



Research Paper

Small and Medium Size Enterprises (SMEs) and Procurement Practice in Nigeria

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Abstract

The public sector in many instances is an important market for small businesses, so improving public procurement practices by removing obstacles and boosting their involvement of SMEs is a key priority. Developing a more SME-friendly approach to public procurement means SMEs can maximize their potential for job creation, growth and innovation. Increasing involvement of SMEs in public procurement schemes can, if properly designed, result in higher competition for public contracts, leading to better value for money and efficiencies for contracting authorities. The paper, therefore, x-rayed the intertwined relationship between Small and Medium Size Enterprises (SMEs) and procurement practice in Nigeria with a view to addressing the grey areas.

Keynotes: SMEs, Procurement, Approach, Participation, Nigeria

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I. INTRODUCTION

Small and medium size enterprises (SMEs) can play a major role in closing this divide. According to the SME Finance Forum, they are crucial for growth and job creation, accounting for nearly 86% of employment opportunities in developing countries (Belfitt, 2019). SMEs are seen to reduce income concentration with a disproportionate impact on minority or poor populations (Adekoya, 2018). SMEs account for the majority of businesses worldwide and are important contributors to job creation and global economic development (World Bank, 2020). They represent about 90% of businesses and more than 50% of employment worldwide. Formal SMEs contribute up to 40% of national income (GDP) in emerging economies.

The current rising rate of inflation, slowdown in growth rate and other pressures bearing down hard against the Nigerian economy speak to the realities of the times we are living in. Further, the closure of over 50 confectionaries in Nigeria's FCT (Abuja) due to a rise in cost of operations and inability to meet their financial responsibilities paints a more vivid picture of the situation (Adamu, 2018). A harsher reflection of this reality can be viewed through the prices of common goods and food items that have literally gone through the roof. However, amidst these challenges, some resilient operators – retail entrepreneurs – are trying to weather the headwinds and make things happen. The retail industry caters for over 25 million people who make a living from it (Adekoya, 2018).

Studies such as Bamisile, (2016) and Abeh, (2017) indicate that women account for 41% in terms of business ownership within this segment that is estimated to be worth \$100 billion. In the last five years, SMEs in Nigeria have contributed 48% of the national Gross Domestic Product (GDP). These data speak to the importance played by the SMEs in the country. Aware of the important role financing plays in driving retail trade, various financial institutions and fulfillment service providers are providing credit to players in the SMEs to enable them sustain and grow their businesses.

According to World Bank (2020), Small and Medium Enterprises (SMEs) play a significant role in most economies, especially in emerging markets where 7 out of 10 jobs are created by SMEs. Records show that SMEs account for the highest number of businesses worldwide and are essential contributors to employment generation and global economic development. Universally, SMEs accounts for around 90% of businesses and more than 50% of employment. In emerging economies, SMEs contribute up to 40% of GDP and it significantly increases when combined with informal SMEs. Furthermore, SMEs development is considered a high priority worldwide as World Bank estimates that by 2030 nearly 600 million jobs will be needed to absorb the rising workforce globally.

Aigbe Omeregbe, the Founder of Young CEO Initiative, enlightened that the role of SMEs in Nigeria's economic development is worthy of appreciation because of the significant role MSMEs play in the development of a nation stretching from contribution to Gross Domestic Product (GDP) to employment creation, export and technology innovation. He further revealed that in 2013 SMEs contribute 54% to Nigeria's GDP and 7.27% to export while in 2014. It is reported that Nigeria Bureau of Statistics (NBS) recorded that 59 million (84.02% of Nigeria's total labour force) Nigerians work in the SMEs sector. Mr. Aigbe admitted that it would not have been possible without the efforts of favourable government policies and programmes implemented to encourage youth entrepreneurship.

Similarly, Central Bank of Nigeria (CBN) statistical bulletin (2020) estimates suggest that SMEs in the account for 48 % of national GDP, 96% of businesses and 84% of job opportunities. The latest SMEDAN/NBS MSME Survey indicates Nigeria's SMEs contribute nearly 50% of the country's GDP and account for over 80% of employment. According to Davila, Gupta and Palmer, (2013), the contribution of SMEs to the economy is generally gathered under five main topics: employment creation; fast adaptation to new situations with its flexibility feature; encouraging entrepreneurship; product differentiation through boutique production; working as sub-industry in large enterprises.

Also, some sources, such as Erridge & Nondi, (2014) and Guth, (2015) suggest that SMEs are a 'unique source of innovation and competition' (see, e.g., EIM, SMEs' Access to Public Procurement Contracts, March, 2004), although the correlation between increased SME participation in public procurement and greater innovation remains unclear. It is found from the work of (Abel, 2017) that small and medium scale enterprises contribute positively towards economic growth in Nigeria. Stimulation for exploration of local resources and creation of employment opportunities for the citizens of the country signify their contribution to the economy of Nigeria.

Under a set aside - essentially a quota - a certain percentage of designated government procurement contracts or total spending is reserved or 'set aside' for a targeted category of bidders that meet the preferential qualification criteria, such as SME status. The critical difference between this approach and use of bid price preferences is that, under set asides, there is a segregation of competition as targeted firms, i.e. SMEs, can only compete against each other. Procurement set asides are most often applied to historically disadvantaged individuals such as minority groups. This approach has been used to promote SMEs in public procurement, particularly in South Africa and the United States.

BENEFITS OF SMES PARTICIPATION IN GOVERNMENT PROCUREMENT

According to DTI, (2015), the potential benefits of SME participation in government procurement can include:

- a) Greater employment as SMEs are more labor-intensive compared to larger firms.
- b) Incremental multiplier effects through decentralized procurement with a disproportionately positive impact on local economies through repeated cycles of localized expenditure.
- c) More varied competition through use of targeted assistance, including "set asides" and/or bid price preferences.
- d) Decreased influence of established networks of larger firms (that may exclude SMEs through collusive or corrupt bidding practices or otherwise).

BARRIERS FACING SMES

The various challenges facing SME procurement practices in developing nations like Nigeria are as follows:

Disproportionate Bidding Costs

A government bidding process means that firms incur threshold administrative or 'fixed' costs not associated with production costs of goods or services (Piga, 2011). This disproportionately affects SMEs as a proportion of their total financial and staffing resources, compared to larger firms. For instance, (Piga, 2011) concluded that, in the United States (US), costs per employee due to regulation appear to be at least 36% higher in small firms than in medium size and large firms, a disproportion in compliance costs that is particularly true in the manufacturing sector.

Other cost-related barriers may include:

- onerous supplier and contractor registration requirements
- detailed bid information and documentary requirements
- costs of supplying a performance bond or guarantee
- costs of inspection requirements during bidding
- protracted bid qualification, evaluation and award procedures
- lengthy payment intervals after contract award which require significant interim cash flows and financing costs
- complex contract dispute resolution procedures

Risk Aversion

Added to these costs is the tendency of government procurers to be risk averse when dealing with SMEs. Government procurers may specify more stringent financial or experience requirements that exclude newer and financially weaker SMEs. Through application of such qualification criteria, procurers also reduce work for themselves by not having to evaluate a larger number of bids from SMEs (Piga, 2011).

Contract Aggregation

Government procurers may also favour fewer, higher value contracts to avoid costs associated with procuring more, but lesser value contracts (Piga, 2011). Large contract values appear to affect smaller- and micro-sized firms far more than larger firms. Centralized procurement - which might be strongly justifiable on the grounds of increased price economy because of aggregated purchasing—tends to result in diminished SME participation in the absence of effective SME preference schemes. Conversely, in more localized or decentralized procurement, the probability is higher that SMEs will win public contracts primarily because of smaller and more manageable contract values.

Empirical evidence suggests that both minority and non-minority small businesses consider unbundling of large contracts as a critical factor in increasing their access to successful bidding opportunities (Piga, 2011).

Violation of World Trade Organization (WTO) regime

Procurement preferences for SMEs may violate the current World Trade Organization (WTO) regime dealing with government procurement in the context of international trade, as framed in the General Procurement Agreement (GPA). National treatment and non-discrimination provisions of the GPA may be seen to prohibit discrimination in favour of national SMEs (). However, SME procurement preference schemes that apply equally to domestic and foreign SME suppliers and contractors (an unlikely situation in practice) would arguably be consistent with such GPA provisions (Linarelli, 2019).

Domestic challenge

Access to capital, increasing brand visibility, horrific driving traffic of goods and services and infrastructural bottlenecks associated with order fulfillment and last mile delivery are some of the major challenges that confront SMEs in Nigeria.

PROSPECTS OF SMEs PARTICIPATION IN GOVERNMENT PROCUREMENT

Notably, in an attempt to achieve the feat of certain advanced economies of the world (such as US and South Korea) with respect to SMEs participation in government procurement, Nigerian economy can equally adopt the same.

US approach

The US approach includes use of SBA Procurement Center Representatives to facilitate implementation. Nigerian government can adopt similar approach using Procurement Center Representatives at both Federal and State levels, as suggested by (Guth, 2015), to carry a number of activities which include:

- a) review procurement solicitations to maximize opportunities for small businesses, including recommending of appropriate bid price preferences and set asides, and suggesting alternative procurement packaging or contract slicing to optimize opportunities for small business;
- b) identify and recommend small business concerns for inclusion in any list of prospective bidders to be solicited for a particular procurement;
- c) conduct periodic reviews of state contracting authorities to ensure proper implementation of SBA policies; and
- d) sponsor and participate in conferences and training designed to increase small business participation in public procurement.

South Korean Approach

The Republic of Korea provides an Asian example of an integrated approach to promoting SME growth using a procurement platform. Unlike countries such as the US and South Africa, the Republic of Korea uses neither bid price preferences nor set asides to encourage SME participation in its public procurement market (AFD, 2020). The Korean Public Procurement Service Authority (PPS) has several initiatives to increase SME participation in government procurement used mostly within Korea's electronic procurement platform, Korea On-line E-Procurement System (KONEPS).

Similar initiatives, as suggested by AFD, (2020), are equally possible in Nigeria through:

- Advance payments to SMEs that qualify for an advance payment program for delivery of goods contracts, as much as 70% of the purchase price.

- An SME network loan program involving selected financial institutions with terms allowing SMEs that qualify for the PPS Surrogate Payment Program to obtain bank loans for up to 80% of the relevant contract price to cover the cost of contract execution.
- An “SME Excellent Government Supply Products” award program to increase SME product visibility among all government suppliers, contractors and consultants. Each year, under this program, high quality performance and innovative technology products provided by SMEs are included in the KONEPS product catalogue accessed by government suppliers of goods, works and consulting services.
- A Multiple Award Schedule (MAS) for SMEs, which is a simplified process for procurement of recurring, high volume purchases at more competitive pricing associated with volume buying through use of indefinite delivery contracts.
- SMEs are given an opportunity to provide continuing orders, assuming satisfaction of MAS bidding requirements overall, and for each specific order, within the duration of the relevant indefinite delivery contract.

II. CONCLUSION

The use of SME procurement preference schemes need to be objective, targeted and with an exit strategy to ensure that they do not become a mechanism to subsidize inefficient and/or corrupt SMEs. A range of options may be considered, including non-procurement related policy tools that affect SMEs in more direct and transparent ways, to promote sustained growth and competitiveness. These include, for example, increased access to credit markets, input subsidies (e.g., for raw materials) and/or technical and marketing support for finished products. Equally important, to promote increased evidence-based policy formulation, it is critical to use robust management information and data collection systems to monitor the relative performance and success of SME procurement preference schemes over time.

Several policy approaches to the promotion of SME participation in public procurement are possible. In some cases, SME structured procurement preference schemes may be necessary. Such schemes need to be justified for targeted sectors in terms of whether competition that SMEs face is constructive or destructive to longer-term industrial growth and comparative advantage. This is typically part of broader policy justification for protection and promotion of nationally identified “infant industries. To the extent unchecked market competition is viewed as destructive to SME growth in a priority or targeted economic sector, such schemes would appear justified.

A range of illustrative procurement-related policy options, in terms of potential level of market distortion, should be provided. More intrusive policy options involve mandating SME subcontracting programmes and/or provision of special financial assistance and subsidies for SME to reduce their government bidding and other procurement-related compliance costs. Clearly, the most potentially market distorting approaches are use of price preferences and set asides for SMEs.

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