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Small and Medium-sized Enterprises in Brazil

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This article presents the main policies for Small and Medium-sized Enterprises in general and more specific in the area of innovation. Brazil has policies and programs on national, state and municipal level besides the initiatives from other (semi-)private organizations and institutions. There are several means of business support for Brazilian SMEs and financial stimulation such as grants or loans. Doing business in Brazil is not easy and a partnership with a local company can be beneficial to both parties involved.

Introduction: Small and Medium-sized Enterprises in Brazil

Instead of using the term Small and Medium-sized Enterprises, as is common in Europe, Brazil uses Small and Micro Enterprises (SMEs). The Brazilian SMEs are qualified solely by revenue, at a max of R\$ 4,8 million/year (~€ 1,1m), considerably smaller than a micro enterprise by EU terms (€ 2 million, max 10 employees). Brazilian SMEs together represent 99% of all Brazilian businesses in absolute numbers, amounting to 27% of Brazil's GDP (2011), and account for more than half of all formal employment in the country. **SMEs benefit from a tax system ("Simples Nacional") that unifies eight federal taxes into one monthly contribution lowering the burden on reporting obligations.** Medium-sized companies do not receive special consideration and are considered to be big companies.

SMEs are the strongest generator of jobs in the country, and **their participation in Brazil's GDP has been growing steadily** from 21% in 1985, through 23,2% in 2001, to 27% in 2011. Their annual growth has also increased, from 0,14% to 0,4%/year. More than half (53%) of retail, 36,5% of services and 22,5% of industrial production is done by them. However, their activity is illustrative **of Brazil's contrasts between** the national and the international economy. In 2016, only 1% of all exports were done by SMEs, and regardless of company size, most exports are commodities such as soy beans and iron ore. SMEs that want to engage in international trade could be interesting for Dutch companies looking for a point of entry in Brazil by means of a local partner.

According to the **World Bank's "Ease of Doing Business" report** (2018), doing business in Brazil is not easy¹. Taxes and bureaucracy remain complex with high demands of both organizational and financial capacity. SMEs need to report to federal, state and municipal governments, apart from compulsory participation in unions and associations. Access to capital is restricted, mainly due to extensive documentation demands and high interest rates of, on average, 30,6% per year. Most SMEs are in need of skilled employees and management. Furthermore in Brazil, the entrepreneur is exposed to personal risk, because tax liabilities and labor related lawsuits are connected to the person and fall outside of bankruptcy protection. Another challenge for SMEs is innovation. The Brazilian market is relatively closed compared to other countries² implying that there is less competition, which may influence innovation.

In Brazil, the **"Lei de Inovação"** (Innovation Law) explains innovation as: "the concept of a new product or manufacturing process, together with the aggregation of new functionalities or characteristics of the product or process which imply incremental improvements and effective gains of quality or productivity, resulting in more competitiveness in the market." The explanation of innovation is similar to that of Europe.

¹ Brazil is number 125 out of 190 countries; the Netherlands is number 32.

² Economic Reports from the OECD, Feb 2018 (Relatórios Econômicos OCDE, Fev 2018)

Government policies for SMEs

National level

General policy

The Special Secretariat of the Micro and Small Enterprise, as part of the Ministry of Industry, Foreign Trade and Services, is responsible for regulating the development of SMEs on a national level. This secretariat is divided in three areas: 1) Chamber of Commerce (company registry); 2) Micro-entrepreneurs & Craftspeople and 3) Support of Micro and Small companies.

Most of the national policies are targeted towards economic growth and job creation (as a response to the recent economic recession), out-of-necessity entrepreneurship, and to the significant number of companies that have growing pains with tax-complexity. Policy highlights are:

- BNDES Giro: temporary financing scheme for emergency working capital offered through the national development bank, not only for small companies. It allows them to apply at their own retail bank's **local branch in person** and receive an immediate decision, that if positive will arrange for a wire transfer within 24 hours. Maximum loan amount of 20% of gross revenue, up to R\$ 70 million (~€ 16 million) a year, and R\$ 20 million (€ 4,5 million) per request.
- Micro Individual Entrepreneur (MEI): a program for previously irregular service providers and retailers, who can now easily become formal individual companies by registering as such and paying a fixed rate of ~R\$ 50/month (~€ 11) to cover all tax and social security, with no further obligations.
 - Portal do Empreendedor: central (online) contact point between the micro individual entrepreneur and the government. Offers company registration, generation of official receipts, and access to government tenders, microfinancing, and simple bookkeeping tools.
- Instituição Amiga do Empreendedor: cooperation between federal government and education institutions (public and private) for better qualification and professionalization of small **companies'** owner-operators.
- Ongoing policies for tax debt renegotiation: presently offering a plan of up to 180 monthly payments. The first five installments need to be of 1% of the debt, and the remainder 95% is payable in up to 175 installments. Adherence grants a significant discount in most fees/interest, and all legal costs are then waived.

Innovation policy

With the introduction of the aforementioned "**Lei de Inovação**" (**Innovation Law**) - instruments to stimulate innovation - and the "**Lei do Bem**" (**Law of Good**) - fiscal policies to stimulate innovation - between 2004 and 2006 by the Prime Minister and the Ministry of Economics, Brazil set the foundation for stimulating innovation among companies through:

- Incentivizing R&D expenditure;
- Stimulating venture capital and angel investing;
- Fiscal incentives such as extra tax exemptions and reductions.
- **The introduction of the new 'Simples Nacional' for SMEs implied less complicated and less bureaucratic tax payments. Instead of paying twelve different taxes to the government and states, SMEs can choose to pay taxes on their revenue only once.**³

With the introduction of the new "**Lei do Novo Marco**" (**New Provision law**) in 2016 the goal is to further stimulate innovation by:

- Better integrating academic research and technological organizations;

³ SMEs can opt to (yearly) choose between this tax scheme or one of the two other tax (more complex) schemes with one based on actual profits and the other on a fixed profit percentage of revenues.

- Motivating investments in research;
- Diminishing bureaucracy and simplifying the system.
- Promoting international cooperation:
- Making it easier for foreign researchers to obtain a temporary visa;
- Local companies and academic institutions are actively encouraged to establish agreements with non-Brazilian companies – something that was not allowed before.

In order to be eligible for fiscal incentives, companies have to send yearly reports to the Ministry of Science, Technology, Innovation and Communications (MCTIC) regarding their innovation policies. If the reports are approved by MCTIC, the Brazilian tax authority – Secretaria da Receita Federal (RFB) – will grant (some of) the tax exemptions. Besides arranging the tax exemptions, most organizations wanting to grant money to SMEs have to be registered at the MCTIC. More information on such organizations and which grants are of interest, see below.

Pilot policies and other innovation activities

Besides the established laws, there are pilot projects and other activities running related to innovation and SMEs. If they are successful they could potentially be implemented by the government in the future:

- Patent Pilot: the Ministry of Development, Industry and Foreign Trade together with the National Institute of Industrial Property (INPI) started a pilot in 2016⁴ to reduce the time required to obtain a patent for SMEs to up to one year;⁵
- Patent Prosecution Highway (PPH): a patent obtained in one of the partner countries will lead to faster, favorable results in the other partner countries. One of the PPH programs Brazil participates in is called PROSUR which also includes Argentina, Chile, Colombia, Costa Rica, Ecuador, Paraguay, Peru and Uruguay;
- Bilateral collaboration: bilateral agreements with the Japanese, the US and the European Patent Office. The difference with the above mentioned PROSUR agreement is that a patent obtained in the US will lead to an expedited request in Brazil, but not necessarily in the other countries;
- Venture capital: angel investors are wealthy individuals who invest in innovative start-ups. They usually invest between R\$ 50 (~€ 11) thousand and R\$ 500 (~€ 112) thousand (source: CNI) and the investor often stays for a minimum of two years. According to the Innovation Law individual entities and investment funds are allowed to take the role of Angel investor in SMEs. Besides investing, the Angel investor will not be considered partner according to the aforementioned law and will thus not have voting rights or other responsibilities which the other partners have.

According to the World Trade Organization, the patent programs lead to an optimized claim scope, utilization of the examination history and a decrease in the number of office actions for the patent offices. The applicants will have higher speed, lower costs and higher predictability, something that is especially convenient for the high tech sector. Overall, quality improvements on both applicant and office side can be expected by the implementation of these patent programs.

State and municipal level

States (there are 26 in Brazil) and cities also play an important role in fostering small entrepreneurship. Regulation is organized nationally. Most states have their development plans in accordance with their own – mostly geographic - competitive advantages. Cities can also take into account the interests of SMEs in their planning. Two examples are:

- To strategize its economic development, the State of Minas Gerais mapped 37 areas of competitive advantage. In partnership with the Inter-American Development Bank, the State Industry Federation and SEBRAE act as promoters of interaction between companies,

⁴ In Sept 2018, the pilot was still running

⁵ Depending on the area, obtaining a patent in Brazil can take years according to INPI

knowledge institutions and development agencies. It is conditional for the program to take into consideration the whole value chain, and therefore to include small companies.

- Empreende Fácil, of the city of São Paulo, is a program to accelerate the time it takes to start a company in the city. **Realizing that they can't change the (national) bureaucracy,** but being responsible of operating it, the city now automates most of the paperwork involved in registering a company. Instead of 105 days for getting the right stamps, it improved to only five days and most interaction takes place digitally.

Business support for SMEs

SEBRAE

The Brazilian Support Service for the Micro and Small Enterprises (SEBRAE) aims to increase entrepreneurship in the country, promote economic growth and improve the position of micro and small companies. With a large knowledge-base, support is offered through courses, consulting, training, lectures, seminars, events and publications that are available at a subsidized rate (often for free), on- and off-line in a network that covers the whole country with 700 local offices, five thousand employees and eight thousand registered consultants. Aside from these activities, entrepreneurs can also get individual support remotely by phone or online.

SEBRAE started as a government institution in 1972, but has been autonomous since 1990 and receives funding from compulsory contributions in the payroll from large enterprises – employees of large companies fund support to small entrepreneurship. The programs that give shape to their strategic planning are usually driven by social development, and have special focus on empowering women, youth and community leaders to enterprise. SEBRAE also acts as a representative of small entrepreneurship against the government, lobbying around public policies that promote microcredit, de-bureaucratization, and special schemes that facilitate participation of small companies in government tenders.

SEBRAE research (2013) shows that out of the 34 thousand interviewed SMEs, the majority (54%)⁶ of the companies said that they invested in creating new products, manufacturing processes or the distribution of goods and new ways of service installments (rendering of services). The Global Innovation Index (GII, 2018), which has among others the National Confederation of Industry Brazil (CNI) and SEBRAE as its knowledge partners, Brazil was 64th in the world when it comes to innovation performance. According to the GII report, Brazil ranks considerably high (8th out of 162 countries) on "domestic market scale, billion PPP\$" and high in the area of R&D (28th)⁷ and knowledge absorption (31st).

One of SEBRAE's support programs in collaboration with the National Council of Scientific and Technological Development – connected to MCTIC - is the Local Innovation Agent initiative (ALI) where an agent becomes part of the SMEs and helps to create more value. The purpose is to stimulate on-going innovation policies within SMEs in a personalized way. The Local Agents visit the company, come up with solutions and help the company where necessary. The agent can stay up to 30 months. The monitoring and inclusion of the ALI is free, however, implementation of the agent's proposals can come at a cost.

Other forms of support can be:

- Direct investments through for example investment funds among others from the National Development Bank (BNDES, Criatec Fund) or private companies;
- Mentoring and consulting programs (Inovative Brasil, Startups Connected);
- Trainings (management training by SEBRAE and Startup Speed Dating, but also many incentives to obtain the MBA).

⁶ <https://exame.abril.com.br/pme/pesquisa-mapeia-inovacao-nas-pequenas-empresas/>

⁷ According to data from the World Bank, Brazil spent 1,14% of its GDP on R&D (2014). For comparison in that same year: the Netherlands spent 2%, Mexico spent 0,54%, Argentina spent 0,59% and the world average was 2,15% of GDP spent on R&D. Israel was top of the list with 4.29%.

Financial support for SMEs

SMEs in Brazil can finance their activities by several means such as credit from their suppliers (common) or by issuing pre-dated cheques. For cash they often use corporate credit cards or overdraft limits, and only after that do they seek favorable loans – either from a state (development) bank or in equal amount from family and friends. Small Brazilian companies default less than the world average, but 42% of them never go to the bank.

BNDES

The Brazilian development bank, BNDES, aims at financing companies and their projects in a way that helps develop the local economy. They prioritize requests that benefit Brazilian society, which often translates into goods and services made in Brazil, by Brazilian companies, employing Brazilian personnel. They offer multiple forms of credit for SMEs, the most important being:

- Financiamento a Empreendimentos: (>R\$ 20 million, >€ 4,5 million) a line of credit for implementation, expansion and modernization of companies, for use exclusively with local goods and services;
- BNDES Automático (>R\$ 2 million, >€ 450 k) for innovation;
- Cartão BNDES: a credit card with up to R\$ 2m (€ 450 k) pre-approved for working capital.

When looking at financing possibilities in the area of innovation, BNDES has the following financing projects available for innovative SMEs:

- MPME Inovadora: gives out loans through accredited banks (up until R\$ 10 million, up until € 2,25 million). The focus is on increasing working capital of the company.
- FINEM: loans bigger than R\$ 10 million (€ 2,25 million) are given directly through the BNDES.

BNDES also works together with Dutch banks in Brazil (ABN Amro, ING and Rabobank). They are accredited by BNDES to give credit to the SMEs on behalf of BNDES and almost all of them are guarantors for the Dutch party in case of collaboration between a Dutch and Brazilian company.

Government support instruments: grants

As mentioned before, all organizations that want to give subsidies have to be registered at the MCTIC. Brazil has many funding options for SMEs, both refundable and non-refundable. The following grants are applicable to Small and Micro innovation companies in Brazil and are on federal level:

- Fomento a projetos de inovação SEBRAE e Embrapii⁸: to promote innovation among SMEs. The project consists for one-third of the grant provided by the organization Emprabii and the other two-third comes from the company itself and/or the Embrapii local Research Unit. Of this two-third, a maximum of 70% can be financed by SEBRAE. Besides the grant, the company will also have access to the network of Research Units;
- Sebraetec by SEBRAE: the focus is on SMEs in one of the seven areas: Design, Productivity, Intellectual Property, Quality, Innovation, Sustainability or Digital Services. The subsidy has the value of at least 70% of the costs spent on obtaining personal consultants (offered by Sebrae) in innovation in the aforementioned areas;
- Sibratecshop by SEBRAE and Senai: this instrument was developed by MCTIC, SEBRAE and Senai (National Service for Industrial Training). Senai owns laboratories in seven states and works together with four others in different states.⁹ If a company has an idea but does not know how to develop this into a product, it can use the laboratories to create a viable prototype and it can receive a subsidy up until 70% of the project (lab) expenses.

On state level, the following grants with focus on innovation are available for SMEs:

⁸ Brazilian Agency for Industrial Research and Innovation linked to MCTIC and the Ministry of Education. Both ministries are responsible for its funding. Embrapii cooperates with several research institutions among the country which are accredited and are called the Research Units

⁹ In the end, Senai has laboratories in 10 out of 25 states: Paraná, Mato Grosso do Sul, Rio de Janeiro, Paraíba, Amazonas, Bahia, Minas Gerais, São Paulo, Rio Grande do Sul and Pernambuco.

- Pesquisa Inovativa em Pequenas Empresas (PIPE) – São Paulo: the State of São Paulo Research Foundation (FAPESP) – linked to the MCTIC - tries to promote the execution of scientific and technological research. If a project is still in the initial phase, it can get up to R\$ 200 (€ 45) thousand. If the project is developing the research and business proposal, it can get up to R\$ 1 million (€ 225 thousand). In case the project has started to develop commercial and industrial products and processes, it can get between R\$ 360 (~€ 80) thousand and R\$ 10,5 (~€ 2,5) million depending on whether the company is micro, small or medium. Note: the company cannot have participated in earlier phases of the project;
- Sinapse de Inovação - Santa Catarina/Espírito Santo/Amazonas: promotes innovation and helps transform ideas in successful entrepreneurship in the states Santa Catarina, Espírito Santo and Amazonas. Value of grant depends on certain factors and is between R\$ 4,2 thousand (€ 950) and R\$ 6 (~1,3) thousand. It also helps the companies to find investors, clients and development of business models.

Government support instruments: Loans

Available innovation loans on federal level are:

- Cidades Inovadoras: R\$ one billion (~€ 230 million) program from MCTIC in collaboration with the Funding Authority for Studies and Projects (FINEP) – a public agency under MCTIC – which aims to finance innovative projects. The money comes from development banks & agencies and other financial institutions, it will be directed to city halls, state governments and companies interested in innovation projects. This way, the financing activities can be decentralized. The program has a rate of CDI¹⁰ + 4,0% (Finep's remuneration) + agent's remuneration (depending on the agreement between the client and agent). The period of the loan is two years and can be paid back in eight years. Areas of focus are water resources, urban mobility, energy efficiency and renewable energy. MCTIC expects to have 400 projects in the first year and around 200 participating municipalities.
- Inovacred by FINEP: offers financing to SMEs for the development and enhancement of new products, processes and services in marketing innovation or organizational innovation. Depending on the size of the company, the loan is subject to different conditions:¹¹

On regional and state level, the following loans available specifically with the goal of innovation are:

- FNE Inovação - Nordeste: promotes innovation in products, services, processes, marketing and organizational processes among entrepreneurs in Nordeste¹² of Brazil by lending money to all sorts of companies. The advantage for SMEs (with revenue up to R\$ 16 million; equivalent to € 3,6 million) is that there is no need for a third party providing money, besides the loan. For non-rural sectors, the interest rate is 6,65% and for rural sectors, the interest rate is 7,65% or 9,05% depending on the size of the company;
- São Paulo INOVA – São Paulo: an instrument from the state of São Paulo to support companies which are installed in incubators or technological parks within the state. If the company has a value up to R\$ 90 (~€ 20) million, the company can obtain an innovation incentive (loan up to R\$ 10 million which is around € 2,25 million). If it has a value between R\$ 360 (€ 81) thousand and R\$ 300 (€ 67,5) million, the company is eligible for the technological incentive (up to R\$ 30 million; equivalent to € 6,75 million).

More information

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¹⁰ The Brazilian overnight interbank rate for unsecured lending and borrowing, similar to Euribor or Libor

¹¹ Finep and Fapesp together have around R\$ 30 million available for research done by SMEs, information derived from their own websites

¹² The region Nordeste consists of the following nine states located in the North-East of Brazil: Maranhão, Piauí, Bahia, Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Alagoas and Sergipe

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