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*for a sustainable future*

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Expert Group Meeting on Domestic Marketing of  
Small Industry Products in Developing Countries

29 May - 3 June 1972, Dublin, Ireland

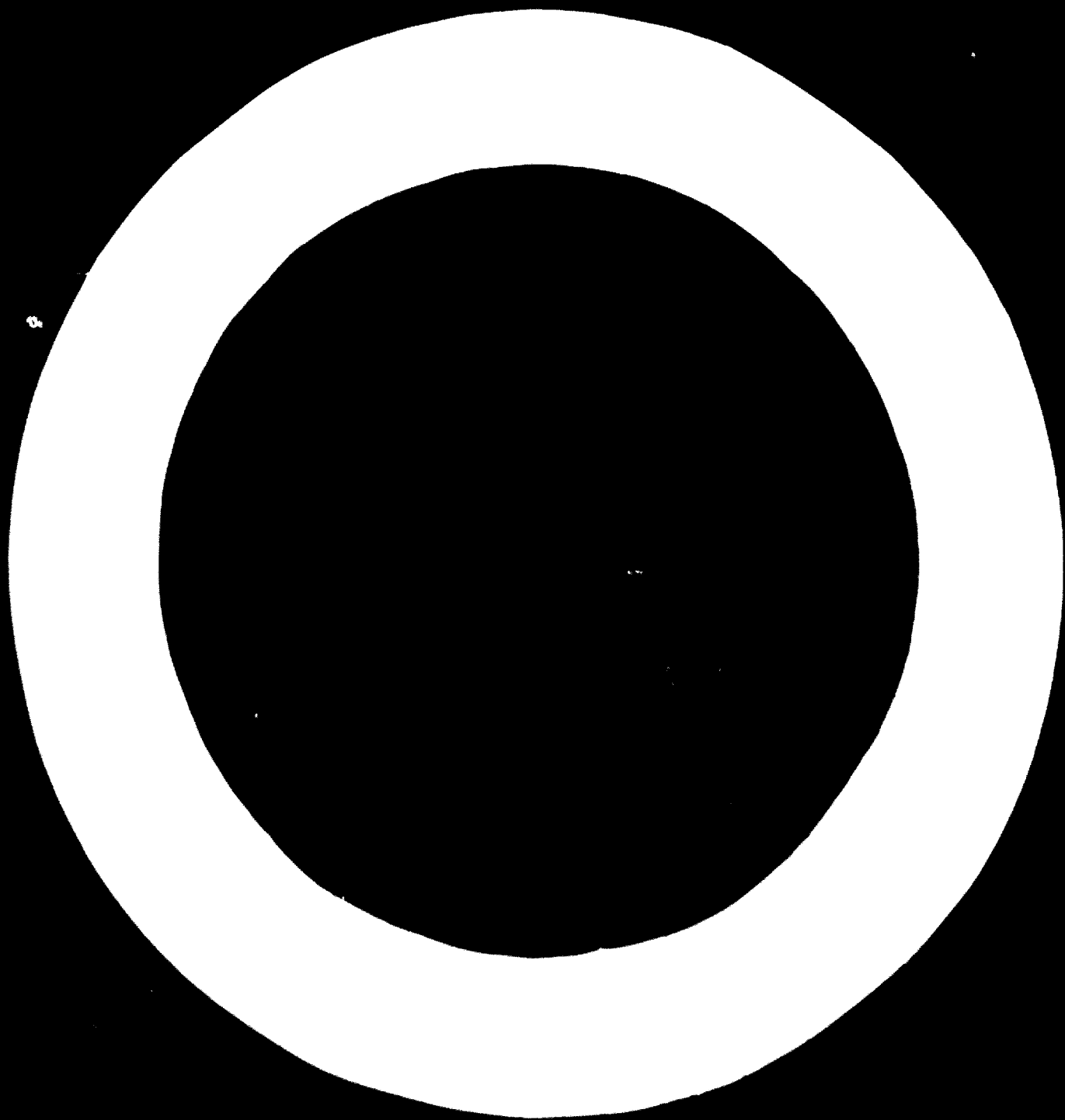
THE PUBLIC INSTITUTIONAL MARKET <sup>1/</sup>

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The size of the domestic market

It is often stated that, in many developing countries, especially in the smaller and in the less developed ones, the domestic market is small, and, consequently, the scope for industrial development is limited. Very frequently, it is on these grounds that the promotion of small-scale industry is mainly advocated: small enterprises with small capacity and output are considered to be just right for narrow markets, whether national or local; in fact, small industries are often seen, to a large extent, as caterers of local markets - province or provincial town.

This view is undoubtedly correct if consideration is given to industrial goods purchased by the population at large. Personal consumption is necessarily modest in developing countries having a small population or a low purchasing power. In these countries, as in others, technical assistance experts and national industrial extension centres usually orient small-scale industries towards the production of light consumer goods bought by the general consumer - foodstuffs, clothing, household items and so on. Especially in the less developed countries, only a small number of such industries are considered to be feasible. When they are established, their products usually compete - and not always successfully, in view of the well-known and often justified preference for the foreign product - with imports. Although much has been written about the desirability of regional groupings of developing countries, which would expand the market of each of their members, little headway has been made thus far, the political, economic and logistic obstacles remaining insuperable. Since the domestic market for personal consumption goods can as a rule expand only slowly - in line with over-all economic and social development - the prospects for the establishment of industries, including small-scale industries, catering to this market are rather limited.

Yet there is, in any country, large or small, advanced or less-developed, a sizable market for manufactured goods: it is the public institutional market, that is, the orders and purchases of government ministries and departments, autonomous agencies and public sector industries. In any country, ministries, the army, police, universities, schools, hospitals, railways,

bus companies, electricity and water companies, airlines, government banks, publicly-owned industries and so on, purchase a wide variety of items. In many developing countries, the majority of these items are imported, though many of them are or can be produced by domestic industries, including small-scale industries. The demand of public departments and agencies is (or can be) well known, is stable in range and amount and may be determined by government decision rather than by the consumer preference of thousands of individuals.

In countries where there is a sufficient number of efficient small-scale industries, measures may be taken to ensure that they receive a fair, and as large as possible, share of public purchases, contracts and subcontracts. These measures are mainly in the form of a competitive bidding and purchasing scheme giving preference to small-scale industries.

Where the number of small-scale industries is inadequate, potential entrepreneurs may be steered towards the production of items catering to the public institutional market. A government purchasing scheme may at some time be set up and be gradually expanded.

The purpose of this paper is to draw attention to the main conditions which should be fulfilled if small industries are to participate in government purchasing. The procedural aspects - tender regulations, registration of enterprises, appeals and settlement of disputes, etc. - are not described in this paper which is not intended to serve as a manual on public procurement and bidding in general, but only to provide an over-all view of the policies for ensuring the participation of small-scale industries in government purchases.

#### The prevailing situation in the developing countries

The prevailing situation, in many developing countries, is that procurement is done by government departments and agencies directly, without any bidding system, without a central purchasing organization, without any, or with a minimum of, publicity. Each agency has its own rules or practices - or has no clear-cut regulations - for purchasing. In some countries, the

procurement regulations of certain agencies specify that purchases up to a given amount may be made simply on indents, and that, above that amount, estimates from a given number of suppliers (say, three) should be obtained, or regular tenders should be issued and publicized. In practice, however, these regulations are often disregarded or got around. All too frequently, the door is open to dubious practices. Under the circumstances, it is not sure at all that the government, which, in most countries, is the single largest buyer of industrial goods, gets stores of the best quality and at the lowest price.

Even where government purchasing regulations exist and are enforced, small-scale industries may not be able to enter the public market. Though invitations to suppliers may be publicized, small industries may not be aware of this and may not know how to approach the buyers. They may be discouraged by involved procedures in respect of tenders, security deposits, inspections, or by strict specification, quality and tolerance requirements and delivery dates. In fact, their capacity to meet specifications, quality standards and delivery schedules may be inadequate and they may not enjoy the confidence of the buying organizations which will usually by-pass them. They may be rebuffed or even endangered by late payments by government agencies - an all too frequent occurrence - since they do not have the financial strength or resilience to withstand such strains. Above all, they are usually outbid by larger industries having a stronger competitive position.

A number of measures should therefore be adopted if small-scale industries are to overcome these handicaps. The principal measures are outlined hereunder.

Measures for ensuring the participation of  
small-scale industries in government procurement

Unified purchasing regulations and procedures

Unified purchasing regulations should be adopted by all government departments and by most agencies and public sector industries (some exceptions might be needed, especially in the case of government-owned industries which may need more flexibility in procurement than other entities). In many developing countries, it would seem appropriate to limit, at the beginning, a Government

purchase scheme to government departments and certain agencies and to extend it to public sector manufacturing industries at a later date.

The regulations should specify the amounts up to which purchases may be done directly on indents, and above which tenders should be issued. The procedures for inviting, accepting or rejecting bids should be clearly defined. A procedure of appeal against rejection should be formulated. The specifications, quantities, delivery dates, etc. of the items to be procured and the conditions of payment should be spelled out and the information should be publicized, e.g. in special periodical circulars or in a gazette. Needless to say, the regulations should be enforced and some control over the operations should be maintained.

In some cases, for instance when the item to be procured is of an experimental or research nature (e.g. a prototype), it may not be possible to draw up detailed specifications and to make a general call for bids. Then the purchase may be made through negotiations with all qualified suppliers, the best offer being accepted.

#### Central purchasing organisation

In certain countries, a single organization is in charge of purchasing for all or most government departments and agencies. This is the case, for instance, in India where procurement is carried out by the Directorate General of Supplies and Disposals. Such a system ensures that the same rules apply to all departments, and is likely to be more efficient and more economical than separate procurement. It may provide better publicity to the procurement needs of the public departments and agencies. In addition, it makes it possible to adopt a centralized "list-in" system, whereby industries, especially the smaller ones, make known, on their own initiative, what they are able to supply. It lends itself better to the application of "set-aside" and price preference systems for small-scale industries.

#### Price preference

As mentioned earlier, when small-scale industries and larger enterprises submit competing tenders, the former are likely, in the majority of cases,



to be outbid by the latter. In recognition of this fact, some countries, both developing and highly advanced, have established a price preference system whereby the quotations of small-scale industries would be accepted even if they exceed, by a given percentage, the quotations of the larger undertakings. In India, for example, this preference is of 15 per cent. In other countries, it is of 10 per cent. In the United States, the Small Business Administration (SBA) can give a special subsidy to the selected small firm to cover the difference between its bid and that of larger industries. The subsidy is paid out of a revolving fund administered by the SBA.

The percentage system would seem to be better adapted to the conditions prevailing in the developing countries.

In some countries, the problem is often of giving an opportunity or a preference to products of national origin over imported products, rather than preference to the products of small-scale industry over those of larger enterprises. In such cases, the government procurement policy and procedures may provide for preference for the national products. Even when contracts are given to foreign suppliers, some parts of the order might sometimes be subcontracted to a local manufacturer.

#### Set-aside system

Under a "set-aside" system, certain items needed by government entities are to be purchased exclusively from small-scale industries. The system does not prohibit larger industries from manufacturing these items. The system can operate only when there is a sufficient number of qualified small firms able to produce the items economically and under competitive conditions; this is also necessary if the Government is to have a fair choice and satisfactory service.

Both the set-aside and the price preference systems require that a legal definition of small-scale industry be adopted in the country. The definition, which would usually be in the form of a ceiling on fixed capital investment (machinery and equipment excluding land and building), employment or both,

would make it possible to distinguish the enterprises qualifying under the schemes from the others.

A corollary of the set-aside system would be registration of small industrial firms on "bidders' lists" maintained by the purchasing agency or agencies. Invitations to bid would be sent to the enterprises listed (in addition to publicity in a gazette). The system might begin to operate even with a relatively modest number of set-aside items, say 10 to 15. The list of set-aside items should be gradually increased and periodically revised.

At some stage, exhibitions of goods, purchased by government departments could be organized.

If an order is too big for a single small enterprise to execute, pools of bidders might be set up on the initiative of the entrepreneurs themselves or on the suggestion of the purchasing organization or of the extension centre. Such pools might be maintained over time. They would be, in effect, what is called in France groupes d'action collective (groupings for collective action) which might have the strength required to compete against large-scale industries in public bidding and would not need to restrict their offers to set-aside procurement.

This arrangement might lead to another one, which would help in overcoming the difficulties encountered by many small firms in submitting well-prepared bids. This might be the creation of a special office representing groups of small-scale industries, and having the ability to prepare bids in the required form. Offices of this type have been set up in a few developing countries by an Association of Small Manufacturers or an equivalent organization.

#### Role of industrial extension centres

Whatever the system of procurement adopted - separate purchasing arrangements or unified procurement rules, open or "set-aside" bidding, equal treatment of bids or price preference - small-scale industries can effectively enter the public institutional market only if they have the necessary technical, economic and managerial competence.

In the developing countries, so far as many small-scale industries would receive the necessary professional and technical support of an industrial extension centre, that is, of a professional institution able to give them the necessary counselling and support in technology, management and marketing. There are many examples of small industries unable to calculate correctly a cost of production, to adhere to specifications, to plan and schedule their production and to deliver the items in due time. In addition to technical and managerial inadequacies, they may be hampered by the well-known difficulties of obtaining credit, whether for machinery and equipment or for working capital, the latter being particularly important in the case of marketing operations. Lack of finance is probably a more important cause of default in deliveries than technical or managerial inadequacy.

Where there is a sufficient number of small industries capable of producing the items required by public departments or agencies, the extension centre should be responsible for providing them with the necessary information and for assisting them at all stages - from the submission of the bid to the timely delivery of the goods. In some countries, extension centres deliver "certificates of competency" to efficient small enterprises. Such certificates might even be delivered to the pools of small enterprises referred to in the preceding section. If the extension centre itself enjoys a good reputation, the certificates should satisfy the government agencies that the bidders are reliable and should prevent bids from being rejected on the grounds that the industries are incapable of executing the contract.

Technical counselling and training will be specially needed in such areas as cost accounting and pricing, inventory control and quality control. The assistance of the extension centre will also be required for facilitating the financing of small-scale industries under supervised credit schemes. 1/

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1/ The above measures would also prove to be effective for facilitating the establishment of subcontracting relationships between large industries (whether public or private) and small-scale industries, whereby the latter would produce parts and components to be incorporated in the products of the former. The subject of subcontracting, however, is beyond the scope of the present paper which is limited to public purchasing of items which are not part of further production.

Where there is an inadequate number of existing small-scale industries and where the main task of the extension centres is to create new industries, it would be useful if feasibility and pre-investment studies were focused on those productions which are steadily demanded by public departments and agencies. Lists of items required by such departments should be drawn up and prospective entrepreneurs should be steered towards the manufacturing of such items, provided these are also in demand on the general consumer market. Indeed, too close a dependence on the public institutional market would be inadvisable, exactly as, in the case of subcontracting, exclusive production for the contractor should be avoided. In either case, alternative outlets should be kept open.

There is evidence that feasibility studies have been very little oriented, thus far, towards productions catering to the public institutional market. As stated earlier, this is a relatively large and stable outlet even in countries having a narrow over-all market, and it would be a sound policy to pay it more attention.

This policy, if linked with competitive bidding and price preference for small-scale industry would, at the same time, contribute to import substitution, create efficient small industries assured of a secure market, improve product quality and lower production costs, improve business ethics and lead to savings in government expenditure on manufactured goods.





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