,180,764
Nedbank	10,842,444	5,134,476	8,179,631	16,353,728	22,806,460	63,316,739
First National Bank	756,145	3,004,220	14,927,419	16,289,457	26,706,300	61,683,541
<b>Total Khula</b>	<b>58,818,912</b>	<b>41,129,939</b>	<b>71,669,484</b>	<b>105,353,326</b>	<b>94,804,174</b>	<b>371,775,835</b>
<b>Khula default rate</b>	<b>26.65%</b>	<b>15.4%</b>	<b>29.8%</b>	<b>85.95%</b>	<b>313%</b>	<b>42.15%</b>
Total CGTMSE	42,078,570	57,767,860	93,295,098	114,930,050	108,867,349	416,939,927
<i>Total CGTMSE (rupees)</i>	<i>Rs272 668 500</i>	<i>Rs374 495 400</i>	<i>Rs605 036 400</i>	<i>Rs745 230 100</i>	<i>Rs705 918 300</i>	
<b>CGTMSE default rate</b>	<b>6.40%</b>	<b>5.70%</b>	<b>6.20%</b>	<b>3.57%</b>	<b>1.00%</b>	<b>2.50%</b>
<b>Number of Reported Defaults</b>						
	2005/06	2006/07	2007/08	2008/09	2009/10	Total
Standard Bank	19	22	26	33	27	127
Absa Bank	190	97	171	231	164	853
Nedbank	62	20	23	47	65	217
First National Bank	5	9	50	42	78	184
<b>Khula defaults</b>	<b>276</b>	<b>148</b>	<b>270</b>	<b>353</b>	<b>334</b>	<b>1381</b>
<b>Khula percentage loan default</b>	<b>59%</b>	<b>27.2%</b>	<b>62.1%</b>	<b>168%</b>	<b>630%</b>	<b>80.1%</b>
CGTMSE defaults	673	986	1 683	2 343	1 985	7 670
<b>CGTMSE percentage loan default</b>	<b>5.5%</b>	<b>3.7%</b>	<b>5.7%</b>	<b>4.4%</b>	<b>1.3%</b>	<b>2.8%</b>

Sources: Khula Finance Limited, CGTMSE.

<sup>58</sup> The default rate is the percentage of loan repayments that are overdue.

## Lesson 1: Targeted lending can drive uptake and guarantees

Unlike in South Africa, a big driver of lending for the CGTMSE is the Indian government's priority lending policy which requires commercial banks to lend 40% of their net bank credit to priority sectors – of which small businesses form an integral part. Foreign banks are required to lend 32% to priority sectors, with 10% specifically earmarked for the small-scale sector.<sup>59</sup>

The Reserve Bank of India penalises those banks that fail to meet these targets by making them deposit an amount equivalent to that of the respective bank's shortfall in priority sector lending, in the Rural Infrastructure Development Fund.<sup>60</sup>

South African banks are not required to lend a certain percentage of their credit to small businesses. Furthermore the Financial Services Sector Charter, which compels banks to spend a certain amount on black small business owners, lapsed in 2009 when banks and the financial services sector could not agree on targets in the charter. The charter could be used as an important tool to encourage banks to become involved more in lending to small businesses and could drive bank's involvement in Khula's guarantee scheme, as banks can score valuable points on the BEE scorecard for meeting targets under the charter. The banks have done very well in this regard<sup>61</sup> but it is not clear why the banks have performed so well under charter targets.

## Lesson 2: Strong IT system

Vinod, CGTMSE's chief executive, attributes the scheme's performance to two things – a significant buy-in from member banks and a web portal which allows member banks to feed applications for guarantees back to the scheme's offices for processing. With the online system business owners can apply for and receive a guarantee within 24 hours. The longest waiting period is two or three days, if the application falls on a weekend, he says.

All the branches of banks participating in the scheme have access to the CGTMSE's website using a user ID and password. Filing an application is easy: a banker simply accesses the scheme's website and feeds an application into the system. This, together with over 100 tweaks which Vinod recently carried out on the portal, has helped streamline the handling of applications. The system is working so well now that a Japanese consultant who recently visited the scheme's head office in Mumbai returned saying there was nothing he could find to improve the working of the system.

Business owners like Asheesh Pal, managing director of Stryka Consultants, are a testament to the effectiveness of the new system. Pal was able to take out a collateral-free loan for his business through Punjab National Bank in the state of Himachal Pradesh. Said Pal: "It was pretty easy for me to get the loan sanctioned and I got the payment the very same day of my actual application, but I had to convince the bank chief manager for the business plan. But, one truth, people are really unaware of these schemes, capacity building in terms of information flow is required."<sup>62</sup>

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<sup>59</sup> The regulations for priority sector lending evolved in the late sixties, at the time when the government nationalised the top 14 banks in 1967, in order to focus attention on the need to ensure adequate credit facilities to certain neglected sectors of the economy particularly in the rural areas. (<http://www.articlesbase.com/business-articles/priority-sector-lending-by-commercial-banks-1106151.html#ixzz110-pSvWaL>)

<sup>60</sup> In the 2008/2009 financial year commercial banks lent out 11.3% of their credit to small businesses., while in the same financial year, most of the 27 foreign banks lent out about 10% of their net bank credit to small business (Reserve Bank of India, Draft Technical Paper by the Internal Working Group on Priority Sector Lending, 2005) & (Reserve Bank of India, Appendix Table IV.4 Advances to the Priority Sectors by Public Sector Banks, Trend and Progress of Banking in India, October 22 2009) <http://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Trend and Progress of Banking in India>

<sup>61</sup> For example in 2006 banks lent out R9.84 billion to black small business owners, with a turnover of between R500 000 and R20 million, almost double the Charter council's R5-billion target. ("Banks favour urban loans", Bignews, January 2008).

<sup>62</sup> Interview with Asheesh Pal, LinkedIn.com, May 2010.



While Khula aims to finalise applications for guarantees within three days, the agency's marketing manager, Zimbili Mosheshe said bank's processes often meant applications could take "weeks" to finalise. There is no back end IT system at Khula and applications to the guarantee scheme are simply emailed by the banks to the agency.

### Lesson 3: Better Communication with banks to get buy-in

Workshops and meetings with member banks have also helped drive up CGTMSE's lending rate, with the scheme roping ordinary bankers into workshops to explain to them the significance of guarantee lending. Last year the scheme conducted 1 384 seminars and meetings its 111 member lending institutions – 858 of these were workshops each attended by groups of about 25 bankers. Member lending institutions have about 60 000 branches in all, with the State Bank of India making up over 13 000 of these. The make-up of the lending institutions on March 31, 2010 included: 27 public sector banks, 16 private sector banks, two foreign banks, 60 regional rural banks and six other institutions (NSIC and Sidbi among others). The scheme also advertises in newspapers, which by law have to offer government advertising rates 12 times cheaper than those they offer private-sector clients.

Business consultant Dolly Bhasin believes credit guarantees through the CGTMSE, may have gained some additional momentum over the last few years, from entrepreneurship drives run by many not-for-profit organisations and the National Entrepreneurship Network, an online resource for entrepreneurs in India, as well as by start-up support organisations.

In South Africa getting buy-in from banks has long proved a headache for Khula. It may well have prompted the cabinet to back the agency's request to lend direct to business owners through the Khula Direct scheme, which is expected to be rolled out this year. Malose Kekana, Khula chairman said it was necessary for the organisation to meet with banks to review processes, and admitted that when he joined Khula in 2010, it had been a long time since the organisation had met with banks. He added that banks experienced a high turnover of staff that dealt with the credit guarantee scheme and that this also made marketing the scheme difficult.

One banker said that in the early days of the scheme Khula had held monthly meetings with banks through a steering committee, but that these had since become quarterly meetings. The banker noted that it was important for bankers which handle the scheme at their respective banks to be committed. It is also notable how when one banker left one of the top performing banks for Khula guarantees, how the number of guarantees had drastically declined.

### Lesson 4: Improving timely claims

Probably one of the most important factors in the Indian scheme's ability to vamp up lending, has been the rate at which it responds to paying out defaulting loans. For Khula the time it takes for the agency to pay out defaults remains a big concern for banks. Khula requires a bank to first seek a default judgement against a business owner before it lodge a claim, which can take between one to three months to obtain<sup>63</sup> or up to five years, according to one banker. Kekana agreed that the time that it took to pay out a claim to banks was too long. In contrast, at the CGTMSE the first payment is made within the same day an application is posted. This, maintains Vinod, is the scheme's "unique selling proposition".

The CGTMSE's claims procedure stipulates that when a member bank or lending institution lodges a claim to the trust, that a lock-in period of 18 months will apply.<sup>64</sup> Claims are paid out extremely quickly in India. Immediately on instituting legal action to recover the defaulted amount, the trust will honour the bank 75% of the guaranteed portion in default subject to maximum of 75% of the guaranteed cap amount (or 85% for select category of borrowers). So far example if a business owner took out a Rs1 million loan (of which the trust covers Rs750 000), the bank will be illegible to immediately recover a

<sup>63</sup> Emailed response from Khula's then managing director Setlakalane Molepo, April 2010.

<sup>64</sup> The 18 months run from either the date of last disbursement of loan to the borrower or the date of the guarantee cover coming into force in respect of the particular credit facility, whichever is later.

sum of Rs562 500 – which is 75% of the guaranteed amount. The remaining 25% of the default is paid on conclusion of recovery proceedings by the lender, according to the Indian scheme.

Vinod said the CGTSMSE had learnt from the failure of a previous government guarantee scheme, the Deposit Insurance and Credit Guarantee Corporation which eventually closed down after struggling to settle claims on time. In a 2008 interview, Vinod said the first payment on a claim was concluded within one day. “The bank makes a claim today and tomorrow morning, the cheque is out,” he said. He added that there was no due diligence. “If something goes wrong, they have to file the claim with us. While filing the claim, there are five or six columns they have to tick.” One is whether the guarantee is valid. Second is whether they have classified the specific loan as a non-performing asset (NPA) in their books; third is if they have classified it as an NPA, have they issued a recall notice; fourth is whether they have filed in the appropriate forum; and, fifth whether there is a certification (form) from an AGM-level officer. “If these things are there, we simply issue a cheque. There is nothing more we need to know. Once that has been done, there is no value addition from our side. We pay 75% of the guaranteed amount immediately. The remaining 25% we pay after the total process is over. After the decree (default judgement) is obtained. Ultimately we share the default 3:1.”

Vinod claims the default rate was “negligible” at August 31 2008 when he estimated the defaults to be Rs110 million out of Rs33 billion lent out at that time.<sup>65</sup> At the time he claimed there was “not a single case pending with us for pay out”.<sup>66</sup>

While according to the CGTMSE’s 2008/2009 annual report the scheme recorded just 2% bad debt in 2008/09, the Report of Working Group to Review the Credit Guarantee Scheme of the Credit Guarantee Fund Trust for MSEs released by the Reserve Bank of India on March 6th, 2010<sup>67</sup>, recommended among other things that the procedure to claim on defaults be further simplified.<sup>68</sup>

Unlike with the CGTMSE, settlements Khula makes are paid in one lump sum when a claim is made to banks, yet the process is cumbersome. Though Khula settles a claim within 30 days of receipt of all the information, banks first have to secure a default judgement against the principal debtor as well as all sureties in court against the defaulting business owner before they can lodge a claim. However, according to one banker, who oversees Khula guarantee lending, “it rarely takes less than a year to pay out claims”. Added to this banks have to submit five or six different pieces of documentation along with each claim form.

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<sup>65</sup> The trust had received 1 263 claim applications from 25 member lending institutions as of March 31 2009. It had settled 784 eligible of these claims, paying over Rs187.7 million towards the first installment. Of the remainder, 73 applications were not eligible within the purview of the scheme. A further 397 applications were incomplete as stipulated conditions for claims settlement had not been satisfied on the date of filing the claim. As on March 31 2009 just nine applications for Rs3.8 million were pending for settlement. As of March 31 2010 there were 2 506 claims totalling Rs5.3bn in settlements of a cumulative of Rs1.16 trillion lent out through 300 105 guarantees.

<sup>66</sup> Dare.co.in, 31 August 2008, <http://www.dare.co.in/people/featured-investor/os-vinod-cgtmse/Page-2.htm>

<sup>67</sup> <http://www.Rbi.org.in/scripts/PublicationReportDetails.aspx?UriPage=&ID=585>

<sup>68</sup> At present, banks have to initiate legal action in all cases before filing claims with the scheme. A suggestion was made for legal proceedings as a pre-condition for invoking of guarantees to be waived for credit facilities up to Rs50 000; another suggestion was for the final claim to be paid by the trust to the bank after three years of obtention of decree of recovery instead of the present procedure of releasing the final claim by the trust only after the decree of recovery becomes time barred, or in other words after 12 years after obtaining decree (See: <http://blog.taragana.com/business/2010/03/06/report-of-working-group-to-review-the-credit-guarantee-scheme-of-the-credit-guarantee-fund-trust-for-mses-released-38866/>).

**Table 5. Yearly Value and Number of Claims (Khula vs CGTMSE)**

Value of Claims Paid						
	2005/06	2006/07	2007/08	2008/09	2009/10	Total
Standard Bank	987,289	0	1,105,447	3,095,208	6,225,826	11,413,770
Absa Bank	14,928,513	14,533,152	15,524,356	18,746,755	17,386,540	81,119,317
Nedbank	0	505,771	1,260,267	1,395,548	132,669	3,294,254
First National Bank	234,660	425,005	0	1,291,180	4,666,975	6,617,821
Khula claims paid	16,150,463	15,463,928	17,890,070	24,528,691	28,412,010	102,445,162
Khula percentage of default*	27.46%	37.60%	24.96%	23.30%	29.70%	27.56%
CGTMSE claims paid	256,534	441,002	22,073,757	26,449,713	98,210,862	147,431,868
<i>Total CGTMSE (rupees)</i>	<i>Rs1 663 540</i>	<i>Rs2 860 890</i>	<i>Rs143 158 800</i>	<i>Rs171 585 400</i>	<i>Rs636 893 300</i>	
CGTMSE percentage of default	0.61%	0.76%	23.67%	23.00%	90.20%	35.40%

Number of Claims Paid						
	2005/06	2006/07	2007/08	2008/09	2009/10	Total
Standard Bank	11	0	8	12	19	50
Absa Bank	106	81	72	105	95	459
Nedbank	0	4	7	5	1	17
First National Bank	3	3	0	7	15	28
Khula claims paid	120	88	87	129	130	554
Khula percentage of defaults	44.00%	59.50%	32.00%	61.00%	38.90%	40.00%
CGTMSE claims paid	62	111	292	347	1 778	2 590
CGTMSE percentage of defaults*	9.20%	11.30%	17.30%	14.80%	89.60%	33.80%

Note:\* - the percentage that the number of claims paid out for that year of the number of defaults recorded for that financial year.

Sources: Khula Finance Limited, CGTMSE.

According to Maggie Mazzullo, the manager of loss control at Khula,<sup>69</sup> this documentation is as follows: bank statements for all accounts from date of default to date of submission of claim; salvage schedules reflecting dates and amounts if proceeds have not been credited to respective accounts; a copy of the attorney's accounts together with the bank's original tax invoice addressed to Khula for the fees being claimed; a copy of relevant pages of the liquidation accounts in event of liquidation; proof of compliance with any special conditions attached to the facility; and a brief summary of legal action taken.

As an example of the red tape that has mired the scheme, one banker pointed to some 500 pages the bank had to file just to recoup a single loan valued at R1.2 million for a deal made in 2007 that had since gone bad. The banker said the number of steps in the claims procedures had grown in size since the agency launched the scheme in 1996, as Khula had continually added additional annexures or schedules.

Khula's finance manager Des de Jager said banks were concerned about the processes that they need to follow and added that this had been cited by the banks as a factor in them not being "overly enthusiastic" about the scheme. He reported that Khula was currently in discussions with the banks to revise the process in which claims are made.

<sup>69</sup> Email from Maggie Mazzullo, October 2010

One banker believed that the “credit indemnity” styling of the Khula-backed finance contributed to business owners walking away from struggling businesses rather than trying to turn them around. “... The reality for these business owners is that Khula insists that we get final judgement on the defaulters, take them for whatever they’ve got, and then they pay out a percentage of the balance still owing. It can take years for Khula to pay out on the indemnity.”

### Lesson 5: Sharpen the assessment process

While the CGTSME approves credit guarantees in under two days, it can take days for banks to grant an approval for a Khula guarantee. Said one banker: “the assessment is more intensive and the documentation requirements are more onerous than in our ordinary credit applications. Yet, the default rate among non-Khula backed transactions in our business credit portfolio peaked at 5.8% compared to the Khula portfolio.” He said this indicated that the assessment criteria demanded by Khula is not as robust as the banks’ own credit assessments. He said added to this the administration of Khula transactions is costly to run and does not lead to earlier identification of those businesses that later find themselves in financial trouble.

The same banker said a related problem was that Khula does not accept behavioural scoring as a credit assessment tool, which could speed up approvals. “We can and do provide a five-minute answer to small business clients using our behavioural scoring methodology. If Khula accepted this as a valid means of assessment, then the turnaround time would be measured in days, not weeks,” he said.

The banker said the real problem was that only about one out of every 20 applications makes it past the initial screening stage, and that only a fraction of those selected are ultimately approved.

Another banker complained that the indemnity required both the banks and Khula to approve each loan. “This process is not completed in parallel; instead banks are required to approve loans first and then pass the applications onto Khula, which creates a bottleneck. In addition, there is not an adequate workflow system set up between the banks and Khula which results in applications taking a couple of weeks to be approved by both parties.”

One bank, Standard Bank, said it had proposed the system of portfolio guarantees where applications are solely managed by the bank itself. This allows the bank to screen all applications and provide finance independent of a Khula assessment. Under this proposal the bank would agree to operate within defined thresholds. “This will improve the process issues and administrative burden created by the current scheme. In addition, the bank would like to work with Khula around their non-financial initiatives to maximise these efforts and ensure effective ongoing support is provided to SME’s,” a Standard Bank banker said.

A third banker said Khula was wrong to recently get banks to sign “portfolio agreements” and believed that the move would not increase participation in the scheme. The agreement would allow banks to negotiate a blanket cover to cover a portfolio of loans, which would allow Khula to spend less time vetting each individual application, thus freeing the agency’s team up to concentrate on Khula Direct applications. But the portfolio agreement could backfire as banks could mistakenly believe that they can lend out more loans more rapidly, which could see banks making relatively careless approvals.

The banker said Standard Bank had “burnt their fingers” some years ago by not sticking to the lending criteria for the guarantee scheme, with Khula allowing this to happen. When it came to paying out settlements on loans that had gone bad, Khula turned around and said the banks had not followed the application procedure to the book. The resulting backlash at Standard Bank had led to the bank virtually pulling out of the scheme. The problem is thus complex.

## Box 2: The sickness that is South Africa's high default rates

The experience of CGTMSE once again brings home the biggest headache that development finance institutions experience, namely that of non-repayment. This is a significant problem in South Africa. Nationally:

- In an answer in Parliament in May 2010, the Minister of Trade and Industry Rob Davies reported that the National Empowerment Fund's (NEF) had a repayment rate of 74%. Davies said at the time that preliminary results revealed that between 5.5% and 8% of all loans advanced would be written off;
- Added to this, Khula wrote off R220.6 million or 13% of the R1.68bn in total disbursements it made between 2003/04 and 2009/10, while the repayment rate declined from 83% in 2008 to 74% in 2009;
- Over two-thirds or 69% of the Industrial Development Corporation's (IDC) arrears for the 2010 financial year were from enterprises with turnover of below R50 million. IDC wrote off R90 million in the year to March 31, 2010;
- Further to this, the South African Micro Apex Fund (Samaf), which provides finance to micro enterprises, recovered just 66% of its loan repayments in the 2010 financial year, with losses of 17% of its loan book or R6.4 million recorded that year.<sup>70</sup> This was similar to the National Empowerment Fund's (NEF) Imbewu fund, which is aimed at small businesses, where 35% of loan repayments were not paid back on time during the 2009 financial year.<sup>71</sup>

At provincial development finance agencies the problem is worse. In 2008 the Eastern Cape Development Corporation (ECDC) was offering defaulters discounts on the interest owed if they commit to repay outstanding debts. The Free State Development Corporation (FDC) was suffering from about a 30% bad debt rate in 2008, a level similar to KwaZulu-Natal's Ithala Development Finance. Bad debt at Limdev, Limpopo's development finance agency, reached 50% in 2008 and 1 500 of all business owners on the agency's books had outstanding debts of more than 90 days. According to Limdev spokesperson, Leo Gama, the problem stemmed from business owners' perception that the money was not that important to pay back. "The mentality is that it is public money so why do we have to pay it back", he said. He reported that some business owners spent their loans on luxury cars or used it as collateral to draw a further loan from their bank. "Some business owners ran to politicians when the organisation began instituting legal proceedings against them", he added.<sup>72</sup>

Said one banker: "A great deal of the entitlement culture we currently witness today, together with 'loans being perceived as grants' is largely due to the historical perspectives of many reluctant entrepreneurs".

Another banker said a robust risk assessment, which involves evaluating both the strength of the entrepreneur as well as the business model is required as well as adequate non-financial support in order to increase lending to SMEs and grow entrepreneurs.

One bank is currently working on solutions to ensure that finance is provided to black-owned SMEs in a sustainable way with or without an indemnity scheme. This involves setting up structures together with corporates, development finance institutions and provincial governments which will ensure that the technical expertise and or general business support is provided to entrepreneurs. But one banker reported that the real issue preventing greater access to finance is the lack of non financial support for business owners and the high default rates. However, a number of mentors who are contracted to provide non-financial to assist SMEs applying for loans under the Khula scheme merely provide a "cut and paste" business plan without any post loan drawdown support he added. "This often results in the entrepreneur not having thought through the business model in detail which leads to the ultimate failure. In addition, without any effective post drawdown support many of entrepreneurs fail."

In addition, there are various other issues which result in high default rates. These include entrepreneurs not using the finance for the project for which it is intended and building up a bad track record with the banks and a lack of adequate screening and assessment processes when awarding tenders and or work resulting in the ultimate downfall of small enterprises.

<sup>70</sup> Business Day, May 20, 2010.

<sup>71</sup> Since 2003, and up to March 31 2010, 156 worth R457m went to small black-owned businesses or franchisees through the Imbewu Fund (NEF, Annual report 2010).

<sup>72</sup> "Small business funding stretched by defaulters", Bignews, May 2008.

According to Khula's former managing director Setlakalane Molepo, the central factors which drive the high default rate are an entitlement mentality by entrepreneurs and entrepreneurs' lack of education. "Entrepreneurs often believe that as development finance institutions are government-owned and most of them are primarily recapitalised by government, they don't have an obligation to pay back the monies." He said that when lending to less "sophisticated" entrepreneurs, especially in the micro and small enterprises, one needed to stay "very close to the operations". "In Brazil, CrediAmigo, owned by Banco do Nordeste (the Bank of the Northeast), has recovery rate of between 98% and 99%. Why? Because the loan-officers are on the entrepreneur's face when he/she defaults. The loan officer knows the customers intimately to such an extent that they have an obligation to him or her to pay their debts." <sup>73</sup>

## CREDIT-RATING SCHEME

- Via a subsidy, the scheme helps business owners to access finance more easily from banks and at better terms and helps SMEs to obtain better credit terms from suppliers.
- However, few business owners have taken advantage of the scheme as they don't see the benefits.
- Those that have accessed the scheme say banks don't recognise the credit rating.

## Overview

The Indian government claims that a scheme in India, which subsidises the cost of a credit rating, helps businesses to access loans or negotiate with banks for lower interest rate terms, but many say banks do not recognise the credit ratings when business owners approach them with the ratings. The challenges associated with this scheme offers a lesson to South Africa should a similar initiative be considered in the country.

A credit rating provides a business owner, their bank and even their suppliers, with an independent, trusted third-party opinion on the capabilities and credit worthiness of a business. The scheme was launched in 2005 after being drawn up in consultation with the Indian Banks' Association and rating agencies. <sup>74</sup>

The National Small Industries Corporation (NSIC), which implements the scheme <sup>75</sup>, claims that 67% of business owners who have accessed the scheme have been able to take out more credit from their bank after informing their banker about their rating status. The NSIC says that almost a third of business owners that have accessed the scheme have reported that the rating helped them gain increased recognition from buyers and customers, while 17% revealed that rating helped them in negotiating lower interest rates when borrowing from banks. <sup>76</sup> The NSIC maintains banks were granting concessional interest rates of between 0.5% and 2% to those business owners who scored good credit ratings. <sup>77</sup>

According to a presentation by the NSIC, of those business owners that have accessed the subsidy nearly 16% experienced higher sales and almost same proportion received more customer queries after getting a rating. A further 23% of those businesses rated improved human resource management systems and

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<sup>73</sup> Setlakalane Molepo, via email, September 14, 2010.

<sup>74</sup> The NSIC subsidises 75% of the cost of a credit rating up to Rs40 000 (R6 100) See: <http://smetimes.tradeindia.com/smetimes/news/top-stories/2010/May/15/nsic-aims-to-provide-credit-rating-to-over-9000-msmes17361.html>

<sup>75</sup> According to business consultant Dolly Bhasin, the scheme was one of the measures identified by the organisation of Southeast Asian Nations (Asean) and the OECD to improve the access to credit for SMEs.

<sup>76</sup> NSIC presentation by Dr HP Kumar, Institutional Framework for Small Business Development, Undated. <http://www.nsic.co.in/creditrating.asp>

<sup>77</sup> Interview with HP Kumar, New Delhi, March 2010



policies equipping them for higher competitiveness and 38% felt that their employee pride had increased with rating of their units.<sup>78</sup>

Briefly the process for rating a firm works as follows: Officials from a rating agency visit a business owner's business place and study the business' audited reports for the last three years. They then compile a report looking at the strengths and weaknesses of the organisation's management and its infrastructure capabilities, while providing feedback on how the business owner could improve their performance. The whole process takes about a month to conduct and a rating is valid for one year. After the initial rating expires, it is then up to the business itself to cover subsequent ratings.<sup>79</sup>

### Criticism: Banks don't recognise rating

According to the Minister of State (Independent Charge) for Micro, Small and Medium Enterprises (MSMEs) Dinsha Patel, up to 31st March, 2010, a total of 19 207 small and micro enterprises had obtained a rating under the scheme, since its inception. Added to this a further 1 652 applications were being processed at that time. Seven rating agencies were part of the scheme.<sup>80</sup> Only 7 505 business owners benefited from the scheme in 2009/2010, a slight increase over the year before when 5 011 accessed the scheme.<sup>81</sup> The NSIC has set a target to provide credit rating to over 9 000 businesses in 2010/11.<sup>82</sup>

Yet, despite the benefits that the NSIC claims the scheme has had for business owners, the scheme is reported to have made very little impact. One key criticism is that the credit rating is often not recognised by banks, because it was not a rating on a firm's financial stability, but rather on its processes.<sup>83</sup>

Bhartendu Dev, who runs Uptodate Plastics & Packagings Pvt. Ltd, based in Laxmi Nagar, Delhi said his business was able to get a credit rating through the scheme about two years ago. However he said his business did not benefit from this. "Banks continued to treat us as before. "Recently we were approached again by the same credit rating agency – Dun and Bradstreet – but seeing no advantage we refused. If you are a good organisation banks know and help to give needed credit. We now believe that such ratings are meaningless for small organisations," he said.

Dev paid about US\$1 000 for the rating. His business was rated as "2A" which, he explained, meant his firm was "high on performance and very high on finance". However he said the banks opt to use their own financial examination of the borrower business. Dev said his business didn't need a loan but rather wanted the bank to reduce its interest rate on working capital. "The bank said our rate of interest was already low," noted Dev, who added that the bank was only interested in having him take out more loans – with or without a credit rating. "These ratings help larger organisations to buy out smaller companies (using the) business information from these agencies ... for their (own) benefit", he said.<sup>84</sup> Similarly, Mohini Kelkar, who together with her husband Ketan owns Precision Engineers, said her company too did not benefit from taking out the subsidy even though she believed the company would get some rebate

<sup>78</sup> NSIC presentation by Dr HP Kumar, Institutional Framework for Small Business Development, Undated  
<http://www.nsic.co.in/creditrating.asp>

<sup>79</sup> Interview with Gaurang Dixit, the NSIC's general manager of finance, New Delhi, March 2010.

<sup>80</sup> In a written reply to a question in the upper house (Rajya Sabha) of India's parliament, SME Times, 24 Apr, 2010  
<http://smetimes.tradeindia.com/smetimes/news/top-stories/2010/Apr/24/credit-rating-not-necessary-for-mses-to-get-loan61336.html>

<sup>81</sup> Interview with Gaurang Dixit, the NSIC's general manager of finance, New Delhi, March 2010.

<sup>82</sup> "NSIC aims to provide credit rating to over 9 000 MSMEs", Saurabh Gupta, 15 May, 2010:  
<http://smetimes.tradeindia.com/smetimes/news/top-stories/2010/May/15/nsic-aims-to-provide-credit-rating-to-over-9000-msmes17361.html>

<sup>83</sup> Rajeev Karwal from Milagrow and Anil Bhardwaj, the secretary general of the Federation of Indian Micro and Small and Medium Enterprises

<sup>84</sup> Interview with Bhartendu Dev, email, May, 2010.

from the bank after taking out a rating. She said the bank used “different norms” to those of the credit ratings.<sup>85</sup>

In contrast, Binoj Cherian, who runs STJ Electronics reported that his business did, in time, benefit from the rating, after he accessed the subsidy through the NSIC. “In the first two years there was no impact on the existing banker, however stronger banks started approaching us with lower interest and lower collateral requirements. This allowed us to move out to better banks. Regarding Suppliers, we shared this data only with one of the suppliers. This was our main international supplier and the feedback was positive. They have more trust in the transactions as it is a third-party document,” he said. Cherian used rating agency Crisil and the rating cost him around Rs16 000 whereas ratings are usually between Rs75 000 and Rs100 000. He has since renewed the rating five times, which he described as a fairly easy process as the rating agency simply updated his rating with new data that he submitted to them.<sup>86</sup>

One rating agency head commented that some business owners are afraid to take advantage of the scheme fearing they may not get a good rating. Also, some financial statements do not paint an accurate picture of applicants as rating agencies had a tendency of only rating entities which have a certain amount of financial statements they can produce. The rating agency head however said Icra considered other factors when compiling a rating, such as the strength of a firm's management and what relationships a firm has with its suppliers and the quality of the firm's product. It also compares the entity with other firms that are of a similar size and operate in the same sector.<sup>87</sup>

According to Dolly Bhasin, a business consultant in India who consults with many small business development agencies<sup>88</sup>, the usefulness of credit rating has never been properly communicated to Indian SMEs which has led to its poor take up. Added to this she believed that despite the subsidy a rating still remained too costly for many business owners.

### Conclusion: Ratings need to be made viable

If a similar scheme is proposed in South Africa, careful thought must be put into ensuring that the rating will be taken seriously by banks and that business owners will see the benefits to accessing such a rating and not view it as an unnecessary auditing-type cost. Another problem is that ratings often only look at those businesses that already have some form of existing financial statements in place. In South Africa many small business owners do not keep financial records. Any rating scheme will have to take cognisance of this particular problem.

### CARTÃO BNDES (BRAZIL)

- Credit card which uses an e-commerce facility which simplifies access to finance for small businesses through banks via government funding and promotes the local production of goods;
- Legislation drives use of card in Brazil along with existing database of suppliers;
- However the Department of Trade and Industry (South Africa) believes that there are various challenges to implementing such a card in South Africa.

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<sup>85</sup> Telephonic interview with Mohini Kelkar, June, 2010. Her business has 150 employees

<sup>86</sup> Binoj Cherian, interview by email, June 2010.

<sup>87</sup> Rajesh Dubey, Executive Director, of rating agency Icra Online Limited, quoted in SME Times, 13 April 2010  
<http://smetimes.tradeindia.com/smetimes/face-to-face/2010/Apr/13/smes-need-to-avail-benefits-of-credit-rating-rajesh-dubey555555.html>

<sup>88</sup> Including Unido, Inwent, USABF



## Overview

A Brazilian development bank's innovative credit card, which has caught the eye of everyone from Singapore to South Africa's Department of Trade and Industry, could help boost funding to small businesses in South Africa, while promoting local industrialisation.

Banco Nacional de Desenvolvimento Econômico e Social (BNDES) expects to lend out R\$4.2 billion (valued at about R17.5 billion in September 2010) to small businesses in 2010 through Cartão BNDES. The card allows small enterprises to source goods and services from pre-approved suppliers. Disbursements through the card have grown from R\$1.2 million in 2003 when Cartão BNDES was launched, to R\$2.46 billion last year, and as of August a total of R\$12.1 billion in credit had been advanced through the card.

The idea of the card, which combines the concept of a credit card with that of an e-commerce platform, is to simplify the red tape associated with bank loans. To access finance for the goods listed by suppliers on Cartão BNDES's website business owners approach one of the scheme's five participating banks to that BNDES advances finance to which is then channelled through the card to business owners. The application process through banks typically takes about 20 days, according to BNDES. The card also promotes local production as BNDES vets suppliers and requires that products have a minimum of 60% local content to ensure that the domestic economy benefits. Suppliers that wish to make an imported product available on the card's website are required to prove to the bank that no similar product exists on the local market. To qualify as a buyer a business must have an annual turnover not exceeding R\$90 million.

Ricardo Albano Dias Rodrigues, the manager of the department of internet operations at Banco Nacional de Desenvolvimento Econômico e Social (BNDES) said the card's website currently lists 303 000 small, medium and micro enterprises as buyers.<sup>89</sup> Rodrigues said 88.3% of buyers were, at the time of interview in August 2010, micro enterprises (those with an annual turnover of below R\$2.4m), 9.9% small enterprises (with a turnover between R\$2.4 million and R\$16 million) and 1.8% medium-sized firms (firms with a turnover between R\$16 million and R\$90 million).

The site also contains 23 000 suppliers – 12 000 of these being manufacturers and 11 000 distributors. A total of 135 000 goods and services are listed on the card's website, including machinery, construction materials and raw materials for production, while some suppliers offer financial services, design and prototyping services and technology transfers. In August BNDES also began offering professional qualifications such as language and tourism courses through the card's website.

Rodrigues said business owners can buy goods of up to R\$1 million at a time, but can arrange with their own bank to finance any shortfall, if need be. Purchases through the website are limited to a minimum of three and a maximum of 48 instalments and an interest rate of 0.97% per month was being charged in August 2010.

The card's website allows the entrepreneur to search for the product and buy it on the site, but Rodrigues pointed out that 99% of buyers prefer to approach the supplier directly. After negotiating a price the supplier is then able to enter the card's website and put the transaction through, themselves.

## Ensuring take-up of the card

The idea for the card said Rodrigues, who currently oversees a team of 25 – with 10 staff designated to analysing suppliers – came from a retired employee of BNDES and an employee of the development bank. It was not difficult for BNDES to source suppliers as the development bank drew most of the initial batch of suppliers for the card, from those that were already registered with another of its funds, he said. But one of the challenges the development bank did face when putting the card into the market was to get business owners to feel comfortable about the product. In order to counter this the bank ran workshops and seminars as well as a television campaign to market the card.

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<sup>89</sup> Interview with Ricardo Albano Dias Rodrigues, Rio de Janeiro, August 2010.

Four of the five participating banks are state banks<sup>90</sup> (with Bradesco being a private bank) and a key factor that drives the banks participation in the scheme is that by law public banks are mandated by article 58 in Lei Geral to report weekly to Brazil's central bank on the number of loans they grant to small businesses as well as the conditions of accessing the loans.

Rodrigues said member banks were drawn to using the card as it offered clients access to a large number of clients, assured their loyalty and offered attractive terms to business owners. He said while participating banks also benefited from the earnings on the interest rate charged to business owners, they could also gain from banking some of the suppliers that registered with the card.

The participation in the card is also spurred on by the fact that the Brazilian government – through BNDES and the various state banks – has historically been very involved in finance and banking in the country. However while state banks accounted for a significant percentage of assets 30 years ago (state and federal banks held 40% of all bank assets in 1985<sup>91</sup>) today public banks account for less than 8% of all bank assets.<sup>92</sup>

### Way forward

The success of the card in Brazil is evident not only by its uptake by small businesses, but also in the fact that new products are continually being offered on the card's website.<sup>93</sup> Luiz Sakuda, professor of entrepreneurship and innovation at FEI university, Sao Paulo believes that as Cartão BNDES offers pre-approved credit, the card is a good way to bring down the amount of red tape entrepreneurs face when trying to access finance. The concept he said was a good one, as BNDES screens both buyers and suppliers.

Commenting on the innovative card, the Department of Trade and Industry's Acting Deputy Director-General of Enterprise Development, Siphso Zikode, said he believed the card could be a useful financial instrument to help small enterprises to fund such things as working capital and some overheads.<sup>94</sup> But he anticipated there would be challenges to carrying out the card in rural areas where the majority of small and micro enterprises were informal and lacked banking facilities. However, he added that such a card could work well in urban areas.

A further challenge would be that of creating awareness around the card, especially as the low level of literacy and lack of record keeping among many business owners would be stumbling blocks. It would also be a challenge to get the banks to enter the sector, particularly when it came to how to lower the systemic risks the banks would face lending to the small business sector.

Zikode said there was a real need for a public/private partnership to look at developing a small business bank which would operate on a different set of rules and requirements. "To expect traditional banks to lower their requirements and standards could be a huge challenge," he said.

Rodrigues said small, medium and micro businesses accounted for 75% (66% being small and micro) or 343 000 of the bank's total number of disbursements between January to July 2010, accounting for R\$41 billion or 50% (31% being small and micro) of the development bank's total disbursements.<sup>95</sup>

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<sup>90</sup> Banco do Brasil, Nossa Caixa, Caixa Econômica and Banrisul

<sup>91</sup> According to Werner Braer in 'The Brazilian Economy: Growth and Development' (Sixth edition), Lynne Rienner Publishers, 2008.

<sup>92</sup> Debt Report, Inter American Development Bank, August 2009

<sup>93</sup> In August BNDES began offering professional qualifications such as language and tourism courses through the card's website.

<sup>94</sup> Email from Siphso Zikode, September 2010

<sup>95</sup> Between January 2009 and June 2010 72% of BNDES funding went to large businesses (R\$83.45 billion) with 23.5% going to SMEs. Of this 6.9% or R\$8.03 billion went to small enterprises, 6.7% or R\$7.76 billion to micro enterprises and 9.9% or R\$11.46 billion to medium size businesses. The remainder went to public administration and physical persons (Pessoa fisica).

## 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,<sup>96</sup> 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

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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.<sup>95</sup>

<sup>96</sup> 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 procurement<sup>97</sup> 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”.<sup>98</sup>

However the government still reserves the manufacture of certain goods for small firms. Currently 114 items reserved for MSE under 11<sup>th</sup> plan.<sup>99</sup> The reservation of products for exclusive manufacture in the small-scale sector<sup>100</sup> 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.<sup>101</sup> 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.<sup>102</sup>

### 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.

<sup>97</sup> 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.

<sup>98</sup> 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>

<sup>99</sup> Ntl Planning Commission, Industry report

<sup>100</sup> 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.

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

<sup>102</sup> 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.<sup>103</sup>

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).<sup>104</sup> 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).<sup>105</sup>

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.<sup>106</sup>

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

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<sup>103</sup> Tres Anos da Lei Geral da Micro e Pequena Empresa, Sebrae publication, 2010.

<sup>104</sup> 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.

<sup>105</sup> Tres Anos da Lei Geral da Micro e Pequena Empresa, Sebrae publication, 2010.

<sup>106</sup> 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.<sup>107</sup>

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.<sup>108</sup>

### 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 study<sup>109</sup> 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 report<sup>110</sup> 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

<sup>107</sup> "Sebrae incentiva a aplicação da Lei Geral em todo o País" from [http://www.agenciasebrae.com.br/audio\\_int.kmf?cod=2155](http://www.agenciasebrae.com.br/audio_int.kmf?cod=2155).

<sup>108</sup> 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.

<sup>109</sup> 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.

<sup>110</sup> 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](http://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.

### 4.3. Business Support

Arguably the most important assistance any business owner could receive, more so than access to markets or finance, is the availability of quality, affordable business advice and support. To this end Brazil offers a lesson to South Africa, through its business support agency Sebrae. The South American country's Global Entrepreneurship Week can also provide a key lesson to South Africa particularly, in how South Africa can create a successful awareness campaign to promote entrepreneurship. Brazil's incubation system also raises questions for South Africa on whether incubators will really drive job creation and whether they can create significant numbers of growth-orientated small businesses. Finally both India and Brazil provide important lessons for South Africa in the role clusters can play in growing small businesses.

#### CREATING AN ENTREPRENEURSHIP CAMPAIGN: BRAZIL'S GLOBAL ENTREPRENEURSHIP WEEK

South Africa is in dire need of a massive drive to galvanise support for small businesses and could do well to learn from a successful weeklong entrepreneurship campaign in Brazil, which in 2009 drew a record five million participants.

Global Entrepreneurship Week, which encourages participants to get involved in activities related to entrepreneurship for one week, is held in several countries around the world, including in South Africa. But it is Brazil that everyone is talking about. The South American country notched up the highest number of participants of any country in the week, after drawing 1.4 million participants in 2008 when it first ran the campaign. In comparison South Africa which in 2009 ran its first Global Entrepreneurship Week, hosted by Endeavor South Africa, secured a paltry 8 000 participants that year<sup>111</sup>.

Brazil's campaign, run by Endeavor Brazil, will also be of particular interest to Khula, the government's small business agency, which in 2010 announced that it would run a small business campaign with ANC stalwart Andrew Mlangeni as the campaign's patron.

In South Africa there is a strong need for the country to create role models which will inspire others to take the risky path of becoming entrepreneurs.<sup>112</sup> Presently there is little respect for and recognition of the contribution entrepreneurs make to society, despite the existence of various government and private-sector initiatives. According to the 2009 Gem Report, entrepreneurship was not sufficiently reported on and celebrated by the media, this while sporting heroes received more coverage and adoration by the press. However, the report noted that Gem studies over the years have conclusively shown that the low rate of early stage entrepreneurial activity in South Africa is influenced by a low level of overall education, social and entrepreneurial factors that do not encourage entrepreneurship as a career path of choice, a lack of access to finance and a difficult regulatory environment.

Taking the above into account, Endeavor Brazil's managing director Rodrigo Teles wants the South American nation to become an example for other countries when it comes to entrepreneurship and promoting a culture of entrepreneurship: "If everybody starts talking about entrepreneurship, people who are related to access to capital will start finding more ways of giving capital to entrepreneurs. Because you have more entrepreneurs who are starting to run their business, they need more money so people will have to find more ways to give cheaper and better money," says Teles.<sup>113</sup> And with better educated and informed entrepreneurs, banks will be more likely to lend out money he points out. The example is

<sup>111</sup> According to Malik Fal, managing director, Endeavor SA. Also, in the Brazilian event, seminars, presentations and debates accounted for 41% of the 1 735 activities which took place during the week, while workshops and courses made up a further 30% of the activities. Almost two thirds or 64% of participants were between 24 and 35 years old.

<sup>112</sup> "The Entrepreneurial Dialogues: State of Entrepreneurship in South Africa", Endeavor SA, 2010

<sup>113</sup> Interview with Rodrigo Teles, São Paulo, August 2010



important given that Brazil is already one of the most entrepreneurial countries – ranked sixth in the 2009 Gem Report, compared to South Africa's 34<sup>th</sup> place.

If everyone talks about entrepreneurship during the same week a stronger message about starting and running your own business is sent out, maintains Ludmilla Figueiredo, who oversees Endeavor Brazil's Global Entrepreneurship Week. Figueirido said many entrepreneurs have reported to Endeavor Brazil that they started their own business after attending an event during the week.<sup>114</sup>

### Lesson 1: Get partners involved

Figueiredo said the success of the campaign, which in 2009 took place under the slogan *Bota para fazer* (make it happen), is built on getting key partners involved such as media, community, training and business organisations which have a nationwide presence. In its first year Endeavor got 30 partners to agree to participate. This swelled to 560 in 2009, including 60 purely online partners.

Because radio and television channels dedicated prime-time slots to speak about entrepreneurship, partners were drawn to participate by the chance to promote their organisation or brand through the heightened news coverage during the week. The idea was then for each partner to register various activities – such as workshops, seminars and competitions, which it would run, or even end or start, during the week.

### Lesson 2: Use the power of the web

Endeavor Brazil essentially took lessons from an event run by Endeavor UK known at the time as Enterprise Insight. But Brazil has since managed to outperform the UK with the inclusion last year of online events, like blogs, webinars, video chats and even surveys.

Endeavor's online community has also grown to 6 000 and many people phone in requesting to be part of the next event. Participants can also add or view events on Endeavor Brazil's website.

### Lack of buy-in in South Africa

Commenting on Brazil's successful campaign, Malik Fal the managing director of Endeavor South Africa said media groups and corporates in South Africa that Endeavor had approached to take part in Global Entrepreneurship Week, had not shown the same commitment to joining the campaign as they had in Brazil. "I think people are very cynical (in South Africa)," said Fal, who pointed out that his interaction with potential partners had been "like pulling teeth", with most corporates only wanting to get involved if they were paid to do so. He pointed to the case of Brazil where newspapers agreed to run full-page advertisements promoting the week for free. A top graphic designer even offered their services free of charge to design the campaign's advert. "People in Brazil understand that if you don't have a country, you don't have a company," he said, pointing to their dire need to promote entrepreneurship if the country is to grow its tax base, create more jobs and stave off social unrest.<sup>115</sup>

Malose Kekana, chairman of Khula, said his agency's campaign which was being conducted in partnership with Business Unity South Africa (Busa), would in the future focus on three main areas, namely: offer recognition to those companies and organisations that were assisting entrepreneurs, fund certain initiatives with the help of the June and Andrew Mlangeni Foundation and build a knowledge repository to hold small business research. Kekana said business owners had been "let down for far too long" and had effectively been forgotten. "Things have not been happening and I am not going to sit around and wait for them to happen," said an adamant Kekana.<sup>116</sup>

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<sup>114</sup> Interview with Ludmilla Figueirido, São Paulo, August 2010.

<sup>115</sup> Telephonic interview with Malik Fal, September 2010.

<sup>116</sup> Telephonic interview with Malose Kekana, September 2010.

## Endeavor forges entrepreneurial culture in Brazil

Teles points out that even though Brazil has a high regulatory environment many entrepreneurs are still making it in the South American country. He said Endeavor Brazil looked toward the OECD's 2006 report Entrepreneurship Indicators Programme which lists six main areas that can be targeted to improve support to small businesses. These are: decrease regulatory burdens, improve market conditions, improve access to technology and research, improve access to capital, improve education and promote a culture of entrepreneurship. It is in the two last areas that Endeavor Brazil has been focusing on to improve the quality of the entrepreneur in Brazil.<sup>117</sup>

When Endeavor Brazil started out 11 years ago a big challenge for the organisation was how to change Brazilian's attitude towards entrepreneurship. At the time there was no word for entrepreneurship and the closest word, *empresário* or employer had many negative associations, with many perceiving them to be mere thieves who robbed from others. "When you have a culture which does not support you as an entrepreneur, if you have people – friends and family – telling you that you are crazy, your confidence will get lower and lower," said Teles who believes that creating a culture of entrepreneurship can open doors for entrepreneurs. But today things are slowly changing, with the buoyant economy helping to sustain the gradual change in attitude towards entrepreneurship from Brazilians.

Entrepreneurship courses at universities are now filling up and more people in the middle-class are now venturing out to start their own business: "It's getting better, it's getting more aspirational," says Teles. Yet still only about 5% to 10% of those who take entrepreneurship courses at universities will go onto start their own business.

## BOOSTING BUSINESS SUPPORT: WHAT SEDA CAN LEARN FROM SEBRAE (BRAZIL)

South Africa's Small Enterprise Development Agency (Seda) can do well to take a leaf out of Brazil's small business support agency Sebrae's book if it is to reach more small business owners and entrepreneurs. Seda is well placed to do so as the agency has for some years already had a technical agreement in place with the Brazilian organisation to share best practices.

Seda, which is mandated to support small enterprises, was formed out of a merger between Ntsika Enterprise Promotion Agency, National Manufacturing Advisory Centre (Namac) and the Community Public Private Partnership Programme (CPPP). The agency was set up in terms of 2004's National Small Business Act. Seda aimed to better reconfigure the existing small business support infrastructure after the failure of Ntsika's wholesale support model.

Ntsika dispensed business support through a network of local business support centres (LBSCs) which made very little impact when it came to assisting small businesses.<sup>118</sup> LBSCs were also often unsustainable as they often relied on funding from government to keep going. The result was that many closed down or proved less successful than expected in dispensing assistance to business owners.<sup>119</sup>

Yet since 2004, Seda too has faced a number of criticisms and its impact on small businesses continues to be questioned. Of these, chief is the firing of the agency's chief executive Wawa Damane in 2008 for

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<sup>117</sup> And to do this the organisation, founded in 2000, maintains a two-pronged strategy, creating role models for potential entrepreneurs and by running various marketing, communication and education programmes. It is already supporting a number of entrepreneurs who can act as role models for those looking to run their own businesses and has a private equity fund to assist these businesses. It screens hundreds of entrepreneurs to find the right one – those with scalable business models which can generate revenues of between \$1 million and \$30 million – focusing on firms with larger turnovers to ensure its support makes a big enough impact on society. It looks to take on between six to eight companies a year to help in this way and has 51 companies already.

<sup>118</sup> For example, in 2004 just 5 725 businesses were assisted and 1 896 received training ("South Africa: Enhancing the Effectiveness of Government in Promoting Micro, Small and Medium Enterprise", World Bank, 2007).

<sup>119</sup> DTI, Review of 10 Years of Small Business Support in South Africa 1994 – 2004, p33.

mismanagement of the agency's funds. Seda has also been criticised for its focus on unsophisticated, micro enterprises<sup>120</sup> and for offering generic, rather than sector-specific support.<sup>121</sup> And despite being set up as a one-stop shop, Seda has no control over the government's many small business support programmes. This, says small business researcher Rob Smorfitt, has led to a "range of conflicting, overlapping objectives and initiatives, resulting in an enormous waste of resources, in particular people and capital".<sup>122</sup>

**Table 6. Recent performance of Seda across a range of indicators (2006/2009)**

	2006/07	2007/08	2008/09
Number of clients accessing agency services per year	140 779	186 195	199 830
Number of people trained per year	1 539	22 893	15 000
Number of unique website visits a year	349 406	514 594	300 000
Number of clients assisted with business plans	-	3 661	1 638
Number of clients trained in starting a business	-	8 271	7 059
Number of business registrations*	-	10 635	5 643
Number of clients assisted with technology interventions	-	-	-
Number of clients assisted with access to finance	-	1 761	800
Number of clients assisted with mentoring	-	-	-

Note: \*Decreased in 2008/09 as Seda changed focus to working over a longer period with clients

Source: Table 35.9 Small Enterprise Development Agency in the National Treasury's Estimates of National Expenditure, 2010.

While there have been signs that at least financially, the agency is turning itself around (with unqualified audits from the Auditor General in both 2009 and 2010 financial years)<sup>123</sup> the agency continues to be hamstrung by a small, R430 million budget. Despite meeting more of its delivery targets in the 2009/10 financial year when compared to previous financial years, it underperformed in a third, or 13 of its 39 targets in the 2010 financial year. To get around its limited budget Seda has in recent years been developing key partnerships with municipalities across the country<sup>124</sup> (The budget constraints have resulted in previous years in six-month moratoriums on service delivery<sup>125</sup>). However, as a comparison below with Brazil's small business support agency Sebrae shows, Seda has had a very limited impact on the SME sector in South Africa.

<sup>120</sup> Small Business Development in SA: Time to Reassess, SB, 2009.

<sup>121</sup> Glen Robbins interview, October 2010.

<sup>122</sup> Smorfitt, Rob, 2008. "A critical assessment of the impact of interventions to stimulate the establishment and growth rates of SMEs in the formal sector in KwaZulu-Natal 1994 – 2008", Doctoral thesis, School of Management University of KwaZulu-Natal.

<sup>123</sup> "With finances sorted out maybe Seda can do its job", Business Report, October 1, 2010.

<sup>124</sup> For example Seda's Eastern Cape provincial office had negotiated with various municipalities to cover the rent and electricity of about three branches there. In Gauteng Seda was engaged in talks with the Tshwane Metro as well as the West Rand Development Agency around a similar deal, said Lupuwana. In total Seda has 21 co-location points at local municipalities (See "Seda gets around budget constraints", November 2009).

<sup>125</sup> "Seda gets around budget constraints", Bignews, November 2009.

## Seda: Far behind Sebrae

A comparison between Sebrae and Seda's recent results show that, even when taking into consideration Brazil's larger population and the larger number of small businesses the South American country has, the Brazilian agency is outperforming the South African organisation on every front. Importantly the comparison shows the dramatic effects that an underfunded and under-skilled organisation can have on its ability to assist business owners.

Sebrae's management report for the 2009 year reveals that the 39-year-old Brazilian agency attended to at least 2.4 million individuals in 2009 – 2.02 million (up from 1.5 million the year before) through its call centre and a further 390 000 through the help of face-to-face assistance. In comparison, Seda in the 2009/10 financial year reached just 168 547 existing and potential entrepreneurs through its branches, events and training courses, down from the 199 830 individuals the previous financial year.<sup>126</sup> Most troubling was that Seda's call centre handled a mere 1 101 calls during the same financial year (Table 7).

**Table 7. Sebrae vs Seda, basic indicators of performance (2009)**

	<b>Seda (2009/10)</b>	<b>Sebrae (2009)</b>
Established	2004	1972
Budget	R485 million	R10.4 billion
Attended to through branches	168 547	390 000
Assisted with products, services	23 874	<i>NA</i>
Attended to over call centre	1 101	2.02 million
Hits on website	450 653	9.1 million
Workshops	81	52,121
Events	9	3 219

Seda's annual report also revealed that 23 874 clients received interventions from the agency, up from 14 373 in the 2008/09 financial year. In the last financial year Seda also held nine entrepreneurship awareness events and 81 workshops – 52 on franchise awareness and 29 on quality management – and trained 22 946 individuals – 18 271 clients in a business start-up course and 4 675 people in other courses. But, these figures are miniscule when compared to the number of entrepreneurs Sebrae supported in 2009.

Key to the Brazilian agency's approach is its use of multiple channels and ways to get to entrepreneurs – everything from television, radio, blogs and events and seminars. When these are factored in, the agency's reach extends to millions of Brazilians. In 2009:

- o Sebrae held 52 121 workshops and seminars, 31 969 group classes, 1 200 events and 2 019 festivals where 20 400 small business exhibitors were hosted.
- o The agency held 257 065 consultations.
- o It reached 282 300 participants in distance learning courses (up from 273 000 the year before).
- o A total of 131 000 (up from 92 000 the year before) university students from 2 339 institutions of learning took part in the agency's competition, Desafio Sebrae.
- o A further 17 million tuned into Sebrae's radio programme, while Sebrae's website raked up 9.1 million hits (up from 6.2 million the year before) – with about 30 000 videos shown every month through the agency's web TV and Sebrae's blogs recording a further 2.3 million hits. In comparison, Seda registered 450 653 hits on its website during the 2009/10 financial year<sup>127</sup>.

Sebrae also has a major focus on business knowledge. For example Sebrae's Federal District office offers 20 free seminars a month. These run for about 1.5 hours and are each attended by on average 20

<sup>126</sup> "Seda figures tell their own story", Bignews, October 2010.

<sup>127</sup> "Seda figures tell their own story", Bignews, October 2010.

people, according to Ary Ferreira Júnior the superintendent for Sebrae District Federal.<sup>128</sup> The office is also equipped with a library containing 6 892 book titles and 1 167 DVD and VHS titles on business support. Sebrae also has 356 titles of publications that are sold through the internet.

One of Sebrae's state offices in the Federal District handles 50 400 walk-in enquiries, according to Ferreira Júnior. This figure represents 45% of the number that Seda handles in total, even though the federal district's population<sup>129</sup> is just five percent of the whole of South Africa!

Yet despite the seemingly sizeable support offered by Sebrae, José Marcelo Goulart Miranda who oversees the Africa section in Sebrae's International Affairs unit said the Brazilian agency was not without its critics.<sup>130</sup> Some, he said have called for Sebrae to close down, claiming that the agency's reach – which Goulart pointed out was presently to about 14% of the country's small and micro firms – was not wide enough even though the agency's aim (according to a study it undertook - entitled "Factors of Birth and Death of Micro and Small Enterprises") is for at least 33% of businesses to access Sebrae by 2010.

Noting the criticisms around the performance of the Brazilian agency, if Seda is to reach more entrepreneurs something must be done to solve its funding constraints. The agency is hamstrung by a budget of R485 million – a mere five percent of the R\$2.5bn (valued at about R10.4 billion in October 2010) Sebrae had at its disposal in 2009.<sup>131</sup> However, even with more funding, Seda Chief Executive Hlonela Lupuwana said the number of businesses the agency attends to is unlikely to grow as the agency's main aim will be to focus more on assisting existing clients to grow rather than on taking on more new clients.<sup>132</sup>

### Similar client make-up

Both Sebrae and Seda have a similar client make up. In all 68% of entrepreneurs Seda assists run businesses with four or fewer employees, according to the agency's 2009/10 Annual Report (the annual report also revealed that a further 29% entrepreneurs supported by Seda have between five and 20 employees, with an additional 3% of clients employing between 21 and 50 people). About 85% of Sebrae's clients have four or fewer employees, according to the agency's former technical director Luiz Carlos Barbosa.<sup>133</sup> This information is reported below, in Table 8.

**Table 8. Sebrae vs Seda – Client Make Up (2009)**

	Seda	Sebrae
Clients with less than five employees	68%	85%
Women	50%	40%

Sources: Seda 2010 Annual report, "Factors of birth and death of small and micro enterprises", Sebrae, 2007 and Luiz Carlos Barbosa emailed response, 2009.

Absent from Seda's support profile are medium firms, despite the agency's often-made assertion that it focuses 20% of its support on these particular enterprises. Seda's focus on micro enterprises has been criticised by small business researchers SBP, who last year questioned the government's focus on these

<sup>128</sup> Interview with Ary Ferreira Júnior, Brasília, August 2010.

<sup>129</sup> The Federal District of Brasília has a population of 2.6m (2009) according to Brazil's statistics organisation IBGE.

<sup>130</sup> Interview with José Marcelo Goulart Miranda, Brasília, August 2010.

<sup>131</sup> Unlike Seda, which derives almost all its funding from the National Treasury, the Brazilian agency is funded by a tax drawn from companies and amounts to one percent of the amount each company spends on employee's benefits.

<sup>132</sup> Seda Annual Report 2009/10.

<sup>133</sup> Luiz Carlos Barbosa, emailed response 2009.

businesses above small businesses in the formal sector, saying there was little indication to suggest survivalist micro firms will create jobs.

A look at Sebrae's client profile<sup>134</sup> reveals that about 60% of entrepreneurs that it assists are male, who have an average age of 38 years old. These entrepreneurs are likely to be very skilled – with 79% having completed tertiary studies and 51% having previous experience in a private enterprise. There are no comparable figures from Seda in its annual report on the skills level of those it assists.

Seda's major challenge is how to balance the support it offers to those who have never run a business before and have no idea what running your own business entails, with the support it offers to those that have the skills, drive and know-how to start their own business but require some additional support.

### Learnings from Sebrae

There is much Seda can learn from Sebrae and the learnings can be simplified into the following areas:

- Use innovative methods to widen reach.
- Reduce influence from government.
- Build awareness of the agency's brand.
- Lean more on private-sector consultants' expertise.
- Assist the right kind of client.
- Put in place an effective monitoring and evaluation system.

#### Lesson 1: Use innovative methods to widen agency's reach

Sebrae's strategy of aiming its support for business owners through a variety of channels – such as television, radio, print media, a competition, blogs – beyond just its call centre, website and branch network ensures that the agency is able to reach a vast number of business owners.

Two Brazilian interventions that Seda is already looking to adopt in South Africa are: distance learning courses and mass classroom-based mentoring sessions (see Box 4 below).<sup>135</sup>

In 2009 Sebrae assisted 282 300 participants through 1 500 distance learning classes<sup>136</sup> and with this in mind the head of Seda's learning academy, John Francis, said Sebrae's distance learning university is looking to partner with Seda to develop programmes and pointed out that distance learning is an affordable way to impart business knowledge.<sup>137</sup>

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<sup>134</sup> "Factors of birth and death of small and micro enterprises", Sebrae, 2007

<sup>135</sup> Seda spokesperson Marius de Villiers said in September 2010 that the agency was currently looking at aspects of its in-house courses which lend themselves to distance education modules and added that it was being supported by Brazil's small business support agency Sebrae with technical assistance to roll out group mentoring classes nationally in the "near future".

<sup>136</sup> In all 97.2% of participants in these courses were satisfied or very satisfied with the courses, according to Sebrae's management report for the 2009 year.

<sup>137</sup> Interview with John Francis, July 2010.



**Box 4: Applying Sebrae-style training in South Africa**

Paul Hoffman, acting head of Seda's George branch, organised a group seminar in Mossel Bay in June 2010 for 300 unemployed people, after returning from a visit to Brazil in April that year where he witnessed a business skills training session organised by Sebrae for 400 people.<sup>138</sup> Such group sessions, which are now being introduced in South Africa, make up an important component of Sebrae's efforts to reach more entrepreneurs and potential entrepreneurs; of the entrepreneurs Sebrae assists only about a third are assisted through one-on-one visits or consulting sessions, the remainder obtain assistance through business networks, in incubators, producer chains and through other collective means.

Hoffman, who said he was impressed by the excitement he witnessed during the group seminar he attended in Natal, Brazil, explained that sessions would start at 6pm and run until 9pm or 10pm and touch on management, sales techniques, marketing and research. The city's mayor even turned up every night to show his support. Each session would start with a presenter briefing all 400 participants on one of the specific topics, before the participants broke away into smaller groups of 50 people spread around the hall. At the end of each session participants were requested to complete various assignments for the next day. They also had to brief one another about their products.

On returning from the eye-opening trip, Hoffman secured the involvement of the Mossel Bay municipality, the Western Cape provincial government's support agency Red Door and Prestigious Training and Manufacturing Services to hold the five-day seminar. Hoffman used the same techniques he drew from the Brazilian, but said the difficulty he experienced was that many of the participants dropped out, with only 100 graduating from the course in the end. However, "one of two" of those who attended had since started their own business and Seda advisors were assisting others who had formed groups to set up co-operatives in certain identified areas. Hoffman reported that Seda George would host another group session in the near future.

Since 2001, Sebrae has made significant progress in assisting consortia in various industry sectors, with some of these consortia made up of both big and small businesses. The agency is presently assisting around 3 000 such groups across Brazil through support interventions which run for on average between two to three years. At the heart of each intervention is a web-based collaborative management toolkit, which allows businesses and consultants to monitor the progress of each project.<sup>139</sup> Barboza, Sebrae's former technical director, admitted that the agency's assistance to individual businesses on a one-to-one basis had not proved as successful as its support to groups of entrepreneurs, particularly in the number of businesses that were assisted.

But Mojalefa Mohoto, the chief director of the enterprise development unit, at South Africa's Department of Trade and Industry, said that though his department was aware of India and Brazil's success with buying consortia, the government currently did not have the capacity to set up consortia.<sup>140</sup> He said setting up consortia of this type would prove to be something that would be "very difficult to manage". Mohoto said however that the government's programme on co-operatives did already cover some buying groups.<sup>141</sup>

Another interesting programme, which Sebrae started in 2009, is that of developing and using local innovation agents (Agentes Locais de Inovação – ALIs). The idea is that these agents make door-to-door visits (some of the businesses are sourced from business associations) of businesses to assess what support and capacitation programmes the firm needs to improve. The agents develop a plan of action for the entrepreneur concerned. The entrepreneur then chooses which support to implement. Some of the support tools are sourced from Sebrae and the agents can also refer consultants to the businesses.

<sup>138</sup> Interviews with Paul Hoffman, July, September 2010.

<sup>139</sup> Email, Luiz Carlos Barboza, former Sebrae technical director, 2009

<sup>140</sup> Telephonic interview with Mojalefa Mohoto, 2009.

<sup>141</sup> "Consortia: A solution for SA?", Bignews: October 2009



Sebrae aims to assist 13 500 enterprises through these agents in 2010 and 2011.<sup>142</sup> In 2009 the agency trained 388 consultants in eight states and 6 936 enterprises were reached, at cost of R\$1.2 million to Sebrae.<sup>143</sup>

### Lesson 2: Reduce government influence

José Marcelo Goulart Miranda, who oversees the Africa section in Sebrae's International Affairs unit, said one lesson Brazil had learnt was that it was not always good to run a wholly government-owned business support organisation as this made business support more open to political manipulation. Sebrae was set up as Centro Brasileiro de Assistência Gerencial à Pequena Empresa (Cebrae) in 1972 as a government agency, through an initiative of Brazilian development bank BNDES (then called BNDE) and the planning ministry. But under presidents José Sarney and Fernando Collor, from 1985-1990 during a period when it moved from the planning ministry to the Ministry of Industry and Commerce, Cebrae began falling to pieces and as its budget became more unstable many technical consultants left the institution. In 1990 alone, 110 professional or 40% of the staff left the agency. In 1990 Cebrae became Sebrae under decree 99.570. The institution became a private not-profit organisation, funded by a special tax. Since then Sebrae has been growing, increasing its branch structure to all states and supporting thousands of SMEs.<sup>144</sup>

### Lesson 3: Build Awareness of the brand

One of the biggest problems that face government support organisations in South Africa, is their lack of visibility, a problem which India also shares. For example in a 2007 report by Centre of Entrepreneurship at UCT's Graduate School of Business revealed that in Gauteng just 13.5% of entrepreneurs had heard of Seda and that just 1.3% had accessed the agency. In the Western Cape the figures were even lower, with an awareness of 10% of Seda and just 0.5% having accessed the agency there. In the recent FinScope 2010 South Africa Small Business Survey only four percent of business owners reported that they had heard of Seda, while just one percent of business owners said they had accessed Seda branches.

Seda has began focusing more on expanding its reach in the media through, and in the 2008/09 annual report, chief executive Hlonela Lupuwana noted that fewer calls were received by the national information centre, and that the queries the call centre handled were based on media coverage received. However there is a need for Seda to increase its presence through a variety of means – this could be easily possible with a larger budget. Sebrae for example makes use of well-placed billboards on roads and at train stations, appears regularly in a number of business magazines and on radio and television adverts. The wide reach of advertising also has the result of increasing the image and brand of the organisation.

An interesting and innovative development in South Africa is around the role of Seda information kiosks which were launched in November 2010. The kiosks are self-service, electronic information units which have preloaded business information for entrepreneurs and interested members of the public that can be downloaded to CD, DVD and USB flash drive. Because the units carry Seda branding and are installed in

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<sup>142</sup> Edson de Barros Carvalho, Nectar's director president, said his organisation as well as an engineer and a manager are overseeing various agents in the states of Bahia, of Pernambuco and of Maranhão. Each agent is required to attend to 50 entrepreneurs within two years and is remunerated R\$2 000 a month by Sebrae, who also gives agents a laptop and 3G card to carry out their work. After the completion of the first year 20 businesses were assisted in Pernambuco, 23 in Bahia and 15 in Maranhão.

<sup>143</sup> Sebrae management report, 2009.

<sup>144</sup> Sebrae website: <http://www.sebrae.com.br/customizado/sebrae/institucional/quem-somos/historico>

various partner agencies, municipal offices and libraries they can help to get the Seda brand out more effectively while doubling as an efficient business information supply service.<sup>145</sup>

#### Lesson 4: Train up private-sector consultants and use more of them

While Sebrae makes use of some 9 500 private sector consultants<sup>146</sup>, Seda has adopted a worrying approach of slowly cutting back on the number of consultants it uses, in favour of inhouse business advisors who have little or no business experience.

As of July 2010, Seda had 194 business advisors distributed across 42 branches<sup>147</sup>. Seda has vamped up its internal training capacity from about three or four staff which manned its old learning centre to 16 individuals. The aim is for the academy, together with outside trainers, to capacitate the agency's business advisors and to produce training programmes for entrepreneurs. A concern however is that the very people who should be dispensing business advice to business owners will have no or next to no business experience. This will limit Seda from offering more sophisticated and focused support as well as support which is sector-specific, as no amount of training can substitute for real experience a consultant has gained in running his or her own business.

There is an obvious need to improve the quality of consultants in South Africa and the way they interact with business owners. An assessment in 2008 of over 500 mentors from various organisations<sup>148</sup> revealed that more than two thirds of mentors failed to score higher than 60% on basic financial literacy tests. Shockingly the assessment revealed that 90% of mentors were computer-illiterate.

Following community interactions by the then deputy minister of trade and industry, Bongsi Ntuli in 2009, the Minister of Trade and Industry, Rob Davies reported that Ntuli's interactions has revealed that business owners believed consultants were "too heavily involved" with business development and their involvement was "not beneficial in the way it should be". Since Ntuli's interactions Seda had scaled back on using consultants, limiting the use of consultants to 20% of all its services accessed by business owners.

There have long been attempts to professionalise the business consulting sector, but little has changed. There are now moves by the recently revived Institute of Business Advisors (IBA), to set up a statutory body for business mentors.<sup>149</sup>

Even the head of Seda's training academy admitted that trying to assist 80% of businesses with inhouse business advisors was "unsustainable" but he added that it was very difficult for the agency to afford the high costs that consultants charged for rendering services to small businesses. He said one had to look to retired business executives if one wanted an affordable option.

In contrast Sebrae has a major focus on training internal staff and consultants through its Sebrae University which offers a range of training programmes to those that assist business owners based both inside and outside of the organisation. Sebrae also holds a national training week for all consultants and internal staff twice a year. It also has several distance-learning courses for advisors and consultants.<sup>150</sup>

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<sup>145</sup> The units utilise a computer-based system and the information is updated from a central point as and when needed by means of 3G technology. Users interact with the system via a touch screen. Once users have accessed the system, they can search for information about Seda, such as its offerings, products and services and training programmes available to entrepreneurs and small business owners. In all 38 of these kiosks were rolled out by November 2010, with two more to be installed by the end of that month (Seda press release, 12 November 2010).

<sup>146</sup> O Sebrae para Conselheiros, [www.sebrae.com.br](http://www.sebrae.com.br)

<sup>147</sup> John Francis, Seda learning academy, interview, July 2010

<sup>148</sup> Such as South African Breweries (SAB), Business Partners, Khula and the Small Enterprise Development Agency (Seda). The assessment was carried out by the University of the North West's Small Business Advisory Bureau.

<sup>149</sup> "Rogue consultant concerns", Bignews, February 2010

<sup>150</sup> Interview with John Francis, July 2010.

Seda should rather get involved in initiatives that upskill private sector business consultants – such as the IBA's grading system or by hosting training programmes for consultants, which also incentivise them to work in a more ethical way.

#### Lesson 5: Target more sophisticated clients

Seda has been criticised for aiming most of its support at micro enterprises, as seen by the above. Seda's open door approach has meant that 40% of the nearly 200 000 people who visited the agency's branches in the 2008/2009 financial year never went further to even attempt to establish their own business.<sup>151</sup>

Sebrae faces similar criticism. Luiz Sakuda, professor of entrepreneurship and innovation at FEI university, São Paulo said Sebrae's open-door policy which meant it had to help any one who approached it, led to the agency helping many who weren't entrepreneurs, but rather students or unemployed people. Sakuda believes Sebrae should aim more of its support at entrepreneurs with existing businesses, but added: "It (Sebrae) could be a lot better, but it is what is possible these days".<sup>152</sup>

Sebrae's Miranda admitted that a key challenge that support organisations face was whether to target the masses of informal or small enterprises or more sophisticated businesses. The latter, while fewer in number, offer higher job creation potential.

The dilemma that Seda, Sebrae as well as governments the world over face is whether to support more high-growth businesses which are traditionally run by more skilled and wealthy entrepreneurs, but which create many more jobs. Or to support micro enterprises which offer those without a job, the possibility of income, but which will either fail soon after starting out, or will amble along without creating more than one or two jobs.

#### Lesson 6: Monitor clients

If Seda is to implement quality training and consulting work to small businesses, it must also focus on setting up systems which will assist the agency not only in project management, but will also act as valuable tools to assess the impact of interventions. Such a system could also enable government organisations to incentivise consultants and internal staff to deepen the impact of their support to entrepreneurs, in that it will allow organisations to tie incentives to those whose interventions which perform well.

The 2009 Gem report suggests that remuneration in government programmes should be based on actual performance, for example not the actual number of business plans that have been completed or funded, but by the number of plans that translate into a business that is able to operate for more than three months, it says.<sup>153</sup>

Seda has already developed a new customer relationship management system. The system will improve the quality of client data stored. An Improvement Assessment Tool was also developed.<sup>154</sup>

Sebrae's Miranda says much of Sebrae's success in carrying out projects lies with their innovative project management system called Sigeor.<sup>155</sup> Miranda was part of the team that originally developed and rolled out the system across the country to all Sebrae offices. By going to [www.sigeor.sebrae.com.br](http://www.sigeor.sebrae.com.br) any member of the public, consultant or business owner is able to view the details of any Sebrae-related business support project or track the progress of each project. The site also allows for members of each project to post news, meeting agenda and training material.

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<sup>151</sup> "Noble purpose a key to success", Business Day, 24 November 2009

<sup>152</sup> Interview with Luiz Sakuda, São Paulo, August 2010.

<sup>153</sup> "Report shows start-ups need support", Bignews, June 2010

<sup>154</sup> Seda's 2009/10 Annual Report

<sup>155</sup> Interview with José Marcelo Goulart Miranda, Brasília, August 2010.

Miranda said that between 2004 and 2007 Sebrae spent about R\$10 million on developing and testing the system. Apart from some technical glitches Sebrae faced when developing the site, the agency also ran up against resistance from some at the organisation towards the site. Some having to upload details to the site would waste time. External partners often argued that since they did not work for Sebrae why should they upload details to the agency's site? Miranda said it was only through numerous workshops – he himself held 30 or 40 workshops in two years in just four states – that partners were finally won over to using the system.

## INCUBATORS

Business incubation is often touted by many as the solution to creating more sustainable high-growth companies in South Africa, but is it really?

### South Africa: A luck-lustre experience

- Most incubators are funded by the government and there are just two privately funded incubators at present.
- A small number of businesses are incubated, but incubatees are less likely to fail than those have not passed through incubation.
- Lack of seed fund and skills and support from tertiary institutions to help incubate businesses.
- The adoption of incubators is constrained by the high skills needed by staff to run incubators.

Incubators in South Africa are largely government funded – either at a national or provincial level, with at least two privately-funded incubators. The challenge that faces the South African government now is whether or not to bolster efforts in setting up more incubators or not and if so, how to go about doing so, particularly as incubation is resource-intensive requiring support from highly-skilled mentors to assist a few, usually low-skilled incubatees.<sup>156</sup>

The South African government is also faced with a number of questions when considering the role incubation can play in developing small businesses. These are:

- Will increasing the number of incubators necessarily lead to a higher creation of enterprises?
- Will it lead to a better quality of businesses that are able to contribute significantly to economic growth?
- Is incubation a solution to creating more jobs?

The South African government's main incubation programme falls under the Small Enterprise Development Agency's (Seda) technology programme, though there are also a few examples of incubators run by provincial government.<sup>157</sup> Seda's incubation programme sprung out of the Godisa Trust in 2000 and was incorporated into the agency as the Seda Technology Programme in 2006. In 2010 Seda had 29 incubators (up from 23 in 2007<sup>158</sup>), representing various sectors from steel in Mpumalanga to seven furniture manufacturing incubators and a sugar-cane incubator in KwaZulu-Natal. Seda's incubators have so far helped to create 900 enterprises, sustain 6 000 jobs and support a further 1 500 enterprises, since the programme was set up in 2006.<sup>159</sup>

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<sup>156</sup> "The Entrepreneurial Dialogues: State of Entrepreneurship in South Africa", Endeavor SA, 2010

<sup>157</sup> There are also examples of incubators funded by provincial government initiatives, such as: The Maxum Business Incubator based at the Innovation Hub in Tshwane; Sedichem, funded by the the Gauteng government and the Bandwidth Barn: A Cape Town-based incubator and subsidiary of the Cape IT Initiative aimed at ICT start-ups (Bignews, February 2009).

<sup>158</sup> Presentation of 2006/2007 Annual Report by Wawa Damane, 10 October 2007.

<sup>159</sup> Charles Wyeth in "Global Practice in Incubation Policy Development and Implementation South Africa Case Study", InfoDev, 2010

In the 2010 financial year Seda's 29<sup>160</sup> incubators supported 243 new SMMEs and 675 existing small and micro enterprises were supported – 90% of which were black-owned —while creating or helping to sustain 6 778 jobs. This is an average of 10 jobs per enterprise.<sup>161</sup> The 200 companies incubated by Seda in 2008 generated a total turnover in excess of R129 million. This translates to an average annual turnover of R645 000 per incubatee.<sup>162</sup>

Seda believes that generally small businesses or start-ups fail at a rate of about nine in 10 in the first two years of operation. Within its incubators, the survival rates are in the region of 84% to 97% in the first two years of operation depending on which incubator the business is enrolled in. After graduating from a Seda incubator the survival rate hovers at just over 70%.

Seda's incubators however still only reach a small number of entrepreneurs. On top of this the "incubation" domain is limited by a lack of skills and real support from tertiary education institutions.<sup>163</sup> Incubators also face funding constraints and none have in-house seed funds.<sup>164</sup> According to Endeavor SA a more rigorous selection process needs to be put in place by incubators if they are to select the right kind of business to incubate.<sup>165</sup>

The country's two privately-run incubators are Raizcorp and Shanduka Black Umbrellas, funded by former unionist Cyril Ramaphosa's Shanduka Trust. Raizcorp has two incubators in Johannesburg and recently opened a third one in Richards Bay. Presently Raizcorp has 200 incubatees, both based at the centres and outside, receiving support. Raizcorp takes an equity share of 33% in each of the businesses it helps incubate and businesses also have to pay certain monthly fees, as well as a rental fee of R1 100.<sup>166</sup> Shanduka Black Umbrellas, a non-profit company which aims to support black entrepreneurs, is based in Cape Town and Johannesburg and presently has 51 member companies. For a monthly fee of R500 or R1 000, the programme provides member small businesses with a working environment and the support services to enable them to thrive. Benefits include office space, computers, internet and telephones, vehicles with drivers, a good reliable book-keeper service, a structured mentorship programme with a business consultant or mentor.

### Brazil: An incubator revolution

- The number of incubators has almost tripled in last 10 years.
- Funding from government for research as well as support from universities is in place.
- But much of funding for incubators is reliant on government, but a private-sector venture-capital model is being sought.
- Not a solution for job creation as only a few businesses have been incubated.
- However incubators are being used to boost underperforming regions and target the creation of high-growth businesses.

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<sup>160</sup> Jayesh Ravjee, the executive manager of the Small Enterprise Development Agency's (Seda) technology programme said funding from the Department of Trade and Industry allowed Seda to set up an average of three new incubators a year.

<sup>161</sup> Annual Report 2009/10, Department of Trade and Industry

<sup>162</sup> "The Entrepreneurial Dialogues: State of Entrepreneurship in South Africa", Endeavor SA, 2010

<sup>163</sup> Charles Wyeth quoted in "Global Practice in Incubation Policy Development and Implementation South Africa Case Study", InfoDev, 2010, p29.

<sup>164</sup> Leon Lourens, chief executive of Softstart BTI in "Global Practice in Incubation Policy Development and Implementation South Africa Case Study", InfoDev, 2010, p29

<sup>165</sup> "The Entrepreneurial Dialogues: State of Entrepreneurship in South Africa", Endeavor SA, 2010

<sup>166</sup> "Joining an incubator eases worries and frees up business owners", Bignews, July 2007  
<http://www.businessowner.co.za/Article.aspx?Page=23&type=29&Item=3332>

Incubation might be regarded as an expensive way to assist businesses, but in Brazil with the number of incubators having tripled in the last 10 years, incubated businesses contribute about US\$250 million annually in taxes in Brazil, multiples more than the US\$280 million in public funds spent building incubators and mentoring incubatees in the last 20 years, according to Ari Plonski, president of Brazil's Anprotec, a non-profit organisation started in 1987 and which represents incubators in Brazil.

Today about 5 500 businesses are being incubated in Brazil – including 1 500 receiving virtual support. A further 2 000 companies have since graduated from incubators since the first batch set up in the late 1980s. On average each incubator in Brazil incubates about 10 businesses.<sup>167</sup>

Driven by media attention, co-operation between the government and the private sector and by Brazil's new Innovation Law, the number of incubators in Brazil has grown almost threefold in 10 years – from 135 incubators in 2000 to about 400 in 2010.<sup>168</sup> Brazil's new Innovation Law passed in 2005, allows researchers at federal universities to work for a period of time for a private company and then return to the same university if they desire to do so. Under the legislation, Finep, a government agency which falls under the Ministry of Science and Technology, provides federal grants to companies for specific research. The funding is provided for projects done in conjunction with a university or research institute.<sup>169</sup>

Finep's Programme First Innovative business (Prime) launched in 2009, provides grants of about R\$120 000 to start-ups focused on innovation. Successful applicants are selected by 17 incubators acting as agents. For the 2009 year the programme aimed to disburse grants of R\$216 million and reach about 1 800 enterprises, which are no more than two-years-old. In total 3 140 enterprises were supported through the grant at the end of its 2009 funding cycle.<sup>170</sup>

Finep also has a 0% interest rate funding programme to stimulate firm growth in early stages, which successful new enterprises can also request loans from – up to R\$120 000 in 100 instalments without being charged interest on the loan. Added to this, a venture-capital programme called Inovar, which disbursed its first funding tranche in 2000 with its second edition in 2008, is aimed at companies that are at least two-years old. Inovar's seed-capital programme also provides funding for early-stage growth. So far 50 SMEs have benefited (and two large companies). Most of the companies are in the IT sector.

Incubators emerged in Brazil at the end of the military regime in the mid 1980s in a grassroots movement that included individuals from several sectors of society, particularly from the university. After the military regime ended the focus of innovation shifted from a top-down, centrally-planned approach to a bottom-up grass roots approach, with the incubator playing a key role in facilitating new venture creation at a local or regional level. By 1986, Brazil's National Research Council (CNPq) had created five technology parks and two incubators, one in São Paulo with the state government and one with the Federal University of Santa Catarina.<sup>171</sup>

At the start of the incubator movement in Brazil, most incubatees were aged between 50 and 60 and close to retirement. Today the majority of entrepreneurs based at incubators are students. The key motivation driving local and state governments to fund incubators is the retention of local talent necessary to drive a regional economy. The case of Florianapolis provides a good example of this. Florianapolis is the capital city of the fairly well developed southern state of Santa Catarina where two incubators and a science park were developed to retain the city's talented IT graduates. The idea for

<sup>167</sup> Interview with Ari Plonski, São Paulo, August 2010.

<sup>168</sup> Plonski and "Approaches to Business Incubation: A Comparative Study of the United States, China and Brazil", Aruna Chandra, 2007

<sup>169</sup> "Approaches to Business Incubation: A Comparative Study of the United States", China and Brazil, Aruna Chandra, 2007

<sup>170</sup> Between 2009 and 2011, and through three rounds of finance, it hopes to reach about 5 000 entrepreneurs with R\$650m in grants, with a total of R\$1bn including additional capital and credit (See <http://www.finep.gov.br/programas/prime.asp>, <http://www.portal-inovacao.mct.gov.br/pi/prime/indicadores/>).

<sup>171</sup> Hooser 2003, from: "Approaches to Business Incubation: A Comparative Study of the United States, China and Brazil", Aruna Chandra, 2007.



Recife's IT cluster Porto Digital also came about in an attempt by the state to retain its IT graduates which are among some of the most sought-after in the country.<sup>172</sup>

### Can incubation create more jobs?

Anprotec's Plonski believes incubation is not a short-term solution to job creation but should rather be viewed as an effective way to retain local talent and maintain a region's economic balance. Research, he said, shows that the average mortality rate of companies that graduate from incubators stands at about 20%, compared to the general rate of 80% for those that have not been through incubation. An average of about 90% of graduate companies are still in operation five years after graduating from incubators.

According to a 2008 study by Sebrae São Paulo<sup>173</sup> 39% of those enterprises based in incubators in the state increased their productivity, while 46% increased their turnover and 24% increased their staff compliment. These rates are about double those of enterprises that don't pass through incubation, according to the study.<sup>174</sup>

Since 2008, Sebrae has set itself a target of doubling the number of businesses assisted by incubators in the less developed regions of the North, North-East and Central-West regions. Sebrae has already selected a number of incubators in these regions with the aim of doubling the turnover of each incubatee. The strategy will benefit 92 incubators encompassing about 600 businesses.<sup>175</sup>

Plonski however emphasised that it was difficult to draw too much from these figures. He said this is because any comparison between companies inside an incubator and those that are outside, is already skewed by the fact that only the very best companies make it into incubators in Brazil, as incubators rely on strong selection criteria. "So they have a natural tendency to survive," points out Plonski.

Anprotec is currently engaged in getting incubators to target more support at fast-growing companies with the aim of increasing the survival rate of graduate firms. Plonski estimated that the 2 000 companies that have graduated from incubators have created, and were sustaining, about 35 000 jobs. This translates to an average of over 17 employees per graduate enterprise. Some companies were turning \$30 million upon graduating, with the annual turnover of the largest, a commercial automation business created by students in the southern and relatively developed state of Paraná, reaching \$160 million, he said.

A key challenge that incubators in Brazil are now facing is access to venture capital for at least the first five years. Plonski said the problem was that many incubatees were not receiving financing beyond the second round, which made it difficult to commercialise products developed in incubators.

José Dornelas of Empreende, which offers training and consulting to business owners, says Brazil has a shortage of high-growth start-ups. These kinds of businesses require a different kind of support, which he believed should not only be handled by incubators alone. He pointed out that in Brazil incubation did not offer a very scalable model for business support because of the small number of firms incubators housed. What was necessary was to develop an ecosystem for innovative businesses. Such support should not be limited to universities alone as was largely the case in Brazil, he added.<sup>176</sup>

Luiz Sakuda, professor of entrepreneurship and innovation at FEI university, São Paulo points out that in Brazil, because many incubators are housed in universities, many try to turn researchers into entrepreneurs. He believes rather that universities would be more effective if they focused on setting up

<sup>172</sup> Interview with Ari Plonski, São Paulo, August 2010.

<sup>173</sup> Sebrae National office spent R\$12 million on businesses in incubators in 2008. Sebrae São Paulo invested R\$9.85m in assisting 72 incubators with 1 469 businesses in total (an average of R\$136 800 per incubator and R\$6 700 per incubatee). This is up from 43 incubators and R\$4.96 in 2003 (R\$115 200 per incubator and R\$9 400 per incubatee). Sebrae, 2008.

<sup>174</sup> Sebrae, 2008

<sup>175</sup> Locus, Oct/Nov/Dec 2009, No 58, Ano XV

<sup>176</sup> Interview with José Dornelas, São Paulo, August 2010.



innovation agencies, where the university tries to find companies interested in buying patents and then determine if researchers would be interested.<sup>177</sup>

Sakuda also believes that setting up clusters and incubators was not necessary the way to go for governments looking to support small businesses. The problem he says is that incubators and clusters are artificial creations. He questions what will happen when government one day withdraws its support for these types of interventions. Added to this incubators he points out, are expensive.<sup>178</sup>

### Innovative funding for incubators

Most of Brazil's incubators still depend on public money, which continues to put a strain on their future viability. In 2009, the Department of Science and Technology's Financing Agency for Projects and Studies, approved R\$14 million to assist with the formation of incubator networks. In total it was expected that 17 incubators would be supported through this funding. Of this R\$10.2 million was granted to 12 existing incubators which would help new incubators to set up. A further R\$3.5 million was granted to five projects in the social arena that incubators would tackle.<sup>179</sup>

As of 2006 Sebrae had invested around US\$50 million to stimulate the creation, development and consolidation of incubators. Initially, Sebrae has provided infrastructure funding for many incubators in the first round but is now focused more on providing start-up funding and training to new ventures.<sup>180</sup>

But there are now moves by some incubators to explore new funding models. In Recife in the state of Pernambuco, the Núcleo de Empreendimentos em Ciência, Tecnologia e Artes (Nectar) has been taking equity stakes in incubatees.<sup>181</sup> These stakes range between five to 10%, depending on the kind of business, said Edson de Barros Carvalho Filho, the director president of Nectar.<sup>182</sup>

Nectar, which has been in operation since 1991, has a close relationship with Recife's Federal University, but remains privately owned. The incubator offers both virtual support and consulting services to entrepreneurs based at its premises. The only public funding his incubator receives is a R\$50 000 annual grant from Sebrae.

De Barros Carvalho Filho believes that to rely on funding from state governments is not a viable model for incubators in Brazil. He said many incubators funded by state governments were closing down because they were often dependent on political support. A change in political leadership could easily see the end for some incubators.

Edson has taken 40% of Alexandre Maciel's<sup>183</sup> voice recognition business Vocal Lab. Maciel is completing a PhD through the Federal University Pernambuco and Edson is his supervisor. Maciel, was able to get a R\$120 000 grant from Finep, and has spent a year at Nectar already developing three products – a speech recognition, speaker recognition and product to produce an artificial voice.

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<sup>177</sup> The Federal University of Sao Paulo (UniFeSP), the University of Sao Paulo (USP) and the Campinas University (Universitaria Campinas) already have such agencies, says Sakuda.

<sup>178</sup> Interview with Luiz Sakuda, São Paulo, August 2010.

<sup>179</sup> <http://www.mct.gov.br/index.php/content/view/314005.html>

<sup>180</sup> "Approaches to Business Incubation: A Comparative Study of the United States, China and Brazil", Aruna Chandra, 2007

<sup>181</sup> Nectar is presently assisting five businesses housed at its premises, 12 outside its building through virtual and assistance and three in a new building in São Luis, Maranhão. Only nine firms have graduated from the incubator since it started, which Edson admits is a rather low number. A further 15 or more have been assisted through virtual support. With the purchase of neighbouring property Edson plans to house 10 more incubatees soon.

<sup>182</sup> Interview with Edson de Barros Carvalho Filho, Recife, August 2010.

<sup>183</sup> Interview with Alexandre Maciel, Recife, August 2010.

Nectar is also assisting Jordano Bruno to launch and expand his IT company. Bruno runs Agilware<sup>184</sup> a public relations database which helps companies to store news, press releases and videos. Edson has a 34% stake in his company and takes a 15% royalty on all the products Bruno sells in the state.<sup>185</sup>

In Rio de Janeiro, the Genesis Institute, set up by the Pontifical Catholic University (PUC) Rio University, has set up a fund to assist incubatees and also takes equity in incubatees, but has faced some problems in this regard. The incubator has incubated 129 companies since it launched in 1997 and is one of about 10 incubators based in the state of Rio de Janeiro. A total of 47 businesses have graduated from the incubator, with three more set to graduate at the end of this year.<sup>186</sup> The incubator currently assists 84 businesses – 20 based at the incubator and 64 based outside the incubator.<sup>187</sup>

Incubatees have access to Venture1 a R\$30 million venture capital fund set up in July 2010. Fund managers aim to make investments of between R\$1 million and R\$2.4 million in each firm. The fund's corpus consists of 40% of funds drawn from government, 40% from a single investor and the remainder from angel investors.

Entrepreneurs currently pay a subsidised fee and the incubator takes a 5% share in companies. However the equity percentage was often diluted when the business begins to expand, as the incubator's 5% is based on the turnover of the incubatee on leaving the incubator. The incubator is now working with lawyers to correct this problem. The incubator also negotiates with an incubatee to take some royalties from companies that developed intellectual property using university funds.

Marcio Nunes, a former lecturer at the PUC-Rio university whose company Bitix develops applications for smartphones said Genesis had the option to take five percent in his company, up to three years after he leaves the incubator.<sup>188</sup>

In Brazil entrepreneurs battle to commercialise intellectual property that is developed at universities. Entrepreneurialism is also stifled as big companies are buying up most of the new innovations developed by universities. It was because of this that the university decided to set up an incubator, using R\$500 000 of the university's funds and R\$200 000 in public money sourced from Electrobras and Faberj the state's research foundation and Citibank. Most of the incubatees are doctorate and masters students and 80% of incubatees have doctorates or masters.

### Management system can ensure quality

There is currently a drive in Brazil to professionalise incubator management and the processes practitioners use in incubators, through a system used by Anprotec called O Centro de Referência para

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<sup>184</sup> Bruno has been operating for four years and 20 companies have already bought his software, helping him double his turnover every year. He attributes most of the growth to the fact that by being based in the incubator he has next to no operating costs. He believes it would be very expensive if he had to run his business without the assistance of Nectar.

<sup>185</sup> Interview with Jordano Bruno, Recife, August 2010.

<sup>186</sup> According to Priscila Castro, the business incubation manager at the Instituto Genesis, interview, Rio de Janeiro, August 2010.

<sup>187</sup> The unit has three incubators, namely a technology incubator, social incubator to help develop technologies to support development (based in a favela in Rio) and a cultural incubator. It currently assists businesses involved in oil and gas, design, jewellery and architecture

<sup>188</sup> He said the incubator's innovative environment, where one could easily bounce ideas off one another, helped keep him inspired and motivated. He is set to almost treble the turnover of his IT company this year thanks to ongoing assistance from the cluster. In February Nunes released a software application he had developed for Iphones which allows clients of leading Brazilian fastfood chain Habib's to order food over their cellphone without making a call to the branches. Things are going so well that he is looking to expand from eight to 20 employees and move into a bigger room at the incubator's building. He is now working on allowing the same application to become available for Blackberry and phones and those cellphones with Google Android system. "I like to say they are almost like part of the team," he says. On top of this being associated to the Instituto Genesis also helps open doors for him. "If PUC accepts me then I must be good" (Interview with Marcio Nunes, Rio de Janeiro, August 2010).

Apoio a Novos Empreendimentos (Cerne). The system includes selection criteria for incubatees.<sup>189</sup> It also offers a certification system for incubatees.<sup>190</sup> Infodev has developed best practices for incubator managers and a model suited for Brazil is currently being developed. In 2007 work began on the project, which is based on the US's Small Business Development Centers (SBDC) and Europe's Business Innovation Centres (BIC). Anprotec decided to develop such a system after attending an international mission<sup>191</sup>.

### What can South Africa learn from Brazil?

- Clear policies, driven from the top, to support incubation are necessary.
- Innovative funding models making use of such things as the enterprise development element of the BEE codes of good conduct and tax incentives, are needed.
- Incubators must adopt systems and monitoring tools to measure their impact.
- Better filtering systems for applicants are also needed.
- Target high-growth firms which offer better chances of upscaling, creating jobs.

Brazil has been able to increase the number of its incubators almost threefold, in just 10 years in what could be called something of an incubation revolution. How did it do it and can South Africa learn anything from Brazil in setting up incubators that can help boost support to small businesses and create more jobs?

From the outset it needs to be emphasised that in Brazil the setting up of incubators is driven by clear government policies which enable incubatees to benefit from grant funding, while incubators are funded by the government.

The case of Brazil also suggests the need for more involvement in incubation in South Africa by universities and tertiary institutions, research arms of large companies and private business consultants.

There is also a need for incubators in South Africa to explore funding models. The example of private sector incubator Raizcorp's use of enterprise development spend, as under the Black Economic Empowerment (BEE) scorecard, is one case in point. Another is the need for incubators to take royalties or equity, with the assistance of perhaps venture-capital funds. A private sector incubation association could assist in drafting and implanting an effective management and evaluation system system for incubators.

In South Africa there is also a need for incubators to adopt effective systems, policies and procedures such as a guiding documents and a code of conduct. Incubator boards need to be comprised of the right people who have relevant experience and who can add value to the incubator. Funders' expectations should also be managed, so that they retain realistic expectations of the kinds of outputs that can be achieved by their respective incubator.<sup>192</sup>

The move by Anprotec to aim more of its incubator support at high-growth firm should also be something South Africa should take note of. Incubation is a highly resource intensive support demanding specific training. It would be wasted on the general mass of businesses, but high-growth firms which offer better chances to create high economic growth for South Africa and the opportunity to create higher numbers of jobs should be supported over ordinary run-of-the-mill-type small enterprises.

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<sup>189</sup> Cerne makes use of four levels to describe the maturity of an incubator, namely: undertaking, incubation, network of partnerships and improvements. The initial stage of undertaking for example includes sensitisation to entrepreneurship, a selection system, a system of qualification of incubatees and students, the number and role of consultants, basic management of the incubator, number of businesses that have graduated, number of incubatees and evaluation.

<sup>190</sup> Interview with Plonski.

<sup>191</sup> Locus, Oct/Nov/Dec 2009, No 58, Ano XV

<sup>192</sup> Charles Wyeth in "Global Practice in Incubation Policy Development and Implementation South Africa Case Study", InfoDev, 2010

Tertiary students should also be exposed to incubators in their communities, thereby making them aware that help is available should they decide to start a business. This could go some way to address the problem of the poor quality of entrepreneurial skills training at schools.<sup>193</sup>

Small business researchers SBP point out that though government-sponsored incubation programmes need to remain open to a wider range of aspirant small businesses, filtering criteria could and should be tightened, business plans should be evaluated more realistically, and incubator should significantly improve their capacity to provide practical support to small businesses. It points out that where programmes emphasise quantity over the quality of participants there are too many dropouts and resources are wasted.

Public-private partnerships in business incubation could also help to improve efficiency. Says SBP: "As far as possible the primary focus should be on supporting real entrepreneurs, who can grow their businesses and thereby create employment for others who are not temperamentally equipped for an entrepreneurial role. Private sector-driven models can provide more intensive support than government initiatives, working with businesses with real growth potential. In this context, government should play a much greater role as a facilitator, encouraging private sector companies to provide incubator services for a broader range of small businesses, through incentives such as tax breaks, or a voucher system enabling new businesses to access training and six months back-office services, for example." Black Economic Empowerment (BEE) requirements can also be used to encourage businesses to put money into enterprise development which can be scaled up through private sector investments.<sup>194</sup>

Incubators will not necessary create a high number of jobs, but they are useful in boosting certain types of small businesses, namely helping to nurture more sophisticated and high-growth firms. Used strategically, incubators can be useful in helping to develop certain underperforming regions by attracting and supporting high-quality entrepreneurs. And by teaming incubators up with tertiary universities South Africa can help create a better research and development (R&D) capacity in small, high-growth enterprises.

## CLUSTER SUPPORT

### Cluster Support in South Africa

Small businesses in outlying economic regions could soon benefit from added business and financial support through the Department of Trade and Industry's plans to set up economic clusters to assist the country's underperforming regions.

The department's efforts are slowly gathering steam since the approval of a draft regional industrial development strategy four years ago, which signals the department's return to cluster support after a more than 10-year hiatus. The draft strategy points out four different ways countries have carried out regional economic development, namely: through tax incentives, strategic projects, special privileges and export processing zones.

Added to this:

- The Department of Trade and Industry's Medium-term Strategic Framework 2010-2013 highlights a plan to roll out five clusters, special economic zones or science parks to support rural industrial development.
- The department's second Industry Policy Action Plan (IPAP), released in February 2010, highlights the support of clusters in a number of sectors (See Appendix 4).

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<sup>193</sup> "The Entrepreneurial Dialogues: State of Entrepreneurship in South Africa", 2010, Endeavor SA

<sup>194</sup> "Accelerating small business growth in South Africa: A roundtable discussion", SBP, 2009

- The department is also piloting a policy adapted from Japan, called “One municipality, One product”, which aimed to promote key products and services in municipalities for support with the aim of getting small towns and rural areas to generate more from exports.

Support for clusters from a national level will put South Africa in line with many other countries around the world including Finland and Italy as well as India and Brazil, that have reaped the benefits of clusters, which among other things allow businesses to learn from one another and buy raw materials and other inputs as well as market and sell to buyers in a more cost-effective way.<sup>195</sup>

Clusters are based on systemic relationships among firms in a common geographic area that share something in common – be it complementary products, production processes, core technologies, natural resource requirements, skill requirements, or distribution channels.<sup>196</sup>

The UN Industrial Development Organisation (Unido) defines clusters as “sectoral and geographical concentrations of enterprises that produce and sell a range of related or complementary products and, thus, face common challenges and opportunities”.<sup>197</sup> Clusters involve the participation of various actors, from upstream and downstream firms, to financial institutions, government institutions on a local, regional and national level and academic institutions.<sup>198</sup>

Alfred Tau, Chief Director of Regional Economic Development said the department hoped a policy on clusters would promote partnerships between the government, the private sector and academic institutions to support economic development. Clusters would benefit from support such as infrastructure development, staff training and interventions in quality and standards as well as productivity improvement, he said.

In the 2009/10 financial year the department completed a pilot project to identify unique opportunities for 10 underperforming regions. Tau said the cluster opportunities identified by the department were:

- A mining supply and linkages cluster in the Rustenburg area,
- The manufacturing of ceramics and small scale clay brick manufacturing around Kuruman in the Northern Cape (Kgalagadi triangle),
- A renewable energy manufacturing and assembly hub in East London,
- A multi-manufacturing facility in Coega to support the automotives sector,
- Poultry farming in King Williamstown and surrounding areas,
- Mohair expansion around Uitenhage, forestry in a corridor stretching from Mpumalanga to Eastern Cape,
- Agro-processing in the north of KwaZulu-Natal (the Umkhanyakude region),
- A farmer-to-pharma cluster in the south of KwaZulu-Natal.

Tau, who added that not all the country's regions had been covered by the pilot mapping phase, said the process revealed mixed results: “In some areas, the long-term potential of those regions were established while in others the opportunities were really not long-term opportunities upon which to anchor regional industrial clusters,” he said.

Presently, Tau said the department, together with the Department of Economic Development and with the support of Unido, was still studying various policy options on clusters. Tau said Special Economic Zones (SEZs) and initiatives such as Productivity SA's Workplace Challenge Programme would be some of the tools used to support industrial agglomerations through clustering.

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<sup>195</sup> “The Development of Clusters and Networks of SMEs”, Unido, 2001, p7.

<sup>196</sup> Rosenfeld, Stuart A, 2002. “Creating Smart Systems: A guide to cluster strategies in less favoured regions, European Union-Regional Innovation Strategies”, Regional Technology Strategies Carrboro, North Carolina: p7-9.

<sup>197</sup> *Ibid.*, p8.

<sup>198</sup> Sölvell, Orjan: *Clusters: Balancing Evolutionary and Constructive Forces*, Ivory Tower Publishers, Karlavägen 70, Stockholm, [www.cluster-research.org](http://www.cluster-research.org): p17

### Workplace Challenge Programme

Presently the government's sole cluster programme is the Workplace Challenge Programme, which falls under Productivity SA. The programme, initiated in 1995 in an attempt to help meet the challenge of South Africa's re-entry into the global market, took many of its learnings from Japan and Finland. The programme aims to increase the productivity of businesses big and small, by getting them to work together in clusters and share learnings.

In the 2009/10 financial year 19 clusters were running, benefiting 187 enterprises.<sup>199</sup> Some enterprises acknowledged that they may have had to liquidate if it had not for the programme. Those businesses that join the programme become part of a cluster or user group located in a particular area, where they are then mentored by consultants for a three-year period. Because they rely on technical service provided by internal Productivity SA resources, user-groups offer member companies more affordable interventions.

According to Justice Tshifularo, the programme's Director, member companies with fewer than 50 employees, pay annual fees of between R5 000 and R30 000 a year, depending on the type of membership selected, with higher fees allowing for more intensive training, coaching, support and assistance by consultants. Businesses that participate in the programme record on average: 49% fewer rejects, 25% fewer instances of late delivery, while 69% of companies record cost reduction and 14% an improvement in attendance.

The programme has helped Melita Mapane, who runs Polokwane Chemical Supplies, cut her overheads by 60% by allowing the business to be restructured. Since joining the three-year programme in May 2009 consultants have helped her cut costs such as salaries, fuel and maintenance of her trucks, by assisting her to retrench six sales representatives and replacing them with a network of agents.

The number of small businesses that benefited in 2009 from the Workplace Challenge programme, which is run by Productivity SA, has almost doubled since 2004, when 57 businesses with fewer than 200 employees were assisted. Productivity SA is now targeting more rural areas for involvement in the programme and as of October 2009:

- o A memorandum with Limpopo province's Department for Economic Development had far resulted in a formation of a cluster with five businesses.
- o In North West 15 businesses have been through the programme.
- o In Mpumalanga, Productivity SA is in the process of signing a memorandum of understanding with the Department of Economic Development in order to launch a programme there.
- o Productivity SA was also looking at expanding the programme to businesses in the services and agriculture sectors and to this end it was carrying out a pilot project with black sugarcane farmers in KwaZulu-Natal.<sup>200</sup>

### Cluster approach in IPAP

The Department of Trade and Industry's Industrial Policy Action Plan (IPAP), identifies key sectors for government support. In the plan the department also identifies cluster-type programmes under these sectors which it intends to support. These programmes are reported in Appendix 4.

### Clusters in India

Clusters began emerging in India shortly after independence in 1947 when the country began to aggressively set up state parastatals on industrial parks. Small industries soon began to spring up around such points, in cities such as Pune, Chandigarh, Hyderabad and Bangalore and Mumbai.<sup>201</sup> Today clusters receive considerable financial and technical support from the Government of India through its Micro and

<sup>199</sup> Productivity SA 2010 annual report.

<sup>200</sup> "Efficiency can cut you costs", Bignews December 2009.

<sup>201</sup> Interview with Anil Bhardwaj, New Delhi, March 2010.



Small Enterprises (MSE) Cluster Development Programme which offers grants for various interventions to support clusters.

#### The Micro and Small Enterprises (MSE) Cluster Development Programme

Under the MSE programme, the government subsidises 70% of the costs of up to 150 million rupees for setting up a common facility centre to carry out joint marketing or procurement or product testing activities. The government also covers 75% or up to Rs2.5 million for business training and workshops, as well as 60% of the cost for infrastructure development up to Rs100 million.

The scheme was set up with the help of Unido in 2003 with a programme springing from the then Ministry of Small Scale Industries' technology up-gradation and management programme called Uptech, which was launched in 1998.<sup>202</sup> In August 2003, the scheme was renamed the Small Industry Cluster Development Programme (SICDP) and in 2006 the scheme's guidelines were revised with increased grant amounts to make the cluster programme more broad based. An amount of Rs3.03 billion has been allocated for the 11th Five Year Plan (2007-2012) to boost the sustainability, productivity and competitiveness of MSEs. The measurable outcomes are in the form of the number of enterprises for developmental interventions, increased turnover and employment and enhanced exports.<sup>203</sup> Up to the end of January 2010, 457 clusters across India had accessed the scheme.<sup>204</sup>

Through the scheme government officials and a local association are tasked to work together to first gain the trust of firms in the cluster. The aim is to achieve an initial level of trust through joint participation of businesses in fairs, joint purchase of raw materials and the design of a collective catalogue. The idea is that in time the enterprises that are members of the cluster would be able to then carry on with the programme without the need of outside help.

For example three clusters near Delhi that the government is supporting through its MSME Institute (Delhi)<sup>205</sup> each consist of an average of 50 businesses. Those clusters near Delhi include: the automotive components (Faridabad), garments (Noida) and printing and packaging (Nariana). In these clusters each small enterprise employs about 10 people and has an average turnover of Rs50 million. Each business usually remains in a cluster for three years. Many entrepreneurs struggle in the beginning to work together. They kept their business confidential and feared sharing information with others, before eventually seeing the benefits of and joining the various interventions provided by the institute.<sup>206</sup>

#### Achievements: Limited impact despite some success

The Indian cluster programme has had some clear success. Faridabad's light engineering cluster is a success story according to one business association head.<sup>207</sup> Given that the cluster received very little government intervention the business association head attributed its success to the Manufacturers Association of Faridabad, which he said was "very active" in leading the cluster. The association had 18 000 members and owned stores where they bought raw materials and goods such as stationary and office materials which were then sold on to members at reduced rates.

Another example is that of 20 textile cluster programmes run between 2002 and 2005 where businesses received training in exporting and marketing during the two-year programme. The training involved 20 members of each cluster who had never exported before to visit 20 countries. In mid-2010 the clusters

<sup>202</sup> Press Information Bureau, Government of India, <http://www.pib.nic.in/release/release.asp?relid=57403&kwd>

<sup>203</sup> Press Information Bureau, Government of India, <http://www.pib.nic.in/release/release.asp?relid=57403&kwd>

<sup>204</sup> MSME ministry Annual Report 2009/2010

<sup>205</sup> According to Suresh Yadavendra, the director of the institute, the institute is staffed by electrical, mechanical and chemical engineers, as well as hoisery and glass and ceramics, electronics experts.

<sup>206</sup> Interview with Suresh Yadavendra, New Delhi, March 2010.

<sup>207</sup> Bikky Khosla, deputy secretary of the Associated Chambers of Commerce and Industry India (Assocham): interview, New Delhi, March 2010.



were still growing and had orders for between three to six months already. About 200 of the 500 of the businesses in the cluster benefited from the programme<sup>208</sup>, and were on average able to double their turnover between 2005 and 2006. In the first year export sales totalled US\$26 million.<sup>209</sup>

Despite some successes, the following points summarise the cluster situation in India:

- Businesses in clusters are not yet sustainable after interventions.
- Clusters that produce goods, contain independent and old businesses and are spread out over small geographic area are more successful than other types of clusters.
- Clusters driven by strong industry associations are more successful than others.
- There is a need for an independent organisation to identify and assist clusters.
- Trust building is still a challenge.
- There is a need to monitor long-term, not short-term, impact of cluster programmes and have in place follow-up support.

Yet, after seven years, cluster-support programmes in India have made little impact on improving the productivity of small businesses and questions have been raised on the long-term impact of firms that participate in clusters funded by the government's grant scheme and whether the scheme has been able to help small firms become self-sustaining.

Many firms have yet to gain the requisite trust needed to benefit from clusters and the government is yet to put in place an effective mechanism to monitor clusters. Even Arun Maira, a member of the Indian government's National Planning Commission who is tasked with economic issues, admitted that some clusters "are running very well, some not at all".<sup>210</sup>

An assessment of the scheme in 2009 by the Indian Institute of Public Administration<sup>211</sup> which focused on 26 clusters, revealed that the scheme's ultimate aim, that of assisting clusters to reach a point where they were strong enough to stand on their own, was not always easily achieved. Often associations involved in clusters tended to lean on a sponsoring agency's assistance for longer than was initially envisaged.

The Institute's assessment also found that clusters which produced goods rather than services and consisted of fairly independent firms that had been in operation for five or more years were more likely to be successful. Added to this clusters which were dispersed over a small geographic area, were more likely to perform better, than those dispersed over an area exceeding 250km<sup>2</sup>.

The recommendations of the study also noted the need for an independent organisation without vested interests in a cluster to carry out the initial identification of a suitable cluster to support. For a cluster to succeed, the study also added, requires that each cluster's managing committee should be guided by clear objectives.

Similarly a 2008 study<sup>212</sup> by business consultancy Milagrow Business and Knowledge Solutions which focused on 11 clusters, found that the government's cluster support scheme was only working in very few cases – where industry associations are efficient and local politicians actively work with clusters. Milagrow founder director Rajeev Karwal believed the cluster scheme had simply turned into a "real estate game" where subsidised land was being handed out to small firms. He believed the majority of companies that had accessed the scheme would continue to remain "very small".<sup>213</sup>

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<sup>208</sup> The Ministry of Textiles is funding Cluster Pulse to continue monitoring these textile clusters. The programme is being implemented by GTZ, World Bank and Sidbi.

<sup>209</sup> Skype interview with Jagat Shah, founder and mentor of NGO Cluster Pulse, May 2010.

<sup>210</sup> Interview with Arun Maira, New Delhi, March 2010.

<sup>211</sup> Indian Institute of Public Administration, 2009. "Evaluation Study of Micro and Small Enterprises Cluster Development Programme", New Delhi.

<sup>212</sup> Milagrow's 11 Cluster Study involved 3 000 MSMEs in four states, 2008.

<sup>213</sup> Interview with Rajeev Karwal, New Delhi, March 2010.

Karwal suggested that the Indian government devise an integrated structure which looks at developing quality labs and improving technology and infrastructure at clusters, as there was often no machine operators and no properly trained people at businesses in a cluster.<sup>214</sup>

Sanatan Sahoo<sup>215</sup>, from the government's MSME Development Institute in Mumbai said that three years on from the initiation of the cosmetic cluster that he oversees, high trust levels remained the biggest hurdle standing in the way of the cluster becoming a success. This was despite his institute having held group visits and getting cluster members to participate together in fairs to facilitate trust among the SMEs.<sup>216</sup> A major challenge was that members of the cluster were too spread out geographically and smaller businesses found it difficult to spare the time for programmes, he said.

However, despite these challenges, the cluster did enjoy some successes according to Sahoo. For example technology upgradation workshops held by the cluster had proved successful as more business owners were making use of new chemicals in their cosmetic products.

But Mukesh Gulati, the executive director of Foundation for MSME Clusters, cautioned that when it came to looking at whether a cluster was successful or not, that it was a matter of what one measured and defined as a success and when one measured it. "In the short term, the organisation of a range of activities and getting immediate outputs as a consequence could be regarded as a success, within the project duration period which can be as short as 12 to 18 months," he pointed out. However he cautioned that recording an impact in such a short time might be "impossible". "Besides, an agency that is judged by its results in the short term is likely to ignore the long term issues that face a cluster and focus on something that can be reflected as success quickly," he added.<sup>217</sup>

He further noted that since most industry associations in Indian clusters are "extremely weak", the focus tends to be on getting external consultants to quickly achieve some quick wins by for instance obtaining ISO certification, productivity improvements or energy audits, to the neglect of strengthening the respective industry association (which he pointed out takes a lot of investment in terms of time but may not produce quick results).

Gulati said another problem was that of conducting follow-ups, where because the implementing agency is concerned about available funds to organise meetings, it desists from holding follow-ups especially as none of the schemes provides for post project follow up support. He believes that of the 441 clusters, only between about 10% and 20% of these have benefited from cluster programmes. However, he said that as no comprehensive study of clusters had yet been conducted, it was not easy to gauge the exact percentage of success stories: "In my opinion what happened to the failed projects (80%) is that ad hoc short-term activities are carried out with some results in the short run but no cementing and little focus on the most strategic issues facing the cluster". He said in some cases clusters might prove only successful in the immediate aftermath of an intervention, but may not necessary prove sustainable in the long-term.<sup>218</sup>

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<sup>214</sup> For example, he commented that "Ludyana which has skills for machinery, textile hosery and light machinery, exports almost Rs75 billion crore of goods, but doesn't have an airport – the nearest one is 130km away in Amristar. Added to this the roads around the cluster were also potholed and transporting goods to the nearest port would add a further two to 2.5% onto a finished product's price." Building the requisite trust needed for businesses to participate in support interventions and work together remained a key challenge.

<sup>215</sup> Interview with Sanatan Sahoo, Mumbai, April 2010.

<sup>216</sup> At Sahoo's cluster, which consists of 90 businesses and collectively employs about 1 500 people, a centre for joint procurement had still not been set up "because members didn't yet trust one another enough", he said. Only about 10 member businesses participated in common fairs held by the institute, with not more than 20% of cluster members taking part in the various workshops. "Many of the smaller firms just didn't have the time to sit and waste in Delhi traffic if they wanted to take part in a workshop", he added. Moreover, despite 8 or 10 businesses having registered, 75% of those in the cluster remained unregistered.

<sup>217</sup> Interviews over email with Mukesh Gulati, May-August 2010.

<sup>218</sup> One such example said Gulati was the Bangalore Machine Tools Cluster, which ran from 2003 to 2005. Initially the cluster was set up by six machine tool companies based in Bangalore. The cluster later expanded to 14 members. The group

**Box 5: Cluster support – Focus on quality drives CII’s approach**

While the performance of cluster support in India is questionable, a private sector cluster initiative by the Confederation of Indian Industries (CII) demonstrates that a focused approach on quality businesses can help small firms to increase their productivity.

Since the inception of the first CII cluster started in 1998 – an auto manufacturer cluster with 20 suppliers serving Maruti set up by Professor Y. Tsuda – 2 135 SMEs have benefited from support to become globally competitive by focusing on improving cost management, energy management and quality systems through 196 clusters. About 1 400 small businesses are presently benefiting from training.<sup>219</sup> Interventions run for between six to 18 months and are aimed at 10 to 15 members with clusters often targeting a certain sector and geographic location. Many are driven by an Original Equipment Manufacturer (OEM) or tier-one customers. Interventions, which have taken place in food processing, automobile and light engineering, help participants to secure ISO 9001 accreditation. Around 60 clusters are still on the go and companies meet every month to share and learn from various implementation practices.

Some of the CII’s recent results include: helping 14 small and medium-sized firms in two Munjal Showa vendor clusters located in Faridabad and Gurgaon (in Haryana state), the members were able to secure combined savings of more than Rs15 million after completing various interventions which were concluded on January 16, 2009; 10 supplier companies of ABB Faridabad were able to reduce accident frequency by 77% and machine breakdown hours and frequency by 20% after a one-year programme on adopting best manufacturing practices which ended in 2007; and, 10 participating companies in a LMW vendor cluster, Coimbatore, reported a 86% drop in customer complaints and a 95% decline in customer returns after an 18-month programme which ended in 2008.

Vippul Ray who runs Elmex Control, which manufactures electrical connectors, has been participating in CII cluster programmes for two-and-a-half years. He employs 200 people and some contractors. The business was started by his father in 1963. About 15% of his turnover is from exports. Since starting the CII’s lean-manufacturing programme which looks at shop floor practices, ways to improve production, reducing wastage and returns, his turnover has increased by 30% and his contract labour force has grown by about 10%. It has also brought on a “100% cultural change” in the workplace with enhanced employees’ involvement. He has been able to clinch 25% more new business as employees’ productivity has sharply increased. Deliveries have also improved and the number of customer complaints and of returns has dropped. The programme also helped him to prepare for the auditors that visit his factory from Europe.

The programme divides the workplace into teams, with each team taking charge of a different zone inside the business and benchmarking itself against other teams in the cluster. His business has since graduated to the advanced cluster which consists of firms of different sizes and from different industries. He has enrolled two of his factories in the programme because he likes it so much. He stressed that the programme proved a great motivation for the workforce as other companies visited the workplace. There is a “peer pressure” effect from working with other business owners. Says Ray: “You recognise that you are facing the same problems”. He does not fear other business owners stealing his secrets and points out that if someone wants to find out about his factories they can

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represented 70% of machine tool production in India in the organised sector. Six machine tool and four vendor consortia were formed. Various working groups were also formed, on designers, electrical design and common procurement. In all 76 projects and planning meetings were conducted by the cluster. The idea was to bring together key groups of suppliers to form networks, while increasing the capacity for innovation, reducing costs and improving productivity. Another aim was to stimulate the formation of new businesses to support the innovation and expansion of the cluster. An excel spreadsheet provided to the author by Gulati reveals that every one rupee invested in the Bangalore Machine Tool cluster, yielded an average of Rs4.2. Yet the cluster did not conclude all the interventions and several projects did not take off because of a lack of leadership amongst the cluster members. However the cluster did benefit in May 2003 from joint negotiation in procuring paints on behalf of 20 companies; paint cost the buyers only Rs75 000 instead of Rs6 million, 80 times cheaper. Also, training during May 2003 of 11 people at the cost of Rs80 000 later saved the cluster members a total of Rs200 000 (Presentation by Srinivas G. Shirgurkar, then managing director of Ace Designers).

<sup>219</sup> Interview with Manish Whorra , CII director, New Delhi, March 2010.

always do so by searching on the internet. He said he was also able to learn how another company packed their material and stored their moulds.<sup>220</sup>

Ravinder Verma<sup>221</sup>, managing director of Ganga Acrowools said because other companies visit your workplace, the programme was “like having free inspectors and auditors”.

NS Bhogal of Bhogal said that while he was “reluctant initially” about trusting other business owners, this changed after CII explained the benefits of the programme. He undertook TQM and cost management and he has been in two different programmes for two years. Because of the programme he was able to reduce his workforce from 250 to 180 and free up 190m<sup>2</sup> (out of a total of 2 200m<sup>2</sup>) of shop floor. His turnover has increased by 10% year on year following a shift away from outsourcing (equivalent to 30% to 40% of his production) to manufacturing all his bicycle parts inhouse following increases in the productivity of his workforce, lowered absenteeism and by renovating old machines. He said he had learned from other members in his cluster how to reduce overload and control the power on his machines. He said the Rs250 000 cost for the programme initially seemed too high, but as his profit grew from the increased productivity, he was able to recoup this by savings he made amounting to Rs7.4 million.<sup>222</sup>

The CII hopes to obtain 80% of its funding for its lean cluster scheme from the government. Presently companies have to pay for the programme themselves: each CII cluster consists of 10 companies that together set up a trust of society (Special Purpose Vehicle – SPVs). Cluster members then deposit their fees into the SPV's own bank account. Following this, consultants then bid to take on the various interventions. Fees can range from Rs200 000 for a single one-year intervention or Rs350 000 for a one-year intervention covering four areas of lean manufacturing and energy efficiency.<sup>223</sup>

## Clusters in Brazil

Brazil has developed a cluster support policy which helps the private and public sector to partner together to identify existing support measures to target priority clusters. The government is hoping that by supporting existing clusters it can undo the country's significant regional economic disparities and promote small business development.

Cluster support has for some time existed in Brazil at a state level<sup>224</sup>, but lacked any clear policy driven from the federal government. Clusters however form an important part of the federal government's 2008-2011 Plano Plouri-Anul, which the Planning Commission uses to guide and review key policies and, since the setting up of a working group in the Ministry of Development, Industry, and Trade in 2004, to drive cluster policy. Since then cluster support has become far more co-ordinated. The Ministry of Development, Industry, and Trade's cluster (or as they are termed in Brazil, Arranjos Produtivos Locais or just APLs) working group essentially prepares guidelines for cluster development.<sup>225</sup> The group is composed of 33 members, with 11 members drawn from government and 22 from the private sector. Added to this each state government has its own cluster working group (Nucleo Estaduais) of which the first was set up in 2006. These ensure that the various development priorities of each state are attended to and are composed of various roleplayers, including: representatives from Sistema S (including Sebrae and training agency Senac among others), the state government, financial institutions, workers and science and technology institutions. The Ministry's Productive Development Plan, released in May 2008, establishes targets for development plans for clusters in 10 states in 2009 and another nine in 2010.<sup>226</sup>

<sup>220</sup> Telephonic interview with Vippul Ray, May 2010.

<sup>221</sup> Telephonic interview with Ravinder Verma, May 2010.

<sup>222</sup> Telephonic interview with NS Bhogal, May 2010.

<sup>223</sup> Telephonic interview with Harinder Jeet Singh, who oversees CII's cluster programme, May 2010.

<sup>224</sup> Such as the Sistemas Productivos Locais before 2000 in Rio Grande de Sul.

<sup>225</sup> Interview with Margarete Maria Gandini, the Co-ordinator General of clusters at the Ministry of Development, Industry, and Trade, Brasilia, August 2010.

<sup>226</sup> “Innovation Production and Dissemination Programme for Local Cluster Competitiveness in the State of Pernambuco”, document of the Inter-American Development Bank.

The ministry's cluster policy provides for the identification of certain geographic regions in the country where firms have already clustered and where the government could possibly form a cluster to channel support to. In 2005 the first attempt was made to identify clusters and 957 were identified, covering 295 141 enterprises and 28 million employees. An updated list of identified clusters is expected to be released in 2010 and the number of mapped clusters is expected to exceed 957 and could be as high as 1 400, going on a recent BNDES study.<sup>227</sup>

Of the total clusters identified in 2005, the country's states have nominated 267 as priority clusters, demanding special attention. In total, 125 plans of action had been developed through the various Nucleo Estaduais to assist priority clusters. After a plan is approved by the Nucleo Estaduais, a cluster's governance will try to present projects for each action in order to get funding. The Permanent Group for Clusters (GTP-APL) also identifies 142 priority clusters.<sup>228</sup>

Support for clusters is divided into five areas: capacity building and governance, innovation, market access, productive capacity and finance. A technical team is currently looking at how many of these plans have been implemented, she said.<sup>229</sup>

After the identification of clusters in 2005, the federal government ran a pilot project for two years to support several clusters. The pilot also helped to better formulate how the federal government would work with clusters and two documents were drafted from this, which form an important part of policy decisions, namely:

- A manual for partners (Manual de Instituições Parceiras) detailing what the various institutions can offer in supporting clusters (such as export assistance, capacitation, business training, access to finance) and how they should work with one another to ensure co-operation in supporting clusters;
- The terms of reference (Termo de Referencia) for cluster policies.

#### Clusters help develop poor regions

The example of a cluster Pernambuco state in the country's Northeast, demonstrates that by supporting the government and local authorities can promote regional growth and equity. Residents in three small towns in the north-eastern state of Pernambuco are today enjoying better houses and the area has more schools and jobs to go around after a cluster support programme was carried out in the area. The programme, Oficina de Moda, was implemented by Sebrae in 2004 in the towns of Caruaru, Toritama and Santa Cruz do Capibaribe – 140km or so inland from Recife.

Thanks to the programme 30 clothing companies saw their turnover grow by about 110% in just eight months after getting assistance in areas such as planning and production, marketing, trademark protections and design, through a cluster programme sponsored by the Brazilian small business support agency, Sebrae. Some of the firms grew from employing 30 people to 300 today. The agency is currently conducting research to ascertain how the area and businesses in the cluster have improved since 2003.<sup>230</sup>

The programme helped Luiz Carlos Bezerra<sup>231</sup> to grow the annual turnover of his firm, Michelle Lingerie, by 40%. Bezerra, who runs his 20-year-old company with his wife Marie José, said Sebrae consultants helped introduce him to innovative ways to market his company. Before the assistance, which also led to a 20% increase in his staff complement, he often adopted a wait and see approach to sourcing clients –

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<sup>227</sup> Interview with Gandini.

<sup>228</sup> These include furniture, wood, ecological tourism, textiles, fishing and aquiculture, swino culture, fruit, software, horticulture, mineral water, meat and aerospace.

<sup>229</sup> APLs Prioritarios GTP 2008-2010, GTP-APL, 2007

<sup>230</sup> Interview in Caruaru with Mário Cesar Freitas Lins, Sebrae's project manager of the textile project in the Agreste region of Pernambuco, August 2010.

<sup>231</sup> Interview with Luiz Carlos Bezerra, Caruaru, August 2010.



simply setting up at a street fair, but today he actively goes out in search of new clients and now also conducts business in neighbouring states of Brazil.

The textile cluster in the region sprung up about 50 or 60 years ago in the area and Sebrae's support for the textile businesses in the region began 16 years ago when the agency began presenting courses to the firms in issues such as business management, costing and pricing and legislation. In 2000 a local union that represents both employees and employers Sindicato das Industrias do Vestuário de Pernambuco (Sinvest) approached the city of Caruaru in a bid to get support to upskill textile firms based there. Sebrae was asked to assist and developed a business support project which ran for two years.

But the cluster has not solved all the problems textile companies in the region face, including confronting cheap Asian imports. On top of this despite the cluster support, most firms still do not co-operate with one another. A Sinvest member said it was also difficult to secure the involvement of the government and institutions in the cluster. Despite this, however, he added that the cluster was able to in 2000 get valuable support from BFZ, a German private company which sourced funds from the German government. BFZ helped Sinvest to organise itself better. The improved degree of organisation, according to the Sinvest member, insured members could meet more easily with other partners.<sup>232</sup>

#### Tax breaks spur tenfold growth in Recife cluster

In Recife, tax breaks and government funding have helped 130 information and technology businesses based at Porto Digital, an IT cluster, to increase their turnover tenfold between 2000 and 2009, while helping to create a more innovative state. Today the companies – 60% of which have less than 10 employees – generate a total turnover of US\$500 million.

Companies benefit not only from a 60% tax break from the city and a 90% tax break from the state, but also from free training offered through Porto Digital, according to the cluster's administrative and finance manager Guiseppe Regina Jr. Some of the companies on the island have also received funding from Finep's Juro Zero (zero interest rate) programme.<sup>233</sup> The cluster, which takes up half of a small island in the city centre of Recife and was set up 10 years ago as way to retain the state's top IT talent, not only helps to produce state of the art companies. It also helps to develop innovative solutions to help the state's other clusters such as those in the shipyard, textiles and dry wall sectors.<sup>234</sup>

Porto Digital's Porto Desembarca programme has seen several companies in the cluster develop an innovative solution to boost pupils performance at local schools. Until recently school pupils were being distracted from doing their homework because they were spending too much time playing computer games. The answer was the creation of a computer learning game by six companies who formed a joint venture in 2008 after a meeting between IT companies, teachers and state school authorities. The game required pupils to enter various clues before they could advance to the next stage. The clues were given out to pupils in answer to homework assignments the pupils had been tasked to complete. The JV even created another version which allowed pupils from different schools to challenge one another, with the chance to win prizes such as Playstations and computers. So successful has the project been that 5 000 schools now take part, up from 400 in its first year. Companies involved in the project have also had to double their staff complement in just two years. The state of Rio de Janeiro is also now implementing this strategy.

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<sup>232</sup> Interview in Caruaru, with Fredi Maia, a member of Sinvest's board who served as president of the union when the project was first mooted, August 2010.

<sup>233</sup> Interview with Guiseppe Regina Jr, Recife, August 2010.

<sup>234</sup> The clusters Porto Digital is supporting in the state include a textile cluster in the Agreste Central region which has about 13 000 small and micro businesses, a milk and dairy cluster in the Agreste Meridional regions with about 2 000 businesses, a sheep and goat farming cluster with 12 000 businesses in the Sertão Central, a fruit cluster in Sertão São Francisco consisting of 3 500 producers can be found in this area (Interview with João Cavalcanti an economic analyst for Sebrae Pernambuco, Recife, August 2010).

More importantly however, is the fact that the cluster has helped the city to retain local IT graduates. The cluster's administrative and finance manager Guisepppe Regina Jr said because the Federal University of Pernambuco produces some of Brazil's top IT graduates, many had been drawn away to other states or overseas. Regina said the high demand for the graduates meant that 70% of all Brazilians that work for Microsoft, came from the state's university.

IT is an important component of the state's economy – making up 3.5% of the state's GDP, compared to just 1.2% of Brazil's GDP. It was for this reason that the state government decided to retain its IT talent by setting up public policy to retain the IT expertise in the state, while getting IT companies to boost the state's economic growth and meet its development goals. The state therefore decided to fund the setting up of Porto Digital. Today 50% of funding comes from the Federal government and 40% of it from the state government, while 10% is drawn from the private sector.

The cluster this year opened incubation facilities in an old brick warehouse where established companies – big and small – can work on specific projects or innovations while receiving business support such as marketing, financial management and legal assistance.<sup>235</sup> The incubator does not cover or subsidise rental fees that businesses housed there must pay. The idea says Regina Jr is that the incubator must be self-sustaining, but that businesses based there will benefit by getting access to free training and consulting.

What has the impact of clusters been like in Brazil?

- Brazilian government is still evaluating the impact of clusters.
- Problems with financing clusters.
- Decision making must involve businesses in cluster.
- Need for a credible organisation to lead a cluster.
- Innovative monitoring system tracks progress of cluster interventions.

So what has been the impact of clusters in Brazil so far? How have they fared in assisting small enterprises and uplifting underperforming regions?

Little evaluation of clusters has been carried out in Brazil. MIDC's Gandini said the ministry's researchers were busy setting up an information system to help manage clusters. The system will include indicators to measure the performance of a cluster receiving support and to help determine the effectiveness of cluster support. She expects the research to be completed by the end of 2010 and added that the system will also contain a national database of those clusters identified and a library for cluster support. She believed the government had done a good job in mobilising actors to take part in cluster support, but said that more partnerships were however still needed. Knowledge on how clusters worked was needed and indicators and an ecosystem of support needed to be constructed. She however emphasised that because it is not always easy to isolate the effect government support has on a cluster from that of other measures, it was not easy to determine the impact of cluster support.

Cristiane d'Avila Garcez<sup>236</sup> an advisor who oversees clusters at Brazil's development bank BNDES, said some clusters in Brazil struggled to perform because associations which the development bank advanced funding to were not sufficiently organised to deal with funding. D'Avila Garcez said BNDES had a programme to lend to associations and co-operatives, but said it often battled because it had no agencies in state capitals, meaning it had to work with state banks and the government of each state.<sup>237</sup>

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<sup>235</sup> The incubator has been running since March this year and the 14 spots were contested by 62 applicants. By August 2010, eight spots had been taken at the moment. Porto Digital started up after a company called Cesar, down-sized its incubator recently after running for eight years.

<sup>236</sup> Interview with Cristiane d'Avila Garcez, Rio de Janeiro, August 2010.

<sup>237</sup> From January 2010 up till August 2010, the programme had earmarked R\$100m in eight states in the Northeast, to state governments, however the finance was yet to be approved.



A key lesson by Sebrae when it came to supporting clusters, is that the decision-making process must follow a bottom-up strategy with the participation of all cluster members, according to Adalberto Durau Bueno Netto, a Sebrae consultant and a member of the Board of Directors of the Paraná Network for APL Clusters Support. A second lesson is that the success of any effort in cluster development essentially stems from having a credible institution lead the process which can attract other support organisations to join in.

Sebrae's method of cluster support precludes the existence of at least 20 enterprises linked to one common specialised production and that these enterprises employ at least a total of 100 people. The cluster must also be capable of effectively contributing to increase exports or to competitively substitute imports, must have market potential, and be able to generate jobs and income.

The agency uses a monitoring and evaluation system (Geor – Gestão Orientada para Resultados) and a set of governance rules that have already been adopted in several international organisations such as the UNDP, Unicef and the World Bank. While a consultant is responsible for constructing and managing the project, the agency uses an open result based management system to communicate, integrate and control the project development towards the achievement of the results (see: [www.sigeor.sebrae.com.br](http://www.sigeor.sebrae.com.br)). Using the system practical results such as clear objectives, a strategic focus, premises, results and actions and defined roles, contributions and scheduled dates, can be drawn.

## Reflections for South Africa's cluster experience

### Discussion 1: Dismal performance of past cluster support in South Africa

South Africa's short experience has yielded some key lessons for the country's policymakers, namely:

- There is no clear funding from government.
- Clusters need to retain sector-specific staff.
- Government must not set overt political agenda.

In South Africa clusters gained importance in the early 1990s when the post-democracy government was interested in developing national-level clusters. The 1995 White Paper on Small Business among other things outlined the importance of strengthening cohesion between small enterprises.

In the 1990s the Department of Trade and Industry invested heavily in studies on how to support clusters from various sectors, even commissioning cluster expert Micheal Porter's consulting company to carry out several such reports.<sup>238</sup> The department set up the Sector Partnership Fund, Workplace Challenge Programme and Competitiveness Fund to boost intra-firm and inter-firm co-operation which at the time were lacking in the country. The department then began analysing sectors and interacting with roleplayers such as industry associations. The department worked to popularise the cluster approach through workshops with key sectors in main manufacturing regions, through Spatial Development Initiative projects.

Yet, these studies did not always translate to sustained collective action by the stakeholders concerned. A key criticism was that the government did not have a clear funding programme to use to back up the formation of clusters.<sup>239</sup> The department was however able to improve working relationships between firms involved and officials at the department and officials were exposed to more knowledge about industry while businesses and other role players gained a better understanding for the department. But this was effectively cancelled out by the inability of the department to retain its sector-specific staff.<sup>240</sup>

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<sup>238</sup> Telephonic interview with Glen Robbins, of the University of KwaZulu-Natal's School of Development Studies, October 2010.

<sup>239</sup> "The Role of Government in Fostering Clusters: the South African Automotive Sector", Mike Morris, Glen Robbins and Justin Barnes, in *The Development Decade? Economic and Social Change in South Africa, 1994-2004*, edited by Vishnu Padayachee, HSRC Press, 2006, pp. 206 - 207.

<sup>240</sup> *Ibid.*, p207.

In turn, while the Sector Partnership Fund gave out a matching grant of 65:35 to assist groups of five or more firms that co-operated on projects, the bulk of applications resulted in one-off projects rather than in sustained networking. Where networking did take place this failed to go beyond single-issue processes, such as the Port Elizabeth auto cluster where the sole focus was on logistics.

Mike Morris, Glen Robbins and Justin Barnes believe the department's dedicated clusters team, "yielded little more than analytical studies and workshops". Participants complained that the department was obsessed with setting agendas for clusters and that it failed to build trust and a shared governance of processes. For example in the Durban cluster initiative in chemical industry, government wanted the focus to be on exports whereas industry wanted it to be on resolving environmental management.<sup>241</sup>

Participants point to several weaknesses in the South African government's approach to clusters, namely:

- The Department's attempts imposed agenda on firms.
- A lack of trust building.
- Little evidence of quick wins.
- A cluster model founded on national, rather than on regional priorities, leaving firms disconnected from agenda.
- Department of Trade and Industry facilitators' lack of credibility.

Glen Robbins, of the University of KwaZulu-Natal's School of Development Studies said the department had been keen to rather follow a one-size-fits-all approach which meant the cluster programmes the department implemented were rather simple and generic. But because of this the programmes ended up having little relevance for participants which resulted in poor buy-in from businesses. Robbins said that on top of this, provinces seemed to "toss money around at random things" when it came to cluster development. The brand of the Department of Trade and Industry was not taken to the local level he added. The department had sought to copy what was a trend when it came to industrial programmes, but when it came to how to organise and network with institutions Robbins said the department was "probably 30 years beyond the curve".<sup>242</sup>

The Department therefore took less of interest in clusters. This was partly because of a loss of skilled staff who had acquired knowledge and contacts. Said Mike Morris, Glen Robbins and Justin Barnes: "The DTI (department) seemed to have drawn the wrong conclusion from the failure of its short-lived policy emphasis on clustering – namely, that the fault lay with clustering per se – rather than reflecting on the role of its own mistakes in the way it formulated the cluster programme." At the turn of millennium the department underwent restructuring and the focus shifted away from clustering.<sup>243</sup>

## Discussion 2: How does one create effective clusters?

Rosabeth Moss Kantor<sup>244</sup> believes clusters grow because of three things:

- Increased access, to new innovations and information, and spin-offs of new enterprises.
- Improved connections and networks, that can speed the movement of ideas, innovations, and information from firm to firm throughout the economy, and
- Better competencies, such as a more skilled workforce, leaders committed to learning and improving their community and the recruitment and retention of talent and tacit knowledge.<sup>245</sup>

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<sup>241</sup> *Ibid.*, p207

<sup>242</sup> Telephonic interview with Glen Robbins, October 2010.

<sup>243</sup> *Ibid.*, p208

<sup>244</sup> Rosabeth Moss Kantor, *World Class*, New York: Simon & Schuster, 1995, cited in Rosenfeld, 2002

<sup>245</sup> *Clusters: Balancing Evolutionary and Constructive Forces*, Orjan Sölvell, Ivory Tower Publishers, Karlavägen 70, Stockholm, (www.cluster-research.org), 2008, pp. 7 – 9.

Douglas Comrie, Managing Director at B&M Analysts, which facilitates five clusters, four of them private-public partnerships<sup>246</sup>, says it's not common in South African culture for companies to co-operate with one another, as the country's business culture does not have high trust levels. The problem with low levels of trust was that the cluster tended to look at external issues, resorting to lobbying for instance, rather than on improving workings inside their own individual companies. He said this meant cluster facilitators had to play a big role in building trust. B&M Analysts' approach was to focus on getting members to trust the facilitators, rather than to get members to trust one another first.

Noting the above position, Trusha Pillay<sup>247</sup>, who owns Maritzburg Engineering and is a member of a chapter of the Durban Automotive Cluster<sup>248</sup> said she was never concerned about sharing information on her business with other cluster members. This was largely because her business offers services unique to those of other members. Her business, which has 38 employees, supplies various mechanical engineering services, manufactured bracket holders and parts for trucks and trailers. Her business has also benefited from cluster's the benchmarking programme. She estimated that she had been able to increase her turnover by over 30% since joining the cluster five years ago – mainly through being exposed to big business concepts and being benchmarked against other companies in the cluster. She also benefited from a training programme which twined her business with a large company. She pays R300 a month in membership fees.

Robbins said if clusters in underperforming regions were to prove successful that it was essential that a "more capable" state and private-sector institutions partner with one another. He nevertheless cautioned that the department's cluster policy could be short-sighted if it was limited to supporting only clusters in underperforming regions, rather than those where a higher number of businesses had set up. He cautioned against the department simply creating clusters where there was no pre-existing relationships between firms in a certain sector. For example firms were best able to work together if they were already involved in a supply chain together or shared issues around the local environment for example.

If the department wanted to create successful clusters it had to demonstrate that it could provide useful assistance to firms. Robbins pointed to one example in the automotive sector cluster in Durban where local authorities involved in the cluster had helped to source funding from the Department of Science and Technology for firms to meet a need identified by members of the cluster improve their employees knowledge on supply-chain standards.

Robbins said it was easier to share issues around absenteeism or HIV/Aids or those around benchmarking or common practice, which he referred to as low risk issues, than such things as export assistance. Here firms felt the risks of sharing information were high, as there was a fear that a competitor might use such information to "squeeze itself back into the market".

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<sup>246</sup> The five clusters B&M Analysts run are the Durban Automotive Cluster, the KwaZulu-Natal Clothing Clothing and Textile Cluster, the Cape Clothing Cluster, the Durban Chemicals Cluster and the Benchmarking club a national association with about 50 members from the automotive industry. Members ordinarily pay half of the cost of a normal interventions, while the remaining half is covered by a local or provincial government. The two clothing clusters had a considerable number of small businesses, while small firms make up about a quarter of the 40 members of the Durban Automotive Cluster. A further 110 small suppliers benefit from enterprise development and supply-chain initiative benefits through 12 of the cluster's members, he said. Only about two of the firms in the chemicals cluster were SMEs, as the cluster committee has been focusing on securing the participation of substantive players in the sector, having only set up in 2009. B&M Analysts are mostly focused on aligned value-chains, where a supply chain was set up in the way that the introduction of one factor or product would influence the whole chain. For example in the automotive sector one had OEM, then tier 1, tier 2, tier 3 suppliers. By setting up a cluster in these sectors it was easier to find common needs for the various members, but not always so in a non-aligned sector such as chemicals sector. Here one had different types of chemicals. But Comrie said there were some commonalities in that all made some form of chemical.

<sup>247</sup> Interview with Trusha Pillay, October 2010.

<sup>248</sup> The KZN Auto Benchmarking Club was set up in 1998 and accessed the Department of Trade and Industry's Sector Partnership Fund (65% funding from government and 35% from auto members). The aim of the the cluster is to improve firms' performance. They led to increased knowledge sharing as firms shared experiences and learning and newsletters diffused to other layers of management within firms.

He said if the government and a sector weren't able to get buy in from a broad cross section of partners and firms from the sector, the cluster risked becoming ineffective.

Robbins pointed to the furniture cluster in KwaZulu-Natal, set up in 2009, which has a low level of firm participation. As not one person on the cluster committee has a strong industry background, could the committee is not able to carry any weight and gain the trust of member firms. The cluster has set up an incubator, but most of the members were micro-firms. The "dynamic" firms in the industry weren't included. Robbins said it was premature for the cluster to set up its own entity, but that a decision was taken to do so after provincial government indicated that this was necessary so that it could allocate funding to the clusters. At one cluster meeting businesses however expressed a reservation about setting up such an entity, so much so that only a "tiny number" came to the following cluster meeting. So it was left with "marginal" businesses and provincial government and Seda; the full value-chain of the industry was not represented and export agents did not even find it credible. Robbins said members in the furniture industry also felt they had wasted their time when government asked them for advice and then did not listen to its recommendations. He said the cluster had looked at minor things like whether it could promote the supply of school desks, rather than at bigger issues which would help improve the overall supply chain and sector. He termed this the "dumbing down of the potential of a cluster".

#### Discussion 3: How to win trust?

Jajat Shah, founder and mentor of Indian NGO Cluster Pulse said he wins member companies over by showing them research from a diagnostic study carried out of the cluster. This helped members to relate better to the consultants and to take them seriously. The participation of members is also secured by getting them to be involved on sub-committees and consortia made up of about 10 businesses. However, Shah, who has assisted 80 or more clusters, stressed that these methods often took time and pointed out that it was important to produce quick wins.<sup>249</sup> He believes that a successful cluster is not one in which everyone succeeds in any case. For example, Shah said he once assisted 20 textile clusters through Cluster Pulse between 2002 and 2005 and that in this case only 200 of the 500 of the businesses in the cluster benefited from the programme.

#### Discussion 4: Evaluation mechanisms

One challenge which is clear in both the Indian and Brazilian cluster policies and initiatives, is the lack of evaluation. Orjan Sölvell points out that many European countries do not evaluate their cluster activities and programmes.<sup>250</sup> When conducting an evaluation, he said it was necessary for clusters to have a "carefully planned impact". But, since cluster support programmes often created unintended side-effects, any evaluation, he said, should be able to assess the unanticipated side-effects outside of goal areas.<sup>251</sup> Sölvell, like Gandini in Brazil, points out that the evaluation of clusters and cluster programmes is a complex proposition. Some clusters are affected by several policy instruments in parallel, including regional policies, science and innovation policies and so on. It is thus difficult to separate out the effects from a particular cluster instrument.<sup>252</sup>

<sup>249</sup> By, for instance, helping members to produce proper business cards and putting the cluster's logo and name of cluster on the cards.

<sup>250</sup> Sölvell, Orjan, 2008. *Clusters: Balancing Evolutionary and Constructive Forces*, Ivory Tower Publishers, Karlavägen 70, Stockholm, ([www.cluster-research.org](http://www.cluster-research.org)), p.88.

<sup>251</sup> *Ibid.*, p.86.

<sup>252</sup> The following are some points about cluster evaluation in various countries: Canada's National Research Council Canada demands that every initiative must be evaluated after a programme has come to its conclusion; Sweden's state innovation authority Vinnova requires that each cluster initiative hire an external partner to follow the project and make evaluations that can also serve to legitimise membership and participation.<sup>252</sup> Scottish Enterprise, which adopted clusters in the 1990s, uses national statistics, to measure the number of firms in a sub-sector to determine the success of a cluster or not. Some specific sector studies were also commissioned to analyse the global sector context and broader economic influences. Indicators used included turnover, employment, gross value added, and net capital expenditure (*Ibid*, p100).

### Discussion 5: Can clusters promote underperforming regions?

Douglas Comrie is sceptical of the South African government's idea to set up clusters in outlying areas. He said it would take "massive" rebates, tax exemptions or land incentives to lure firms to these regions. He said most businesses had already clustered in a particular area to take advantage of a cheap labour pool – such as clothing firms that were situated near the Lesotho border – to be near manufacturers, such as the automotive sector, or to be near the market – such as companies in the chemicals sector clustered near the Durban port.<sup>253</sup>

There is no clear-cut evidence internationally of the role clusters can play in promoting underperforming regions. In Europe regions with strong clusters are innovative leaders, according to Sölvell (2008). The author refers to data from the European Cluster Observatory ([www.clusterobservatory.eu](http://www.clusterobservatory.eu)) which indicates that regions with no clusters or isolated research facilities have fallen behind other regions. Sölvell says globalisation has increased the benefits of strong clusters and raised the costs for regions which fail to develop some level of clustering.<sup>254</sup> Stuart Rosenfeld adds a nuance to this position and points out that the ability for clusters to promote underperforming regions is often limited because of a number of things. These include:

- Weak infrastructure
- Poor access to capital, technology, innovation, and capital.
- Regional insularity and isolation
- Low educational levels and skilled workers.

For Rosenfeld,<sup>255</sup> the most successful clusters are those that include firms that are part of global networks, that are exposed to global market opportunities, and that employ people active in international professional associations and networks.<sup>256</sup> Yet, he establishes that most of the world's successful clusters came about as accidents of circumstance. Although public policies may have been the catalyst of the success they have rarely been with the intent of starting a cluster. The growth of the largest clusters has been driven by market demand and entrepreneurial spirit. Some began as large companies that originally located in less populated areas to take advantage of low wages and surplus labour markets and that later disintegrated into smaller firms. Examples of regions that looked at transplanting clusters to weak economies via recruitment and incentives, have shown that this was usually only achieved at a very high cost.<sup>257</sup>

For Sölvell, clusters emerge because of the existence of natural factors (such as a particular climate, soil, ore deposit, forest resource) or because of a transportation route or node such as a port. Clusters have also been driven by "historical accidents" where an entrepreneur in a particular location happened to start a business, which in due time led to increasing local demand, new firm formation, spin-off firms and so on, and ultimately to a cluster<sup>258</sup> although other factors can also be important.<sup>259</sup>

Rosenfeld points out that there is no "single recipe" for less favoured regions to follow that will meet the needs of all clusters. Nevertheless, those that take into consideration the following might prove successful:

- Understand and benchmark regional economies.

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<sup>253</sup> Telephonic interview with Douglas Comrie, October 2010.

<sup>254</sup> *Ibid.*, p.34

<sup>255</sup> Rosenfeld, Stuart A, 2002. "Creating Smart Systems: A guide to cluster strategies in less favoured regions, European Union-Regional Innovation Strategies", Regional Technology Strategies Carrboro, North Carolina.

<sup>256</sup> *Ibid.*, pp. 9 - 10.

<sup>257</sup> *Ibid.*, p.11.

<sup>258</sup> *Ibid.*, pp. 54, 55.

<sup>259</sup> For instance, Sölvell says Silicon Valley is the result of federal legislation and allocation of research grants through the Bayh-Dole act in 1980, the setting up of world-class research facilities and the setting up of Stanford University which drove some of the clusters early initiatives (Op. Cit. pp. 67 – 68).

- Engage employers and institutions.
- Organise and deliver services.
- Build a specialised work force.
- Allocate and attract resources and investments.
- Stimulate innovation and entrepreneurship.<sup>260</sup>

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<sup>260</sup> Op. Cit, p.14.

## 5 Five key learnings from Brazil and India

What can South Africa learn from Brazil and India to boost support to small businesses? There are five key learnings that this report offers to policymakers, particularly those in South Africa, these are:

- Develop a national entrepreneurial vision with measurable targets, with backing from the president.
- Build more forums based on partnership between government and the private sector.
- Simplify the government's support architecture.
- Put effective real-time monitoring mechanisms in place.
- Improve the capacitation of government agencies.

### 5.1 Develop an entrepreneurial vision based on clear targets

Brazil's small business policies are built on clear and measurable targets set by its planning ministry. South Africa should adopt a similar approach, particularly with the setting up of the National Planning Commission in the Presidency in 2009 and the crafting by members of the planning commission of Vision 2025. Entrepreneurship and small business promotion must form a key part of this plan and vision which should be backed up the President if the country is to promote an entrepreneurial culture and boost support to small businesses.

Policymakers should base measurable targets (such as number of loans and amount of finance aimed at small businesses, number of small businesses registered as taxpayers, number of small firms exporting for example) using reliable but ongoing research, rather than *ad hoc* research (such as the Finscope's 2010 study). The government must set aside funding to develop and maintain such research, which would be best housed on an easily accessible website.

Added to this, and building on the success of Brazil's Global Entrepreneurship Week, there is a clear need for South Africa to embark on a massive, ongoing entrepreneurship campaign. Such a campaign should target all levels of society, particularly:

- Learners at schools who know nothing of the struggles of running ones own business.
- Experienced foremen or managers in factories or offices who yearn to start their own manufacturing business having gained valuable on-the-job experience and insight into the workings of a particular sector.
- Existing entrepreneurs, particularly black business owners who have overcome many obstacles to start and run their own business.
- Civil servants who have little appreciation for the fact that entrepreneurs that run smaller businesses face widely different problems to those running or managing a large business.
- Community members, who often view business owners as rich capitalists and have little understanding of the struggles entrepreneurs undergo and the role they can play in uplifting society.

### 5.2 Develop inclusive partnerships

The example of the two emerging economies (particularly Brazil) also shows just how weak the social compact is between the private sector and government. While the Brazil government has various forums which include private-sector organisations, the South African government appears to have very few of such forums.

The implications are that South Africa will need to widen the inclusion of private sector groups on all its agencies and initiatives targeting small businesses. It must reform its National Small Business Advisory



Council, which because of its relegation by the Department of Trade and Industry to serve as a backroom think tank has, in many business owners' and policymakers minds, ceased to exist.

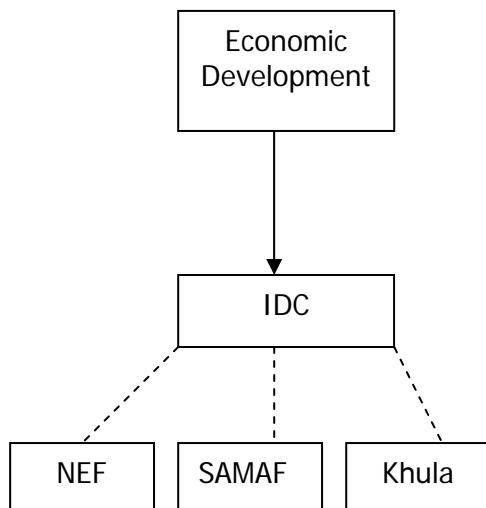
What the country really needs is a body such as Nedlac, made up of key members from the government (in particular Department of Trade and Industry, Department of Labour, Department of Science & Technology, the Department of Economic Development and the Presidency), government support agencies (Khula, Seda, NYDA, NEF, IDC), business associations as well as chamber bodies and universities. In this regard, the role universities play in funding and supporting incubators in Brazil is particularly instructive.

### 5.3 Simplify support architecture

More specifically, the experience of Brazil and India reveals that South Africa's principal small business support organisations – Seda and Khula Finance Limited – have made little impact in making a real and meaningful contribution to small businesses. South Africa needs to better capacitate its small business support organisations, simplify its support architecture and increase the budgets of these organisations by developing new and innovative funding streams.

Much of Brazil's lending to small businesses is channelled through its development corporation BNDES. In Brazil the state is not legislated to lend directly to businesses, so finance is on lent to state banks and then to business owners. As banks in South Africa are all privately-owned, the government has resorted to setting up a whole assortment of funds to lend to small businesses. There are at least five development finance institutions at a national level that lend to small businesses (IDC, Khula, NYDA, Samaf, NEF). In Brazil and India there is only one such organisation: BNDES and the Small Industries Development Bank of India (Sidbi), respectively. A question then is: would it be more effective if all the state development institutions aimed at small businesses were to fall under a single umbrella organisation? This is something that would be similar to the strategy followed by the Department of Science and Technology's Technology Innovation Agency as it has grouped together various programmes and funds under one roof.

For example, the South African government's various funds for businesses might be more strategically deployed if they were housed under the IDC (see diagram below). Presently Khula forms a separate fund which, together with Samaf falls under the Department of Economic Development, while the NEF falls under the Department of Trade and Industry (for a full diagram see Appendix 2).



## 5.4 Put effective monitoring systems in place

The experience of Brazil and India also re-emphasises the need for the South African government to put in place proper monitoring systems for its small business organisations and programmes. The Department of Trade and Industry does carry out reviews on its incentive programmes for example, but what the government really needs is an IT system which it can use to monitor clusters, individual and group support programmes and lending, in real time. This will help the government to recognise problems and react to them faster than if the department ran once-off reviews once a programme was coming up for renewal.

## 5.5 Capacitate government agencies

The example of Brazil's small business support agency Sebrae, shows how South Africa must not overlook the constant need to train up not only internal staff that interact with those that visit Seda and Khula's offices, but also to capacitate external business consultants.

Presently the government has responded to concerns about the quality of external consultants by cutting the number of consultants it relies on at Seda. But the private sector, through its wealth of experience, is the most equipped to deal with business owners. Rather than reduce the number of consultants the government should look at viable ways of upskilling and supporting these consultants. Added to this the government must look to recruit more experts and retired businessmen to advice and consult with businesses.

Finally, it is clear that more co-operation are needed through bodies such as the India Brazil South Africa (Ibsa) initiative and further information sharing through the existing agreements Seda, Brazil's Sebrae and India's NSIC have with one another. As the three countries have similar problems, one idea might be to conduct continuous benchmarking of the similar support programmes and organisations with one another. These could include:

- Credit guarantee schemes: Khula with India's CGTMSE and Brazil's credit guarantee scheme the Fundo de Aval às Micro e Pequenas Empresas (Fampe)
- Research grant funding: South Africa's Technology Innovation Innovation (TIA) agency, with Brazil's Programme First Innovative business (Prime), and India's Technopreneur Promotion Programme (TePP).

The study shows that while the South African government faces immense challenges in assisting small enterprises, it is not alone. The example of India shows that the South African government must endeavour to simplify its support architecture and focus on building up organisations such as Seda and Khula to turn them into recognisable brands that business owners will learn to trust.

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Gama, Leo, spokesperson, Limdev

Hoffman, Paul, acting manager, Seda George

Kekana, Malose, chairman, Khula Finance Limited

Lupuwana, Hlonela, chief executive, Seda

Mapane, Melita, owner Polokwane Chemical Supplies

Martin, Nazeem, Managing director, Business Partners

Mazzullo, Maggie, manager of loss control, Khula Finance Limited

Mohoto, Mojalefa, chief director of the enterprise development unit, Department of Trade and Industry

Molepo, Setlakalane, former chief executive, Khula Finance Limited

Mosheshe, Zimbili, marketing manager, Khula Finance Limited

Pillay, Trusha, who owns Maritzburg Engineering

Ravjee, Jayesh, executive manager, Seda technology programme

Robbins, Glen, University of KwaZulu-Natal's School of Development Studies,

Schussler, Mike, economist, Economists.co.za

Tshifularo, Justice, director, Workplace Challenge Programme, Productivity SA

Zikode, Siphon, acting deputy director-general of enterprise development, Department of Trade and Industry

### Webpages: Brazil

[http://en.wikipedia.org/wiki/List\\_of\\_countries\\_by\\_income\\_equality](http://en.wikipedia.org/wiki/List_of_countries_by_income_equality)

[http://www.info.sebrae.com.br/br/rumo\\_lei\\_geral/index.htm](http://www.info.sebrae.com.br/br/rumo_lei_geral/index.htm)

<http://www.agenciasebrae.com.br/noticia.kmf?canal=40&cod=10239282>

<http://www.agenciasebrae.com.br/noticia.kmf?canal=214&cod=10601936>

<http://www.agenciasebrae.com.br/noticia.kmf?canal=207&cod=10596251>

<http://www.agenciasebrae.com.br/noticia.kmf?canal=208&cod=10279412>

<http://www.agenciasebrae.com.br/noticia.kmf?canal=32&cod=10545930>

<http://www.desenvolvimento.gov.br/sitio/interna/interna.php?area=4&menu=1982>

<http://www.sebrae.com.br/customizado/lei-geral/lei-geral/compras-governamentais/o-que-significa-para-a-mpe/significado-das-compras-governamentais>

<http://www.agenciasebrae.com.br/noticia.kmf?canal=208&cod=10088505>

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[http://www.info.sebrae.com.br/br/rumo\\_lei\\_geral/index.htm](http://www.info.sebrae.com.br/br/rumo_lei_geral/index.htm)

<http://www.desenvolvimento.gov.br/sitio/interna/interna.php?area=4&menu=2071>

<http://www.desenvolvimento.gov.br/sitio/interna/interna.php?area=4&menu=2070>

<http://www.mct.gov.br/index.php/content/view/314005.html>

<http://www.portalinovacao.mct.gov.br/pi/prime/indicadores/>

<http://www.sebrae.com.br/customizado/sebrae/institucional/quem-somos/historico>

<http://www.universia.com.br/carreira/materia.jsp?materia=6475>

### Webpages: India

<http://www.businessstandard.com/india/storypage.php?autono=390620>

<http://www.dare.co.in/people/featured-investor/os-vinod-cgtmse/Page-2.htm>

<http://www.dcmsme.gov.in/schemes/Purchase&PricePreferencePolicy.htm>

<http://www.lubindia.org/ssi/what-is-ssi.php>

(<http://in.news.yahoo.com/20/20100303/372/tbs-govt-constitutes-expert-group-for-ms.html>)

<http://pib.nic.in/release/release.asp?relid=57553>

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[http://msme.gov.in/msme\\_schemes.htm](http://msme.gov.in/msme_schemes.htm)

<http://www.nsic.co.in/creditrating.asp>

<http://smetimes.tradeindia.com/smetimes/news/top-stories/2010/Mar/03/20-pc-quota-for-mses-in-public-procurement-soon14556.html>

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<http://www.smecreditbureau.com.my/about.jsp>

<http://www.venturecenter.co.in/funding/funding.php>

## Websites

### *Brazil: general*

Ipea: [www.ipea.gov.br](http://www.ipea.gov.br)

MPE Data: [www.mpedata.com.br](http://www.mpedata.com.br)

### *Brazil: SME news:*

Exame.com: <http://exame.abril.com.br/pme/>

Sebrae news agency: [www.agenciasebrae.com.br](http://www.agenciasebrae.com.br)

Pequenas empresas e grandes e negocias: <http://revistapegn.globo.com/>

Valor: [www.valoronline.com.br](http://www.valoronline.com.br)

### *Brazil: government*

Ministry of Development, Industry and Commerce (MDIC): [www.desenvolvimento.gov.br](http://www.desenvolvimento.gov.br)

Government information for entrepreneurs: <http://www.brasil.gov.br/para/empreendedor/incentivo-a-educacao>

Regional Permanent Forum on Small and Micro Businesses for Parana: [www.forumpme.pr.gov.br](http://www.forumpme.pr.gov.br)

### *Brazil: Finance*

Banco Central do Brasil: [www.bcb.gov.br](http://www.bcb.gov.br)

BNDES: [www.bndes.gov.br](http://www.bndes.gov.br)

Central de Atendimento Empresarial: [www.facil.dnrc.gov.br](http://www.facil.dnrc.gov.br)

Finep: [www.finep.org.br](http://www.finep.org.br)

### *Brazil: business support*

Empreendedor programme:

<http://www2.desenvolvimento.gov.br/sitio/sdp/proAcao/proBraEmpreendedor/proBraEmpreendedor.php>

Empreende: [www.empreende.com.br](http://www.empreende.com.br)

Empreender: [www.empreender.org.br](http://www.empreender.org.br)

Endeavor Brasil: [www.endeavor.org.br](http://www.endeavor.org.br)

Endeavor Brasil magazine: <http://www.cafeeditora.com.br/revistaendeavor/ed02/>

Global Entrepreneurship Week: [www.semanaglobal.com.br](http://www.semanaglobal.com.br)

Jose Dornelas: <http://www.josedornelas.com.br/>

Redeagents: [www.redeagents.com.br](http://www.redeagents.com.br)

Sebrae: [www.sebrae.com.br](http://www.sebrae.com.br)

Sebrae Sao Paulo: [www.sebraesp.com.br](http://www.sebraesp.com.br)

*Brazil: Associations:*

Abrampe: [www.abrampe.org.br](http://www.abrampe.org.br)

Ajorme: <http://ajorpeme.com.br>

Ampe: [www.ampebrusque.com.br](http://www.ampebrusque.com.br)

Anpei: [www.anpei.org.br](http://www.anpei.org.br)

CNI: [www.cni.org.br](http://www.cni.org.br)

Comicro: [www.comicro.org.br](http://www.comicro.org.br)

FIESP: [www.fiesp.com.br](http://www.fiesp.com.br)

FIESP (magazine): <http://www.hkl.com.br/fiesp/>

Monampe: [www.monampe.com.br](http://www.monampe.com.br)

Simpres: [www.simpres.com.br](http://www.simpres.com.br)

*Brazil: incubators*

Anprotec: [www.anprotec.org.br](http://www.anprotec.org.br)

Cietec: [www.cietec.org.br](http://www.cietec.org.br)

Conselho Nacional de Desenvolvimento Científico e Tecnológica (CNPq): [www.cnpq.br](http://www.cnpq.br)

Edson Barros Carvalho: [www.edsondebarroscarvalho.com.br](http://www.edsondebarroscarvalho.com.br)

Fiesp: [www.fiesp.com.br](http://www.fiesp.com.br)

Fundo Criatec: [www.fundocriatec.com.br](http://www.fundocriatec.com.br)

Incubanet: [www.incubanet.org.br](http://www.incubanet.org.br)

InfoDev: [www.infodev.org](http://www.infodev.org)

InfoDev Incubator support centre: [www.idisc.net](http://www.idisc.net)

Innovation centres: <http://www.mct.gov.br/index.php/content/view/318837.html>

Prime Pernambuco: <http://prime.incubanet.org.br>

Portal Inovacao: [www.portalinovacao.mct.gov.br/pi/](http://www.portalinovacao.mct.gov.br/pi/)

Programe preincubatao Unifei: [www.preincubacao.unifei.edu.br](http://www.preincubacao.unifei.edu.br)

Venture capital: [www.venturecapital.gov.br](http://www.venturecapital.gov.br)

*Brazil: clusters*

APL Grande ABC: [www.aplgrandeabc.com.br](http://www.aplgrandeabc.com.br)

APL Moverlaria Paulista: [www.movelariapaulista.org.br](http://www.movelariapaulista.org.br)

Ipea APLs: [http://www.ipea.gov.br/005/00502001.jsp?ttCD\\_CHAVE=286](http://www.ipea.gov.br/005/00502001.jsp?ttCD_CHAVE=286)

MDIC's page on cluster conferences: <http://www.desenvolvimento.gov.br/conferencia-apl/modulos/edicao4/programacao.php>

MDIC's cluster page: <http://www.mdic.gov.br/sitio/interna/interna.php?area=2&menu=937>

Porto Digital: [www.portodigital.com.br](http://www.portodigital.com.br)

Rede APL mineral: [www.redeaplmineral.org.br](http://www.redeaplmineral.org.br)

Redesist: [www.redesist.ie.ufrj.br](http://www.redesist.ie.ufrj.br)

TCI Network: [www.tci-network.org](http://www.tci-network.org)

*India: General*

[www.msmedinewdelhi.gov.in](http://www.msmedinewdelhi.gov.in)

Union Budget: <http://indiabudget.nic.in>

*India: Government*

Ministry of Science and Technology: <http://www.dsir.gov.in/>

MSME Ministry: <http://msme.gov.in>

MSME Ministry Office of the Development Commissioner: <http://dcmsme.gov.in>

MSME Development Institute Agra: [www.msmediagra.gov.in](http://www.msmediagra.gov.in)

MSME Development Institute Delhi: [www.msmedinewdelhi.gov.in](http://www.msmedinewdelhi.gov.in)

MSME Development Institute Mumbai: [www.msmedimumbai.gov.in](http://www.msmedimumbai.gov.in)

MSME Testing centres Delhi: <http://www.rtcnr.gov.in/index.htm>

NSIC: [www.nsic.co.in](http://www.nsic.co.in)

*India: Clusters*

CII cluster programme: [www.ciiclusters.org](http://www.ciiclusters.org)

Cluster Kraft: [www.clusters.org](http://www.clusters.org)

Cluster Pulse: [www.clusterpulse.org](http://www.clusterpulse.org)

Foundation for MSME Clusters: [www.msme.foundation.org](http://www.msme.foundation.org)

National Resource Center for Cluster Development: [www.nisiet-cluster.org](http://www.nisiet-cluster.org)

*India: Finance*

CGTMSE: [www.cgtmse.in](http://www.cgtmse.in)

Reserve Bank of India: [www.rbi.org.in](http://www.rbi.org.in)

Sidbi: [www.sidbi.com](http://www.sidbi.com)

Venture centre: [www.venturecenter.co.in](http://www.venturecenter.co.in)

*India: SME publications*

Economic Times: <http://economictimes.indiatimes.com>

Financial express: [www.financialexpress.com](http://www.financialexpress.com)

SME Times: <http://smetimes.tradeindia.com>



*India: Associations*

Assocham: [www.assochem.org](http://www.assochem.org)

CII: [www.ciionline.org](http://www.ciionline.org)

Ficci: [www.ficci.com](http://www.ficci.com)

Fisme: [www.fisme.org.in](http://www.fisme.org.in)

Laghu Udyog Bharti: [www.lubindia.org](http://www.lubindia.org)

## Appendix 1 - Small business: Definitions

The respective definitions used by the South African government (Appendix Table 1), the Brazilian government and Sebrae (Appendix Table 2) and the Indian government (Appendix Table 3) to classify small, medium or micro enterprises, appear in three tables below:

**Appendix Table 1: South Africa: National Small Business Amendment Act of 2003** (Selected main sectors\* for SMMEs by annual turnover\*\*)

	Micro	Very small	Small	Medium
Manufacturing	R0.2m	R5m	R12m	R51m
Wholesale trade, commercial agents and allied services	R0.2m	R6m	R32m	R64m
Finance and business services	R0.2m	R3m	R13m	R26m
Community, social and personal services	R0.2m	R1m	R6m	R13m

Notes: \* - The criteria vary depending on the sector (of which the National Small Business Amendment Act of 2003 prescribes 11 different ones: Agriculture; Mining and Quarrying; Manufacturing; Electricity, Gas and Water; Construction; Retail and Motor Trade and Repair Services; Wholesale trade, commercial agents and allied services; Catering, accommodation and other trade; Transport, storage and communications; Finance and business services; Community, social and personal services).

\*\* - The size of a business in South Africa is chiefly defined by its number of employees: Micro: 0 to 4 employees; Very small: 5 to 9 employees; Small: 10 to 49 employees; Medium: 50 to 200 employees

**Appendix Table 2: Brazil: Lei Geral defition**

	Micro-enterprise	Small enterprise
<b>Turnover</b>	to R\$240 000 (about R1.1m)**	up to R\$2.4m (about R11m)*
<b>Construction and industry*</b>	Up to 19 employees	from 20 to 99 employees
<b>Commerce and services*</b>	Up to 9 employees	10 to 49 employees

Notes: \* -In addition to annual turnover, Sebrae uses these two definitions by employee for two sectors.

\*\* - But the thresholds differs for states and municipalities, only when considering Simples tax. Depending on the state, the thresholds range between R\$1.2m and R\$2.4m.

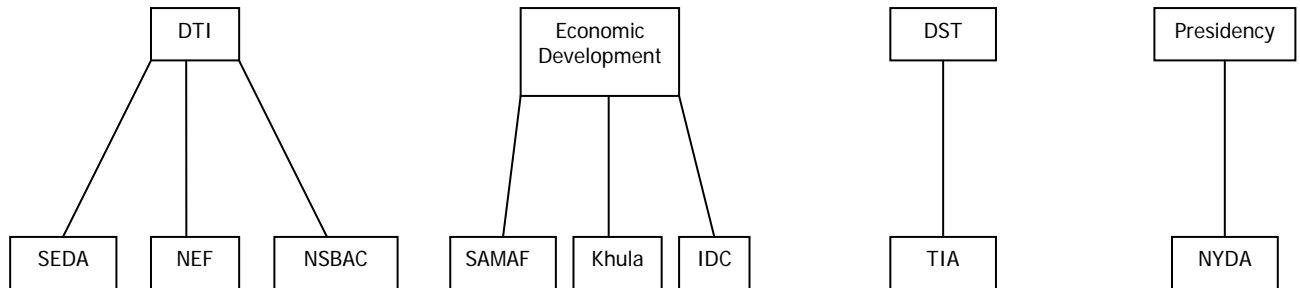
**Appendix Table 3: India: MSME Act definitions**

	Micro	Small	Medium
Manufacturing sector (Investment in plant & machinery)	Up to Rs2.5m	(Rs2.5m-Rs50m) <b>R418 000 to R8.4m</b>	(Rs50m-Rs100m) <b>R8.4m to R17m</b>
Services sector (Investment in equipments)	Up to Rs1m	(Rs1m-Rs20m) <b>R170 000 to R3.5m</b>	Rs20m-Rs50m) <b>R3.5m to R8.4m</b>

Note: \* - According to Fisme secretary general Anil Bhardwaj: Only 5% of all enterprises are classified as MSMEs – of these just 10% are registered and can therefore access government programmes. The remaining 95% are mostly handicraft, wholesale, communication, retail, transport, handloom businesses.

## Appendix 2 – Institutional Make-Up

### South Africa



#### **Department of Trade and Industry (DTI)** - [www.thedti.gov.za](http://www.thedti.gov.za)

Small business falls under the Minister of Trade and Industry Rob Davies, and specifically under two of the Department's units: the Enterprise Organisation, presently headed by Deputy Director General Tumelo Chipfupa, and the Empowerment and Enterprise Development Division, presently headed by acting Deputy Director General Siphso Zikode. The department has various entities under it, namely:

##### **i) Small Enterprise Development Agency (Seda)** - [www.seda.org.za](http://www.seda.org.za)

An agency of the Department of Trade and Industry mandated to support small enterprises, Seda, was formed out of a merger between Ntsika Enterprise Promotion Agency, National Manufacturing Advisory Centre (Namac) and the Community Public Private Partnership Programme (CPPP). The Godisa Trust and the Technology Programmes were integrated into Seda in 2006, becoming Seda Technology Programme (STP).

##### **ii) National Empowerment Fund (NEF)** - [www.nefcorp.co.za](http://www.nefcorp.co.za)

Set up in 1998 and operational in 2004, the NEF aims to fund black-owned and empowered (both big and small) businesses. Between 2003, and March 31 2010, the fund made 208 disbursements of over R1.5 billion. Of these 156 worth R457 million went to small black-owned businesses or franchisees (through the Imbewu Fund).

##### **iii) National Small Business Advisory Council (NSBAC)**

The National Small Business Advisory Council, launched in 2006, falls under the Department of Trade and Industry and reports to its chair Trade and Industry Minister Rob Davies. The council has eight members and serves to advise the minister on ways to boost support to small businesses. The first council collapsed after two years in 1998 amid allegations of mismanagement.

#### **Department of Economic Development**

The Department of Economic Development was set up in 2009 to co-ordinate the South African Government's economic policy. It oversees Khula, the IDC, Samaf, as well as the Competition Commission. The department oversees various entities, namely:

##### **i) Khula Finance Limited** - [www.khula.org.za](http://www.khula.org.za)

The government's small business finance organisation was set up in 1996 to help fund small businesses. As of 2009, Khula falls under the Department of Economic Development. It has various schemes to assist business owners, such as a credit guarantee scheme, a reverse factoring facility, a land-reform facility

and a network of retail financial intermediaries to which it advances to, which then lend this onto business owners.

**ii) Industrial Development Corporation (IDC) - [www.idc.co.za](http://www.idc.co.za)**

The government's development finance institution was set up in 1940, and the funding of small businesses forms a large part of its mandate. The IDC falls under the Department of Economic Development. The IDC financed 159 small enterprises to the tune of R2.13 billion (from a total of R10.9 billion) in 2008/2009. This compares to 94 dispersals the year before, valued at R933 million (out of a total of R8.4 billion). Altogether 142 of the net approvals during 2010 (67% of the total number of approvals) were for SMEs.<sup>261</sup> R2 103 million (more than 23% of the total value of approvals) were for these SMEs (companies with fewer than 200 employees, turnover less than R51 million and/or less than R55 million total assets).

**iii) SA Micro Finance Apex Fund (Samaf)**

Samaf was set up in 2005 as a micro-finance organisation and began operating in 2006. It provides loans to entrepreneurs of up to R10 000.

**Department of Science and Technology**

**Technology Innovation Agency (TIA) - [www.tia.org.za](http://www.tia.org.za)**

A new umbrella body, launched in 2010, for funding innovation set up in 2009, includes the Tshumisano Trust which housed the technology transfer stations, the Innovation Fund, the Council for Scientific and Industrial Research (CSIR)'s Advanced Manufacturing Technology Strategy.

**The Presidency**

**National Youth Development Agency (NYDA) - [www.nyda.org.za](http://www.nyda.org.za)**

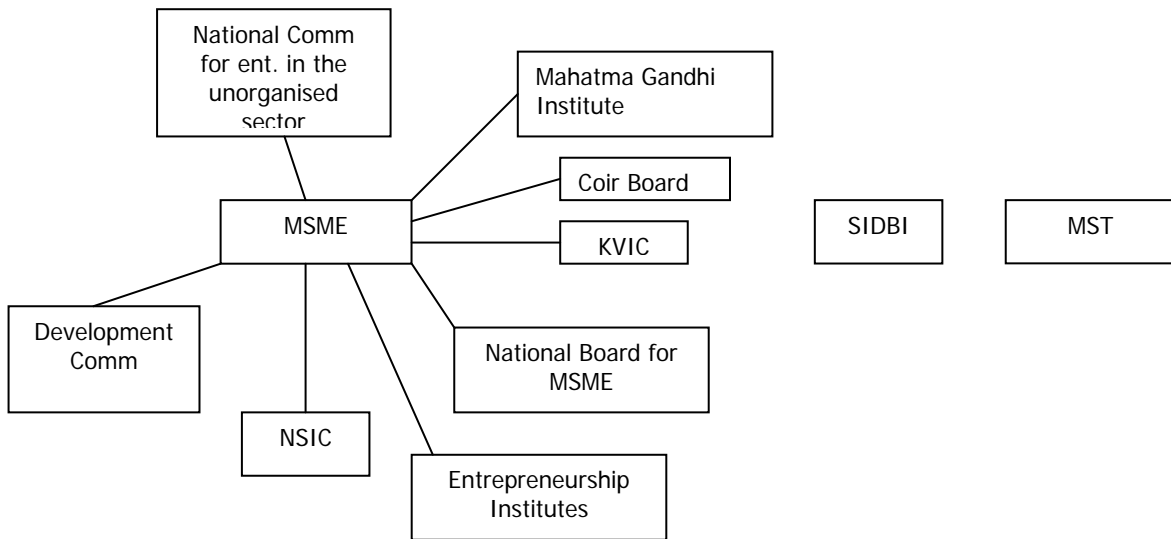
Born in 2009 out of a merger between the National Youth Commission and the Umsobomvu Youth Fund, the NYDA aims to assist youth with career skills and to help start their own businesses. It funds training and gives out loans. The agency disbursed 7 500 micro loans to value of R23 million and a further R4 million in loans in 2009/10<sup>262</sup>.

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<sup>261</sup> Bignews, June 2009

<sup>262</sup> Business Report, May 13, 2010

## India



### **Ministry of Micro, Small and Medium Enterprises (MSME)** - [www.msme.gov.in](http://www.msme.gov.in)

Presently headed by the Minister of State (Independent Charge), Ministry of MSME Dinsha Patel, with Uday Kumar Varma as the secretary (equivalent of South Africa's director general), the MSME ministry came about as a result of a merger between the Ministry of Small Scale Industries (SSI) and the Ministry of Agro and Rural Industries in 2007. The ministry has various entities under which fall under it, namely:

#### **i) The Office of the Development Commissioner MSME** - [www.dcmsme.gov.in](http://www.dcmsme.gov.in)

The Office of the Development Commissioner (Small Scale Industries), previously known as the Small Industry Development Organization, is an apex body, established in 1954, to assist the ministry in formulating, coordinating, implementing and monitoring policies and programmes for the small-scale industries. It has over 60 offices and 21 autonomous bodies under its management, including: 30 MSME Development Institutes, 28 branches, 10 tool rooms, six MSME technology development centres (R&D for clusters or act as training centres) and various training centres:

#### **ii) National Small Industries Corporation Limited (NSIC)** - [www.nsic.co.in](http://www.nsic.co.in)

The National Small Industries Corporation (NSIC) is a public sector company set up in 1955 to support small businesses in the country in areas such as marketing, purchase of raw materials, credit ratings and management practices. The organisation has 121 offices around the country. It also has an office in Johannesburg.

#### **iii) National Board for Micro, Small and Medium Enterprises**

Board was set up under the MSME Act in 2006 to look at the factors affecting promotion and development of small enterprises and review policies and programmes relating to the sector, with a view to making recommendations to government on these matters. It is effectively a continuation of the old Small-Scale Industries Board which also fell under the ministry.

#### **iv) Three autonomous national level entrepreneurship institutes**

The Ministry of MSME set up three entrepreneurship institutes to help train and create new businesses. These are based in Hyderabad, Guwahati and Delhi. The Institutes conduct training and research.

#### **v) Rural and informal businesses**

- a) Khadi and Village Industries Commission (KVIC): The KVIC was set up in 1956 and is a statutory organisation aimed at promoting and developing family-run khadi (cloth) and village

enterprises in rural areas. The commission's role is to plan, promote and organise schemes for generation of employment opportunities in khadi and village industries.

b) Coir Board: The Coir Board was established in 1953 to promote the coir industry and to improve the condition of those workers involved in this traditional industry.

c) Mahatma Gandhi Institute for Rural Industrialisation: The Institute in Wardha, Maharashtra aimed at improving research and development activities in the rural industrial sector.

d) National Commission for Enterprises in the Unorganised Sector: set up in 2004, the NCEUS acts as a watchdog for informal sector businesses and looks at the problems that this sector faces, making various recommendations to the government of India.

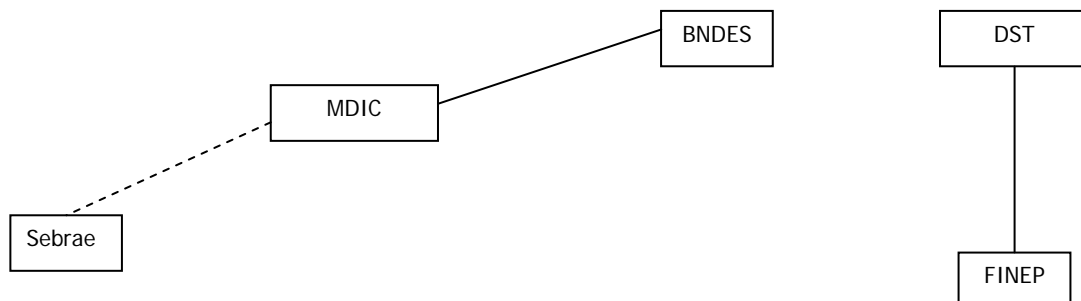
**Ministry of Science and Technology** - [www.dsir.gov.in](http://www.dsir.gov.in)

The Department for Scientific and Industrial Research which falls under the ministry, operates a number of schemes aimed at technology entrepreneurs. The ministry also supports a network of about 50 incubators and offers seeding funding to incubatees through some incubators, according to the ministry's 2009/2010 annual report.

**Small Industries Development Bank of India (Sidbi)** - [www.sidbi.com](http://www.sidbi.com)

The Sidbi was established in 1990 as a small business bank. The central government has about an 80% shareholding in Sidbi, through various government institutions and funds. It operates different programmes and schemes through 5 Regional Offices and 33 Branch Offices. The financial assistance of SIDBI to the small scale sector is channelised through the two routes – direct and indirect.

Brazil



**Ministry of Development, Industry and Foreign Trade (MDIC: Ministério do Desenvolvimento, Industria e Comercio Exterior)** - [www.mdic.gov.br](http://www.mdic.gov.br)

Presently headed by the Minister Miguel João Jorge Filho, with Sergio Nunes de Souza as the director of the Department of Micro, Small and Medium Enterprises.

**Banco Nacional de Desenvolvimento Econômico e Social (BNDES)** - [www.bndes.gov.br](http://www.bndes.gov.br)

Brazil's state development bank, set up in 1952, includes the financial support of small, micro and medium enterprises as one of its goals and has a number of programmes aimed at SMEs. BNDES reports to MDIC.

**Agência de Apoio ao Empreendedor e Pequeno Empresário (Sebrae)** - [www.sebrae.com.br](http://www.sebrae.com.br)

A private non-profit company tasked with providing non-financial support and developing policies for small business in Brazil. Sebrae was set up in 1972 (as a government institution called Cebrae, before transforming to a private organisation in 1990) it receives government funding through the "S" system.

**Ministry of Science and Technology**

**Finep** - [www.finep.gov.br](http://www.finep.gov.br)

Financiadora de Estudos e Projetos — FINEP (Research and Projects Financing), is a publicly owned company which falls under the Ministry of Science and Technology and was founded in 1967. Its mandate includes supporting small enterprises with funding to access innovation.



## Appendix 3 – Important SME schemes

Below are some of the most prominent government support schemes for small businesses that the author studied to determine which might be most suitable for South Africa to learn from. Also included here, for their usefulness is a list of the most prominent South African government support schemes for SMEs.

### South Africa

South Africa has a wide range of support schemes that target small business owners, in the areas of research and development, business and marketing support, exports and support for setting up manufacturing, tourism and co-operatives. The majority are in the form of incentive schemes, which pay out matching grants to business owners, with either half or a large percentage of the project costs being funded by the applicant themselves.

Most of the schemes are located under a unit at the Department of Trade and Industry called The Enterprise Organisation. The schemes include:

- The Black Business Supplier Development Programme (BBSDP): a cost-sharing grant offered to black-owned small enterprises to assist them in improving their competitiveness and sustainability. Grants of up to R1 million are given out for enterprises with an annual turnover of up to R35 million.
- The Export Market and Investment Assistance (Emia): This scheme assists businesses to attend trade fairs or to conduct trade visits by refunding a significant portion of their air fare, accommodation, transport of samples and marketing material.
- The Co-operative Incentive Scheme: Provides start-up funding from R10 000 to R300 000 to co-operatives, with the government covering 90% of the funding in the form of a grant.
- The Enterprise Development Programme: Matching grants are provided to small manufacturing firms and businesses in the tourism sector.

Added to this the department also oversees the Support for Industrial Innovation (Spii) and Technology and Human Resources for Industry Programme (Thrip).

- Spii funds research and development (R&D) for new innovations in manufacturing, through a grant of 50% to 75% of up to R3m and has been in operation since 1993.
- Thrip supports scientific research and aims to foster a collaboration between academic institutions and industry through a cost-sharing grant offered by the department. The programme is managed by the National Research Foundation (NRF).

Business owners can also benefit from the cluster-based initiative the Workplace Challenge Programme run by the Department of Trade and Industry and managed by Productivity SA, an agency of the Department of Labour. The programme aims to increase the productivity of businesses big and small, by getting them to work together in a cluster and share learnings. In all 19 clusters consisting of 187 enterprises in all were up and running in the 2010 financial year.<sup>263</sup>

The recent performance of the schemes show that:

- Spii had funded 1 025 projects to the tune of R933 million up until March 31, 2010. In 2007 the programme was chosen by the OECD and World Bank as the best incentives programme within the South African government.<sup>264</sup>

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<sup>263</sup> Productivity SA's 2010 annual report.

<sup>264</sup> Business Day, 18 August 2009.

- Thrip: Between 2006/07 and 2009/10, 866 SMMEs were funded to the tune of R240.3m.
- BBSDP: Since its inception in 2002 till March 31 2010, 9 657 enterprises with total disbursements of R187.5 million have benefited.
- Emia: In 2008/09 a total of 1 276 businesses benefited from R110.9 million in funding through the scheme. This is down from the 1 332 assisted in the 2008/2009 year, when R106.4 million was disbursed in funding. Emia supported 779 projects in 2009/10.
- Co-operative Incentive Scheme: From 2006 to September 7 2010, 357 co-operatives had been assisted to the tune of R71.2m.<sup>265</sup>
- The Enterprise Development Programme: 164 tourism projects (to the value of R417 million) and 290 manufacturing projects (R1 billion) had been approved up to the end of February 2010.<sup>266</sup>

## India

India has numerous schemes, which fall under the Ministry of Micro Small and Medium Enterprises (MSME) and which form part of the country's 11<sup>th</sup> Plan which came into affect in March 2007 and runs until 2012.

The most prominent schemes are:

- Assistance to set up or upgrade mini-tool rooms: The government funds up to 90% of the cost of setting up a tool room, up to Rs.90 million, whichever is less. For the upgrading of existing tool rooms, assistance of up to 75% of the cost or Rs.75 million, is granted to state governments.
- Credit linked Capital Subsidy Scheme: Launched in 2000 and revised in 2005, this scheme aims to help small businesses to upgrade their technology by providing a 15% capital subsidy on loans for plant and machinery that run up to Rs10 million.
- Credit rating and performance subsidy: subsidises 75% of the cost of a credit rating, up to Rs40 000.
- ISO reimbursement scheme: reimburses entrepreneurs who take out ISO9000, ISO14001 or Hazard Analysis and Critical Control Points (HACCP) certifications. Enterprises can have 75% of the costs for certification reimbursed, up to Rs75 000 in each case.
- National Manufacturing Competitiveness Programme: launched in 2007 to help MSMEs compete better in global markets and against multinational companies.

The National Manufacturing Competitiveness Council (NMCC) has finalised a five-year National Manufacturing Programme and 10 schemes have been drawn up including schemes for promotion of ICT, mini tool room, design clinics and marketing support for SMEs. Implementation will be in the form of a public-private partnership model.

Some of these schemes are<sup>267</sup>:

- MSE Marketing Development Assistance (MDA): offers to fund up to 75% of a small business's air fare for participation in overseas fairs and trade delegations. The scheme also provides for funding for producing publicity material (up to 25% of costs), for sector specific studies (up to Rs200 000) and for contesting anti-dumping cases (50% up to Rs100 000) – for individual MSMEs & Associations.
- Integrated Infrastructure Development (IID): This scheme grants assistance of up to Rs20 million or 40% of the project cost, whichever is less, for setting up new industrial estates for MSEs (up

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<sup>265</sup> Parliamentary question 2444, 7 September 2010.

<sup>266</sup> Parliamentary question 322, 18 March 2010.

<sup>267</sup> A summary can also be found on: [http://msme.gov.in/msme\\_schemes.htm](http://msme.gov.in/msme_schemes.htm)

to 80% or Rs40 million for the states in the north eastern regions). The government has earmarked 50% of the support for rural areas.

- Assistance to Entrepreneurship Development Institutes: To strengthen training infrastructure for entrepreneurship institutions, the government provides assistance of up to 50% or Rs5 million whichever is less. The financial assistance targets areas like building, training aids, equipment and other support services and will be on matching basis, say 50% of the cost restricted to Rs10 million in each case.
- Under the Ministry of Science and Technology's Department of Scientific and Industrial Research, the technology entrepreneurs can access the Technopreneur Promotion Programme (TePP) which offers grants of between Rs75 000 and Rs4.5 million for creating prototypes, patenting ideas and testing new innovations.

Performance:

- Credit linked Capital Subsidy Scheme: In 2008/2009 1 790 businesses benefited to the tune of Rs974 million – up from Rs638 million and 1 407 businesses in 2007/2008.<sup>268</sup>
- ISO reimbursement scheme: Up to 31 December 2009, 19 468 entrepreneurs had benefited since the inception of the scheme.
- Credit rating and performance subsidy: 7 505 business owners benefited from the scheme in 2009/2010, a slight increase over the year before when 5 011 accessed the scheme.<sup>269</sup>

## Brazil

Most of Brazil's support for small business falls under either its small business support agency Sebrae, the Ministry of Development, Industry and Commerce (MDIC), as well as under its development finance institution BNDES and state banks.

Some of the more prominent schemes include:

- Programme Enterprising Brazil, or Programa Brasil Empreendedor (PBE): an initiative of MDIC focused on supporting existing small businesses and encouraging new start-ups. It was launched in 1999. Support is dispensed through state bank Banco do Brasil, as well as through Sebrae, BNDES and a number of other state banks to business owners that work together in focus groups of 25 firms with similar interests.
- Criatec programme: A venture capital fund created by development bank BNDES in 2007. It aims to invest R\$100 million in about 50 small innovative companies, with investments each of between R\$1.5 million and R\$3.5 million.
- The Fundo de Aval às Micro e Pequenas Empresas (Credit guarantee fund for micro and small businesses): formed from resources drawn from Sebrae's budget has been in operation since 1995 and aims to guarantee credit to small businesses.
- Inovar Project: a venture capital fund and information network, hosted by the Brazilian government's innovation agency, Finep (Financiadora de Estudos e Projetos – Research and Projects Financing).
- Programme First Innovative business (Prime): launched in 2009, provides grants of about R\$120 000 to start-ups, selected by 17 incubators acting as agents, focused on innovation. Between 2009 and 2011, and through three rounds of finance, it hopes to reach about 5 000 entrepreneurs with R\$650 million in grants, with a total of R\$1bn including additional capital and credit. Finep also has a 0% interest funding programme to stimulate firm growth in early stages, which successful new enterprises can also request loans from – up to R\$120 000 in 100 instalments without interest.

<sup>268</sup> MSME Ministry Annual report 2009/2010.

<sup>269</sup> Interview with Gaunang Dixit, manager of the credit rating subsidy at the NSIC, March 2010.

- Primeiros Exportações: MDIC's Primeiros Exportações is an export-ready support programme set up in 2000. Fabio Castejon Resende, an analyst of the foreign trade secretariat at the ministry<sup>270</sup> said only a very few small firms – 21 000 according to the MDIC – are involved in exporting, despite the fact that about half of all export firms are SMEs.

Performance:

- Programme Enterprising Brazil: since 1999 it has made available more than R\$3 billion for investment in small and medium-sized enterprises.
- Criatec programme: In 2008 Criatec invested a total of R\$15.4 million in 11 businesses, with an average investment of R\$1.4 million in each enterprise.<sup>271</sup>
- Fampe: In August 2010, the fund which guarantees loans principally through Banco do Brasil, (which is disbursing over 99% of all guarantees) had given out R\$3.6 billion to 143 544 micro and small businesses.<sup>272</sup>
- Inovar: The first funding Inovar I kicked off in 2000 and a second one was recently launched in 2008. So far 52 businesses have benefited – 50 of which are SMEs. Most of the companies (19) are in the IT sector.<sup>273</sup>
- Prime: In all 3 140 were supported through the grant at the end of its 2009 funding cycle.<sup>274</sup>
- Primeiros Exportações: Of the first three states that completed the programme – Rio Grande do Norte, Espirito Santos and Goias, 44 companies completed training with the assistance of 84 agents and today just 12 of these are exporting. Companies that complete the programme can participate in Apex missions free. According to Fabio Castejon Resende, an analyst of the foreign trade secretariat at the ministry, who oversees the ministry's Redeagents project, since 2000 the programme has trained 50 000 people – 70% employers or employees of small enterprises.

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<sup>270</sup> Interview with Fabio Castejon Resende, Brasilia, August 2010.

<sup>271</sup> BNDES, Annual report 2008

<sup>272</sup> "Fampe permite a liberação de R\$3,6 bi em avais de crédito para micro e pequenas empresas", 27 August 2010, Sebrae agency news: <http://www.agenciasebrae.com.br/noticia.kmf?canal=32&cod=10545930>

<sup>273</sup> According to Venture capital: [http://www.venturecapital.gov.br/vcn\\_ing/en\\_oquee\\_Pl.asp](http://www.venturecapital.gov.br/vcn_ing/en_oquee_Pl.asp)

<sup>274</sup> According to Finep: <http://www.finep.gov.br/programas/prime.asp>, <http://www.portalinovacao.mct.gov.br/pi/prime/indicadores/>

## Appendix 4 – Clusters supported by IPAP

The clusters supported under IPAP include:

1. Under metal fabrication, capital equipment and transport equipment: increased support for:
  - a) The National Tooling Initiative<sup>275</sup>
  - b) The National Foundry Technology Network<sup>276</sup>
2. Under the Agro-processing, the setting up of two abalone hatcheries at Hondeklip Bay in the Northern Cape and the establishment of marine aquaculture zones by the Department of Agriculture and Fisheries, after running a pilot in Port Elizabeth in the 2010/11 financial year.
3. In the automotive sector: The Department of Trade and Industry will continue with its support to the sector through the Automotive Production and Development Programme, benchmarking, the setting up of a web portal to help SMEs to optimise existing technology investments and providing mentorship of SME component manufacturers.
4. The clothing and textiles sector: The Department of Trade and Industry will continue with its support to the sector. A new programme, the Clothing and Textiles Production Incentive was launched in 2010 and the department will also roll out training programmes, a programme to clamp down on illegal imports and oversee the commercialisation of certain fibres.
5. Under the Forestry, timber, paper and pulp and furniture sector the Department of Trade and Industry plans to:
  - a) Set up furniture clusters for small manufacturers in outlying regions.<sup>277</sup>
  - b) Set up charcoal plants in the Eastern Cape.<sup>278</sup>
6. The Cultural industries: Crafts, film and music sector, which in 2008 contributed 0.01% of manufacturing value-add and employed 2.9% of those in the manufacturing sector, will benefit from the establishment of craft hubs with rural satellites in priority provinces.<sup>279</sup>

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<sup>275</sup> This includes benchmarking of suppliers as part of the Unido's Sub-contracting and Partnership Exchanges (SPX) programme and participation in Unido's CSDP, developing a support instrument template to access support through the Small Enterprise Development Agency (Seda) as well as Khula, the National Empowerment Fund (NEF) and banks, rolling out a competitiveness improvement and export development programme, apprenticeship programme and carrying out an evaluation by the department of the programme.

<sup>276</sup> The National Foundry Technology Network, which provides technical support to foundries in South Africa. Support includes: carry out a training and benchmarking programme as part of Unido's SPX programme, technology assistance packages, facilitation of research and development through Mintek, the Council for Scientific and Industrial Research (CSIR) and the network.

<sup>277</sup> The furniture clusters aim to assist businesses to conduct joint selling and share various manufacturing costs. The department aims to develop a business plan and marketing strategy sector, as well as appoint facilitators to set up clusters, in the 2010/11 financial year. In tandem with the clusters, the department aims to, in the same financial year, approve a business plan for the setting up of a furniture centre of competence, which also aims to aid small manufacturers.

<sup>278</sup> The aim is to in the 2010/11 financial year to get the Small Enterprise Development Agency (Seda) to train and register 12 co-operatives in communities showing an interest in charcoal production. The National Empowerment Fund (NEF) and the Industrial Development Corporation (IDC) will provide funding and Seda will also implement a business plan and co-operatives monitoring programme.

<sup>279</sup> The Small Enterprise Development Agency (Seda) will co-operate with the Department of Trade and Industry and provincial governments in the respective provinces to launch hubs in the North West in 2010/11 and KwaZulu-Natal in 2011/12. In the 2011/12 financial year, the IDC will set up a R10 million fund to support enterprises being developed in those hubs.

## Appendix 5 – Corruption in India

Indian entrepreneurs still face a number of obstacles including numerous labour laws, bureaucracy and severe corruption – a fallout from the licensing regime – and highly saturated market.<sup>280</sup> Indeed, the World Bank's Doing Business 2010 Report ranks India 133 for ease of doing business, just behind Brazil at 129 and way behind South Africa at 34.

An even bigger threat to business owners in India, is corruption. While business owners in South Africa list as one of the biggest problems they face as crime – particularly with the increase in armed robberies, (Gem Report and SME Study) Indian business owners have to contend with an alarming rate of endemic corruption. In India – ranked 84 out of 180 countries by Transparency International's Corruption Perception Index in 2009, 29 places below South Africa – a little money baksheesh can go a long way to solving just about any misunderstanding. It can also help buy you an ISO 9001 certificate or secure the land needed to set up a new factory. In a 2008 survey by business consultancy Milagrow Business and Knowledge Solutions 97% of small and medium enterprises polled who had accessed government schemes, said they had been asked to pay a bribe by officials. In all 82% of business owners polled said they had been adversely affected by corruption.

Milagrow's director Rajeev Karwal can even relate his own experience, when a labour inspector visited his offices recently and asked to see his Establishment Act certificate, necessary if one wants to set up a business. The inspector asked for a little sweetener – 4000 rupees (R650) – before he renewed the certificate. Karwal refused to pay the bribe and the inspector dragged him to court. The director won the case, but in a final act of spitefulness the inspector scribbled on top of the certificate, changing the validation date from three years to one year. According to Karwal: "A lot of companies just compromise because who has the time, to go and fight the system, to go to the courts, because they have to run their businesses".

Then there is the Delhi business owner I spoke to who exports buttons and items such as garden tools and handicrafts. Just over a year ago he tried to access a government scheme that subsidises small firms that want to attend trade fairs. His first port of call was the government agency which runs the scheme. Officials there indicated to him that he would have to first register his business as a Medium, Small and Micro Enterprise before he could benefit from the scheme. But before he could register he needed to get approval from local authorities that he wasn't running a hazardous business. This required obtaining a No Objection Certificate. He also needed clearance from the city's pollution control committee. Eighteen months later he is still waiting for the two licenses and it is becoming increasingly evident what is expected of him. Just recently he says, he bought the certificate he needed to run his factory, by paying "quite a large bribe". Had he not paid the bribe he would still be waiting for his certificate.

Yet corruption in India might be on the rise. According to economist Arvind Panagariya in *India: The Emerging Giant*, at independence the country inherited a "largely honest and efficient bureaucracy". To encourage more entrepreneurs to enter the economy the government introduced licenses, which reserved many sectors for small businesses. As the economy started growing and became more complex, as the paperwork began piling up bribes became the order of the day and many smaller businesses unable to afford the bribes lost out to more cash-endowed larger businesses. Corruption has since become endemic.

Says one entrepreneur: "I myself unsuccessfully participated in bidding processes of government contracts and I was shocked to know the level of intimidation and corruption – the same goes on the in private sector. If you have a pocket full of money to buy anyone, certainly you will succeed."

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<sup>280</sup> Arvind Panagariya, *India: The Emerging Giant*, p.59.

## Appendix 6 – Highlights from Sebrae's 2009 management report

Objectives and results from Sebrae's 2009 management report:<sup>281</sup>

### 1. Promote innovation

A total of R\$260.2 million or 38% of Sebrae investments were in 2 051 projects and activities to stimulate innovation. Among these were:

- i) Investment of R\$58 million in strategic partnerships to promote innovation with various institutions such as Finep and the National Industry Confederation (CNI).
- ii) A series of 120 programmes about innovation called Faça Diferente with 500 radio transmission to the cost of R\$5 million.
- iii) Local innovation agents (Agentes Locais de Inovação – ALIs) – 388 professional were capacitated in eight states with 6 936 enterprises reached, to the cost of R\$1.2 million.

### 2. Strengthen co-operation between SMEs

A total of R\$15.2 million was spent on 588 projects and activities to encourage institutions and small and micro enterprises to form partnerships, such as:

- i) Project Empreender Sebrae GO to promote associations and co-operation among SMEs (R\$1.2 million).
- ii) The Programme to Strengthen the System of Association of Micro and Small Enterprises (Programa de Fortalecimento do Sistema Associativo das MPE) – R\$1.05 million.
- iii) Project Co-operation (Projeto Cooperação como Estratégia Competitiva para as Pequenas Empresas) implanted in five states in 2009 (R\$327 000).

### 3. Assist SMEs to enter the market

Sebrae aims to assist SMEs to enter the market through mechanisms such as e-commerce, conscious consumerism, electronic payments, certification, socio-economic responsibility, producer chains, consortiums and co-operatives

The agency spent R\$113.8 million through 1 585 projects, including:

- i) Mercopar Fair 2009 (Feira Mercopar 2009) hosted by Sebrae's Rio Grande do Sul office, with business in industrial innovation which had over 500 exhibitors national and international (R\$2.88m).
- ii) Centre of Events of the Pantanal (Centro do Eventos do Pantanal Sebrae Mato Grosso) – R\$2.1m.
- iii) Programme of internationalisation of micro and small enterprises (Programa de Internacionalização das MPE) with 500 enterprises reached in five states (R\$1.44 million).

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<sup>281</sup> Author's own translation.



#### 4. Assist with capacitation in management, technology and processes

Sebrae aims to offer products and services to assist SMEs to compete better.

The agency spent R\$175m in 1 972 projects and activities, among those were:

- i) Educação Sebrae (Sebrae Education) which offered internet courses, reaching 282 300 participants in 2009 through nine courses (R\$6 million).
- ii) The agency spent R\$4.3 million through strategic partnerships with a number of organisations:
  - o The National Foundation of Quality's Competitiveness competition (Prêmio Competitividade do Fundação Nacional da Qualidade) with 57 718 applications.
  - o Competition for Women in Business (Prêmio Mulher de Negócios) with 3 060 participants.
  - o Abeta's Programme of Qualification and Certification in Adventure Tourism (Programa de Qualificação e Certificação em Turismo de Aventura) which assisted 756 enterprises.
  - o Roberto Marinho Foundation (Fundação Roberto Marinho) which spread entrepreneurship through Canal Futura.
- iii) Sebrae Programme for advanced enterprises attended to 1 180 individuals in 2009, the goal in 2010 is to attend to 30 000 enterprises (R\$1.09 million)

#### 5. Promote a culture of entrepreneurship

Through education drives Sebrae spent R\$47.9 million in 2009 on 453 projects and activities:

- i) Management and accompaniment of projects attended to individuals (R\$5.9 million).
- ii) Eight entrepreneurship fairs were realised with 630 exhibitors and 116 180 visitors, with R\$24.8 million in business generated (R\$5.6 million).
- iii) Sebrae virtual competition for universities (Desafio Sebrae) received a record 131 183 applications (R\$4.96 million).

#### 6. Strengthen networks of partnership

Sebrae spent R\$18.3 million on mobilising resources, knowledge and competencies to benefit small and micro enterprises through 448 projects and activities, including:

- i) Partnering with BID and the Centre of Technology Itaipu (Centro Tecnológico Itaipu) Projeto Centro de Desenvolvimento de Tecnologias to integrate micro and small enterprises with with other Latin American countries (R\$2.04 million).
- ii) Project furniture units (Projeto Unidades Móveis) in partnership with Finep to supply technological services and laboratories (527 assisted).
- iii) Technical co-operation programme with Anprotec to support the development of science parks and incubators.

#### 7. Stimulate the access to financial services

Sebrae spent R\$5.1 million on eight projects, the highlights being:

- i) Partnerships with Rede Ande e Ancosol – Cooperativa de Crédito Solidário no Brasil (R\$1.5m).
- ii) Support to the micro finance sector and credit co-operatives to increase their financial offerings to small and micro enterprises and reduce costs (R\$500 900).

iii) Assisting Fundo de Aval as Micro e Pequenas Empresas to set up agreements with 10 financial institutions. The fund helped 40 000 enterprises access R\$1.5 billion (R\$1.2 billion guaranteed) – R\$285 000.

## 8. Articulate, propose and support the implementation of public policies

The key goal of the agency is to see Lei Geral implanted in 2 800 of the 5 000 municipalities by 2012. At the end of 2009 this figure stood at 1 222.

Sebrae spent R\$16.8 million on 261 projects in all states to prioritise a legal environment Among other things:

- i) It spent R\$2.7 million on the National Front for Mayors (Frente Nacional de Preitos) to alert municipalities of the benefits of Lei Geral.
- ii) It spent R\$951 000 on a meeting with the National Federation of Accountants that Service Business
- iii) Support to the implanting of Empreendedor Individual. In 2009 121 910 such businesses were registered and the goal in 2010 is one million.

## 9. To ensure excellence in management of its results through Sistema Sebrae

In all R\$82,1m was spent on 2 435 projects such as supporting tourism projects in 13 states (R\$2.18m).

## 10. Develop competencies and retain talents inside and outside

Sebrae spent R\$28m on 102 training projects for staff and consultants, including R\$3.8 million on Sebrae's University (Universidade Corporativa Sebrae) which offered 17 disciplines online with 2 259 participants and 3 076 applications in courses.

The agency also spent R\$270 000 on capacitating 261 directors and nationala dn state councillors and R\$233 000 on capacitating partners (914 individuals trained) that can then spread Sebrae solutions.

## 11. Develop and implant management and knowledge about SMEs in Sebrae

In all R\$9.8 million was spent on 164 activities and projects, of which R\$749 000 was used to set up MPE Data (a site which contains data on SMEs) as well as on surveys and publications.

Also R\$448 000 was spent on 2 919 new texts in 2009 which is the principle foundation used to attend to SMEs. Its's "Ideias do Negócio" alone, with 360 titles, received over 385 000 visits per month on Sebrae's website.

The online library now has 3 187 documents available through Sebrae's web portal.

Objective	Composition	Value in Reals
1.Promote innovation	34%	260.1m
2. SME co-operation	2%	15.1m
3.Market access	15%	114.2m
4.Capacitation	23%	175.9m
5.Entrepreneurship	6%	48.1m
6.SME networks	2%	18.6m
7.Access to finance	1%	5.9m
8.Public policies	2%	17m
9.Management system	11%	82.6m
10.Internal competencies	3%	28.3m
11.SME knowledge	1%	9.8m
TOTAL	100%	775.7m