Chapter 1. Public procurement and SMEs: Why the relationship matters?

This chapter discusses the rationale behind promoting SME participation in public procurement policies, and countries’ efforts to support their involvement. Given their considerable purchasing power, governments can avail themselves of sizeable funds to pursue diverse public policy objectives while using taxpayers’ money efficiently. SMEs meanwhile form the backbone of economies worldwide and are often the primary focus of economic policies. This chapter unveils the linkages between comprehensive public procurement strategies that countries implement and the development of SMEs, highlighting the mutual benefits achieved through closer and greater engagement between small businesses and the public sector. The chapter demonstrates that while SMEs’ access to the public procurement market constitutes one of many elements that are essential for their performance, the wide array of efforts developed by countries through public procurement reforms in fact diffuses beneficial effects across the entire SME business environment, and affect multiple policy areas.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.
Public procurement is a complex government activity. It refers not just to the act of purchasing, but rather to a whole process – from identifying what is needed and determining who the best person or organisation is to supply this need, to seeing that what is needed is delivered to the right place at the right time for the best price, and meanwhile ensuring that all this is done in a fair and open manner (OECD, 2015[1]). The complexity of public procurement is also shaped by the variety of stakeholders involved in the processes and the system. Various interests in public procurement systems are held not only by public procurement officials and suppliers, but also by policy makers, oversight bodies, bidders and citizens.

Public bodies spend large sums of money through public procurement to meet their mandates, carry out functions, and deliver quality public services to citizens. Public procurement spending represents on average 12% of GDP, and accounts for almost one-third of government expenditure in OECD countries (see Figure 1.1). That makes governments some of the biggest purchasers of goods, services and works and emphasises their role in harnessing public procurement’s economic leverage to support sustainable and inclusive growth (OECD, 2014[2]) and transform supply-chain business models (Martin-Ortega, 2018[3]).
Governments increasingly recognise the strategic use of public procurement. Depending on how a government carries out public procurement, its decisions can significantly affect economic and social development. Public procurement can indeed be used as a strategic tool to advance various public policy goals, from budget accountability and efficient public spending, to pursuing environmental protection (OECD, 2015[5]); supporting economic and social development; fostering innovation (Appelt and Galindo-Rueda, 2016[6]);
encouraging socially responsible suppliers into the global value chain; and promoting social and gender inclusiveness. In fact, all OECD countries have integrated broader public policy objectives into their public procurement system. The OECD Recommendation of the Council on Public Procurement (2015) puts into perspective the strategic role that public procurement plays in achieving efficiencies and economic gains, as well as promoting secondary policy objectives (see Box 1.1). (OECD, 2015[1])

**Box 1.1. OECD Recommendation on Public Procurement – Principle on Balance**

The Council:

V. RECOMMENDS that Adherents recognise that any use of the public procurement system to pursue secondary policy objectives should be balanced against the primary procurement objective.

To this end, Adherents should:

i) Evaluate the use of public procurement as one method of pursuing secondary policy objectives in accordance with clear national priorities, balancing the potential benefits against the need to achieve value for money. Both the capacity of the procurement workforce to support secondary policy objectives and the burden associated with monitoring progress in promoting such objectives should be considered.

ii) Develop an appropriate strategy for the integration of secondary policy objectives in public procurement systems. For secondary policy objectives that will be supported by public procurement, appropriate planning, baseline analysis, risk assessment and target outcomes should be established as the basis for the development of action plans or guidelines for implementation.

iii) Employ appropriate impact assessment methodology to measure the effectiveness of procurement in achieving secondary policy objectives. The results of any use of the public procurement system to support secondary policy objectives should be measured according to appropriate milestones to provide policy makers with necessary information regarding the benefits and costs of such use. Effectiveness should be measured both at the level of individual procurements, and against policy objective target outcomes. Additionally, the aggregate effect of pursuing secondary policy objectives on the public procurement system should be periodically assessed to address potential objective overload.

*Note:* Secondary policy objectives refers to any of a variety of objectives such as sustainable green growth, the development of small and medium-sized enterprises, innovation, standards for responsible business conduct or broader industrial policy objectives, which governments increasingly pursue through use of procurement as a policy lever, in addition to the primary procurement objective.

*Source:* (OECD, 2015[1]).

Among the various policy objectives governments address through public procurement, environmental performance was the first to gain traction in OECD and non-OECD countries. Even so, support for small and medium-sized enterprises (SMEs) has increasingly become another key area. Governments have developed a host of policies, initiatives and measures to facilitate their access to public procurement markets, and, in some cases they indeed support SME development through the economic leverage of public
procurement. This chapter discusses the rationale behind SME-enablement programmes, and gives an overview of the development of public procurement policies and strategies to support SMEs.

1.1. Understanding the SME ecosystem

To identify and assess the procurement policies and strategies implemented by countries that are supporting or enabling SMEs, an initial understanding of the SME ecosystem is necessary – and this is where the first challenges arise. Indeed, one common way to define SMEs is as non-subsidiary firms that employ fewer than a given number of employees, taking into consideration business aggregation and independence parameters. However, the number of employees used for SME definition varies from country to country, and is sometimes combined with other factors such as turnover and financial assets.

In the European Union (EU), the most common upper limit personnel designation of an SME is 250 employees. Small firms often refer to those with fewer than 50 employees and micro-enterprises fewer than 10. In addition to staff headcount, turnover and financial assets are also considered when defining micro-, small- and medium-sized enterprises (Table 1.1).

Table 1.1. Definition of an SME in the European Union

<table>
<thead>
<tr>
<th>Category</th>
<th>Staff headcount</th>
<th>Turnover or</th>
<th>Balance sheet total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medium-sized</td>
<td>&lt;250</td>
<td>≤ EUR 50 million</td>
<td>≤ EUR 43 million</td>
</tr>
<tr>
<td>Small</td>
<td>&lt;50</td>
<td>≤ EUR 10 million</td>
<td>≤ EUR 10 million</td>
</tr>
<tr>
<td>Micro</td>
<td>&lt;10</td>
<td>≤ EUR 3 million</td>
<td>≤ EUR 3 million</td>
</tr>
</tbody>
</table>

Note: Small and medium-sized enterprises are defined in EU Recommendation 2003/361.
Source: (European Commission, n.d.[7]).

In the United States, the Small Business Administration establishes the definition of small businesses, which is matched to the North American Industry Classification System. The Small Business Size Standard specifies the largest size that a business can be to still be classified as a small business, which is described in terms of number of employees or average annual receipts. The standard varies by industry (US Small Business Administration, 2017[8]).

In Korea, SMEs are defined solely in terms of sales volume, either annual or average, as stated in the Framework Act on Small and Medium Enterprises. In addition to the criteria for inclusion as an SME, there are specific factors that can exclude an enterprise from SME status, including where an enterprise whose total assets exceed USD 423.8 million own more than 30% of the total and outstanding shares (OECD, 2016[9]).

1.2. SME development supports inclusive growth

SMEs are the backbone of national economies in OECD and non-OECD countries alike, and crucial actors in the global economy. They represent practically the totality of the business population, and account for large shares of employment. In 2014, SMEs accounted for more than 99% of all firms (Figure 1.2) and 60% of total employment (Figure 1.3) in the non-financial business sector of the OECD area.
Figure 1.2. Enterprises by size, non-financial business sector

Percentage of all enterprises, 2014 or latest available year

Note: For USA, RUS and CAN, data do not include non-employers. Data for CHE exclude enterprises with less than 3 persons employed.
For AUS and TUR, 1-9 refers to 1-19. For AUS, 20-49 refers to 20-199, 250+ refers to 200+. For JPN, 50-249 refers to 50-299, 250+ refers to 300+.
For AUS, CAN, ISR, NZL and RUS, data refer to 2015; for MEX, 2013; and for JPN, 2011.
For KOR and MEX, data refer to establishments. For GBR, data exclude small unregistered businesses; these are both self-employed without a VAT or PAYE administrative basis and incorporated businesses with one employee, as the latter are likely to be owners/workers in the business.
Source: (OECD, 2017).

Figure 1.3. Employment by enterprise size, non-financial business sector

Percentage of all persons employed, 2014 or latest available year

Note: Data for RUS, USA, JPN, CAN, ISR and KOR, are based on number of employees. Data for CHE exclude information for enterprises with less than 3 persons employed.
Data for KOR, MEX are based on establishments. For AUS, CAN and TUR, 1-9 refers to 1-19. For AUS, 20-49 refers to 20-199, and 250+ refers to 200+. For CAN, JPN and KOR, size class 50-249 refers to 50-299, and 250+ refers to 300+.
Data for GBR data exclude small unregistered businesses; these are both self-employed without VAT or PAYE administrative basis and incorporated businesses with one employee, as the latter are likely to be owners/workers in the business. Data for JPN were compiled in Japanese Industrial Classification and include overseas employment. Data for RUS were reported in International Standard Industrial Classification (ISIC) Rev.3.

Source: (OECD, 2017[10]).

In addition to their economic presence, representing the dominant form of businesses, SMEs are significant contributors to value added in the economy. In 2013, they generated between 50% and 60% of value added in OECD countries (Figure 1.4). The relatively lower level of SMEs represented in exporting activities are considered to underestimate their actual engagement. Their leading role as providers of intermediate inputs for exports become more evident when looking at the data on SMEs’ value added in exports (López González, 2017[11]).

Their contribution in terms of both employment and value added tends to be higher in the service sector, as compared with manufacturing (Figure 1.5). This can be in large part explained by the increasing returns to scale from more capital-intensive production in the manufacturing sector.

Figure 1.4. Value added by enterprise size, non-financial business sector

Percentage of total value added, total business economy, 2014, or latest available year

![Graph showing value added by enterprise size, non-financial business sector](image)

Note: ISR data include value added of enterprises with at least 1 employee. CHE data exclude enterprises with fewer than 3 persons employed. AUS: 1-9 refers to 1-19, 20-49 refers to 20-199, 250+ refers to 200+; TUR:1-9 refers to 1-19.
ISR, MEX: data refer to 2013; TUR: 2012. Data refer to value added at factor costs in European countries and value added at basic prices for other countries. Data cover business economy excluding financial intermediation. Data for MEX refer to establishments.

Source: (OECD, 2017[10]).
Figure 1.5. Contribution of SMEs and large enterprises to employment and value added

Percentage of total employment and of total value added, 2013 or latest available year

Notes: AUS: SMEs refer to < 200 persons employed.
CAN, JPN, KOR: SMEs refer to < 300 persons employed.
CAN, CHE, ISR, JPN, KOR, USA, RUS: SME data do not include non-employers.
Data for KOR, MEX refer to establishments.
Value added data refer to value added at factor costs in European countries and at basic prices for other countries.
Data cover the business economy, excluding financial intermediation.
SMEs are the prime focus of economic policies of many governments. Recognising their contribution to (among others) employment, productivity and innovation, among others, governments endeavour to provide an environment conducive for their growth so as to fully exploit the potential of SMEs in promoting economic prosperity and social well-being. These efforts include various elements of the business environment, including the institutional and regulatory framework, access to markets, access to resources, and entrepreneurial culture (Figure 1.6). Within this, conditions for accessing public procurement markets constitute one key element for their development. Furthermore, the institutional and regulatory frameworks that shape public procurement markets also influence SME’s access to resources and entrepreneurial cultures.

**Figure 1.6. SME business environment: A conceptual framework**

1.3. Engaging SMEs in public procurement brings benefits

Engaging SMEs in public procurement helps governments to better meet the procurement needs of the public sector. Increasing their participation in the public procurement market ensures a more competitive bidding process and affords access to a wider choice of available and innovative solutions (Flynn and Davis, 2017[14]). This in turn helps
governments to meet the needs of the contracting authorities in a more responsive way and achieve better value for money in their purchases. The benefits from engaging SMEs in public procurement have long been acknowledged. For instance, an advisory committee report published in 2008 in the United Kingdom on actions to reduce the barriers that SMEs face in the public procurement market clearly recognises these benefits that SMEs can offer (Box 1.2).

**Box 1.2. Benefits SMEs can offer**

*Better value for money* – Bringing in more suppliers will often bring greater competition to the market place, reducing the costs of procurement from all suppliers. SMEs have lower administrative overheads and management costs than larger firms, depending on the nature of the procurement; this can result in lower prices.

*Better quality of service* – SMEs have short management chains and approval routes, so they can respond quickly to changing requirements. SMEs may also be highly focused on particular markets, making them particularly responsive to changes in those markets.

SMEs are often better able to offer a more personal level of service, – developing bespoke products and services or tailoring existing ones to meet specific customer needs – and to develop long-lasting relationships with their customers.

SMEs may also be better able to supply higher-quality specialist products or services than their larger competitors, either because larger suppliers are discouraged by the limited demand, or because by concentrating on niche markets SMEs can retail skills, originality and commitment in that field that are greater than those found in larger competitors.

*More innovation* – SMEs can bring innovation through the early exploitation of new technology, providing products or services in new or underdeveloped markets, or by using innovation to differentiate themselves from established market players.

*Source:* (HM Treasury, 2008[15]).

Public procurement markets also provide SMEs with attractive business opportunities. The large sum of money spent on public procurement – again, representing approximately 12% of GDP in OECD countries (OECD, 2017[4]) – and the diversity and stability of the public sector’s needs result in mutual benefits for SMEs and government. There are moreover additional factors that make governments attractive customers for SMEs:

- SMEs can be assured that government will engage in fair business practices. Public procurement is subject to laws, regulations, policies, and, for most OECD countries, trade obligations. Many jurisdictions in OECD countries include fair and equal treatment of bidders among the core principles of their public procurement systems.
- Experience as a supplier to a government may give the SME a trusted status and recognition as such in other markets. This experience demonstrates the credibility and competency of SMEs, in terms of meeting the requirements, deadlines, and terms and conditions of delivery set in the tender documentation.

Engaging SMEs in public procurement could in fact result in economic and social benefits on a wider scale, through SME growth. This potential often informs the objectives of different SME-enablement and support programmes that facilitate their access to and
chance of winning public procurement opportunities. Establishing business relationships with governments could increase the volume and stability of demand for SMEs, and thus provide a favourable environment for them to invest and scale up. Additionally, as SMEs constitute substantive contributors to employment, value added and innovation, certain programmes seek the economic and social benefits by focusing on subgroups of SMEs, such as innovative entrepreneurs. Further economic benefits include supporting the creation of new supply markets, responding to supply market dominance and fragmentation, and (thus) helping maintain an effective level of competition (Caldwell et al., 2005[16]).

There are also social and political justifications for policies supporting SMEs. These can be found for instance in government policies to support certain subgroups of SMEs that are historically, economically and/or socially disadvantaged, such as minority support policies. Such diverse rationales behind SME policies may have resulted in policy goals being stated in very broad and political terms (Nicholas and Fruhmann, 2014[17]).

Recognising these benefits, governments in OECD and non-OECD countries have developed a host of strategies and policies to fully exploit the potential of engaging SMEs in public procurement. Indeed, the most commonly discussed objectives that they aim to achieve include facilitating SMEs’ access to public contracts and ensuring a level playing field for all economic operators. In addition to opening up public procurement markets to offer suppliers equal opportunities, SME policies and strategies are often employed by countries to achieve domestic economic and societal development. Promoting their growth can, for instance, increase the competitiveness of national SMEs; stimulate employment and job creation; and boosting innovation. For the contracting authorities, countries pointed to the objective of accessing a wider and more diverse range of solutions (Figure 1.7).

**Figure 1.7. Main strategy/policy objectives in facilitating SME participation in public procurement**

![Bar chart showing the percentage of respondents indicating the relevance of various objectives.](chart)

**Note**: Based on survey responses received from 26 OECD countries. The survey respondents were asked to indicate how relevant each option is in their country context – from 1 (not relevant) to 4 (very relevant).

**Source**: 2017 OECD survey on strategic use of public procurement to support SMEs.
In contrast to discussions on the benefits of engaging SMEs in public procurement, the cost of doing so has not yet been fully explored. There exist diverse policy options to facilitate SME participation and support their performance in public procurement, which will be discussed in subsequent chapters. Among them, some measures that favour SMEs in tender processes, for instance, may incur an efficiency cost, or an opportunity cost of limiting certain competent and competitive large firms from participating. Certain studies suggest that economic returns from SME growth offset the efficiency losses associated with SME contracting (Storey, 1999[18]). This argument however relies on a concrete understanding of the costs of the support measures. The current lack of evidence on the costs, as well as on the extent to which each measure affects economic and social outcomes, hinders the policy discussions (see Chapter 5).

1.4. SMEs face difficulties in participating in public procurement markets

Despite the potential benefits of having SMEs participate in public procurement markets, they are in fact underrepresented in the process compared with their overall weight in the economy. Consensus is currently lacking on the share of public procurement contracts that should go to SMEs. However, the figures on their share of public procurement contracts are often lower than their share of the market, for instance, in terms of value added or turnover (Figure 1.8). This underperformance of SMEs in public procurement markets could be “taken as evidence of market failure that justifies intervention” (Nicholas and Fruhmann, 2014[17]).
Figure 1.8. SMEs’ share of public contracts won, compared with their market share for some European countries

SMEs’ share of above-threshold contracts won, by aggregate value of contracts, average total for 2009-2011 (percent) compared with SMEs’ share of turnover (2013) and value-added (2013)

Note: The line in each figure represents a line of equality, which means that the vertical or horizontal distance between the data point and the line represents the difference between the values on x- and y-axes. For a methodological discussion on the calculation of SMEs’ share of above-threshold contracts won, please refer to (PwC, ICF GHK and Ecorys, 2014[19]). For detailed information on turnover and value added, please refer to (OECD, 2016[12]).

Source: Adapted from (PwC, ICF GHK and Ecorys, 2014[19]) and (OECD, 2016[12]).
That being said, at least two elements make it difficult to assess the share of public procurement contracts that should go to SMEs. Indeed, many SMEs – and probably an even larger share of micro-enterprises – are not interested in public contracts, because their activities do not correspond to the needs of public purchasing authorities (for instance florist retailers, café-bars, cobbler, craftsmen and small shopkeepers working usually for natural persons). While it is logical to take this share into account to determine the overall weight of SMEs in the economy, comparing their activities to the procurement needs of public authorities can only reduce SMEs’ fair share of public contracts compared to their overall weight in the economy.

In addition, there are SMEs that participate to some extent in public procurement, but are not taken into account in many statistics. Examples include enterprises that do not directly apply for public contracts but carry out a part of the contract on behalf of the prime contractor, and as described in technical documents of the contract. Such enterprises are often qualified as sub-contractors, a category that in fact includes a large share of SMEs (see section 2.3.3 for further discussion). Others supply prime contractors with components that will be incorporated into the final product delivered to the procuring entity (for instance windows or undercarriages for planes). Here too, enterprises with this function generally are SMEs. In both of these cases, even if the procuring entity has no relation with the enterprises in the supply chain, the award of a public contract leads to the award of second rank contracts and to payments made by the prime contractor to other enterprises which are often SMEs. Therefore, although these second rank contracts are often not registered in the share of public contracts that goes to SMEs, they may be a significant part of the SMEs’ activity.

The underperformance of SMEs is recognised both by governments and SMEs themselves. The long history of policy decisions by governments to support SMEs in public procurement reflects that recognition, as well as acknowledgement of the difficulties SMEs have expressed having associated with accessing public procurement markets.

Addressing the barriers to participation by suppliers of all types in public procurement markets has been one of the main areas of public procurement reforms. Facilitating SME participation is not a recent trend; governments and academics have long considered SMEs’ performance in the public procurement market in order to understand the barriers. Many studies have tried to comprehend in particular the barriers that small firms face in accessing government contracts, and the reasons for their reluctance to sell to governments. An early example of this can be found in the study carried out by MacManus (MacManus, 1991[20]). This academic study of data from the late 1980s involved a survey among a large number of businesses in two counties, of Texas and Florida, in the United States. From the survey it was able to identify a set of difficulties that firms encounter in doing business with the government at a sub-regional level:

- Slow payment cycles (44.5%)
- Bid specifications written too narrowly to permit real competition (35.5%)
- Difficulty making contact with actual user of service/product (31.6%)
- Too much paperwork required for application (28.8%)
- Competition from other firms pushes prices too low for firm to compete (27.8%)
- Confusion over official responsible for specific purchasing decision (26.9%)
- Reluctance to consider new products/services (25.7%)
- Bid specifications written too generally and imprecisely (23.9%)
- Too much paperwork required for contract received (23.7%)
- Inordinate delays between bid closing and actual contract decision (23.4%)
• Difficulty in competing against large firms (22.4%)
• Absence of rigorous performance audits to weed out bad contractors (19.6%)
• Bid bond requirement (18.3%)
• Performance bond requirement (17.0%) (MacManus, 1991[20]).

Many of the challenges SMEs faced in participating in public procurement in the 1980s and 1990s persist today. Governments have reacted with policy measures to remove the barriers and facilitate access to both national and international markets. In spite of the efforts made by governments to address the constraints identified by SMEs, today discussions still focus on how to remedy the situation. As a result of the 2012 consultation across Europe, procedures for awarding public contracts ranked in the top 10 most burdensome EU laws for SMEs (European Commission, 2013[21]). This consultation gave momentum to revision of the directives that govern public procurement market in the European Union – with special attention given to facilitating SME access (see Box 1.3).
Box 1.3. Legal revision to facilitate SME access to public procurement markets in the European Union

The European Commission (EC) published the European Code of Best Practices Facilitating Access by SMEs to Public Procurement Contracts in 2008 in order to make public procurement of all sizes as accessible as possible to SMEs. The Code highlights and elaborates a number of practices within the EU regulatory framework that optimise tenders for the participation of SMEs and ensure equality of opportunity. It also describes best practice and provides guidance to EU Member States and their contracting authorities so that they can fully exploit the potential of the EU public procurement directives. The Code aims to provide a level playing field for all economic operators wishing to participate in public tendering.

In a broad consultation initiated by the EC carried out in 2012, approximately 1,000 SMEs and business organisations identified the public procurement regime as one of the top 10 most burdensome EU laws.

During the process of revising the public procurement directives, the European Parliament requested that the EC apply more effort to facilitating SME access to procurement markets, in particular by:

- evaluating the impact of public procurement directives on SMEs in their role as subcontractors, and assessing whether further rules on the award of subcontracts are required (with the specific aim of ensuring that SMEs as subcontractors are not subject to worse conditions than the main contractor awarded the public contract)
- simplifying public procurement procedures so as to ensure that contracting authorities and companies are not obliged to spend a huge amount of time and money on purely bureaucratic matters.

When the new public procurement package was introduced in April 2016, the promotion of SMEs was highlighted as one of the five main points of public procurement reform. The measures provided in the Directive to facilitate the participation of SMEs in public tenders can be summarised as follows:

- Contracting authorities are encouraged to divide contracts into lots, making tenders more accessible to SMEs.
- The turnover required to participate in a tender procedure is limited, allowing more SMEs and newcomers to participate.
- The documentation requirements for procurement procedures are considerably reduced and streamlined.
- The mandatory use of e-procurement allows SMEs to exploit the full benefits of the Digital Single Market, and will bring efficiency gains.

Source: (OECD SIGMA, 2016[22]).
To illustrate some of the hurdles faced by SMEs in accessing public procurement markets, a recent study carried out by ChileCompra, the Chilean central purchasing body, identified the following barriers to Chilean SMEs participating in the public procurement market:

- very large contracts
- insufficient access to information on business opportunities in public procurement
- lack of knowledge regarding public procurement procedures
- excessive bureaucracy
- limited experience in bidding
- expensive standards and certification requirements
- disproportionate levels of technical qualification
- disproportionate levels of financial qualifications and incompatible payment terms
- unclear tender requirements
- lack of time to prepare bids
- preference for lowest price tenders
- centralisation of public procurement contracts
- lack of feedback from public buyers (EBRD, 2017[23]).

Major barriers identified by governments echo across jurisdictions and time. The main constraints identified by public procurement policy makers and practitioners in OECD countries reaffirm the survey conclusions (Figure 1.9). While these findings cannot conclusively say to what extent they pose a burden on SME participation or their evolution over time, the complexity and administrative burden of public procurement systems seem to persist as one of the main impediments for SME participation.

Figure 1.9. Main constraints on SME access to public contracts in OECD countries

Note: Based on survey responses received from 26 OECD countries. The survey respondents were asked to indicate how relevant each constraint is in their country context –from 1 (not relevant) to 4 (very relevant).
Source: 2017 OECD survey on strategic use of public procurement to support SMEs.

These constraints are not limited to the bidders when accessing public contracts. After an SME decides to participate in a public tender, it faces various constraints at each stage of the process (Table 1.2). These relate to the SMEs’ resources and capacity, which can be disproportionately affected by the design of the procurement process.
### Table 1.2. SMEs’ public procurement challenges by stage of procurement

<table>
<thead>
<tr>
<th>Stages of procurement</th>
<th>Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access to information</td>
<td>- Finding opportunities on tendering platforms on line.</td>
</tr>
<tr>
<td></td>
<td>- Suppliers do not know whom to contact when seeking contracts or clarification. Buyers are inaccessible. Information is disorganised.</td>
</tr>
<tr>
<td></td>
<td>- Lack of information or feedback for understanding the procurement process. Lack of related training (e.g. bid writing, submission process).</td>
</tr>
<tr>
<td></td>
<td>- Preconceptions that governments prefer to contract with large suppliers.</td>
</tr>
<tr>
<td>Pre-qualification</td>
<td>- Clarity of solicitation documents. Limited resources to engage in prequalification processes (e.g. vetting bids).</td>
</tr>
<tr>
<td></td>
<td>- Governments ask inappropriate questions (e.g. proprietary information).</td>
</tr>
<tr>
<td></td>
<td>- Time invested does not guarantee invitation to tender. Excessive paperwork.</td>
</tr>
<tr>
<td></td>
<td>- Lack of feedback following prequalification stage of applications.</td>
</tr>
<tr>
<td></td>
<td>- Unsolicited use of proprietary information (e.g. informal, on websites).</td>
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<td></td>
<td>- Difficulty getting on bid lists for local contracts.</td>
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<td></td>
<td>- Restrictive bonding or securing requirements.</td>
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<tr>
<td>Tendering</td>
<td>- Contracts awarded based on lowest price rather than overall best value.</td>
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<tr>
<td></td>
<td>- Suspicion that selection processes favour insiders and established firms.</td>
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<tr>
<td></td>
<td>- Cost of bidding. Contract bundling that limits SME opportunities.</td>
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<tr>
<td></td>
<td>- Federal jargon and complex legislation (national and international standards) create unrealistic expectations with respect to technical and financial capacity and compliance standards.</td>
</tr>
<tr>
<td></td>
<td>- Just-in-time procurement (inventory) reduces the number of long-term relationship and limits number of suppliers.</td>
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<tr>
<td></td>
<td>- Sub-contracting is as difficult as contracting directly with governments.</td>
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<tr>
<td>Contract administration</td>
<td>- Lack of capacity and resources to meet compliance requirements.</td>
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<tr>
<td></td>
<td>- Complexity of federal accounting and payment systems/schedules.</td>
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<td></td>
<td>- Inflexible terms of payment even when caused by government delays.</td>
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<tr>
<td>On-going relationship</td>
<td>- Expectation creep, unplanned and unrealistic demands.</td>
</tr>
<tr>
<td>management</td>
<td>- Informal add-ons without due compensation.</td>
</tr>
<tr>
<td></td>
<td>- Turnover of federal employees and loss of relationships.</td>
</tr>
<tr>
<td></td>
<td>- Lack of communication with respect to expectations.</td>
</tr>
</tbody>
</table>

*Source: (Liao, Orser and Riding, 2017(24)).*

### 1.5. Integrating SME consideration into public procurement policies

Policy makers increasingly recognise the strategic dimension of public procurement and its potential to contribute to socio-economic development. These changes in how public procurement is perceived have led to reforms of public procurement systems in many countries. Amidst these changes, supporting SMEs has been at the centre of the public procurement policy agenda. In fact, the survey carried out by the United Nations Environment Programme (UNEP) has identified employment and SME development as top priority areas for governments’ sustainable public procurement policies (Figure 1.10).
The objective of supporting SMEs and facilitating their access is actually embedded in public procurement policies and strategies in most OECD countries (Figure 1.11). This strategic dimension principally supports use of the public sector’s purchasing power to stimulate SME participation and competition, thus increasing value for money in carrying out public procurement. It also reinforces governments’ aspiration and commitment to modernising the public sector, stimulating the competitiveness of SMEs, fostering innovation, and supporting sustainable and inclusive growth. Linking this strategic use of public procurement to enabling SMEs could be integrated into broader SME support policies in order to reinforce the policy linkages by considering possible synergies and trade-offs between them.

**Figure 1.10. Priority social goals in sustainable public procurement policies**

Source: (UNEP, 2013).

**Figure 1.11. Incorporating support of SMEs in public procurement and/or wider policy in 31 OECD countries**

Source: 2017 OECD survey on strategic use of public procurement to support SMEs.
The legal and regulatory frameworks that govern public procurement in OECD countries include provisions that ensure SMEs get a fair chance of participating in public procurement markets, such as through the principle of fair competition in Australia’s Commonwealth Procurement Rules (Box 1.4). In some cases, such as that of Mexico (Box 1.4), the frameworks include specific provisions that apply to SMEs in order to facilitate their participation in public procurement.

**Box 1.4. Objective of supporting SMEs in legal public procurement frameworks**

**Australia’s Commonwealth Procurement Rules**

5.4 To ensure that SMEs can engage in fair competition for Australian Government business, officials should apply procurement practices that do not unfairly discriminate against SMEs and provide appropriate opportunities for SMEs to compete. Officials should consider, in the context of value for money:

a. the benefits of doing business with competitive SMEs when specifying requirements and evaluating value for money;

b. barriers to entry, such as costly preparation of submissions, that may prevent SMEs from competing;

c. SMEs’ capabilities and their commitment to local or regional markets; and

d. the potential benefits of having a larger, more competitive supplier base.

5.5 The Australian Government is committed to non-corporate Commonwealth entities sourcing at least 10% of procurement by value from SMEs.

**Mexico’s Law of Acquisition, Leases and Services for the Public Sector**

The Law of Acquisition, Leases and Services for the Public Sector (*Ley de Adquisiciones, Arrendamientos y Servicios del Sector Público*) stipulates that:

- The Ministry of Economy is in charge of promoting enterprise participation, especially SME participation, in public procurement. Agencies moreover must put in place programmes to develop SME suppliers in order to strengthen the supply chain of goods and services that are regularly procured.

- In cases of goods with a manufacturing process of longer than 60 days, agencies and entities shall provide, under equal circumstances, from 10% to 50% of advance payment when the supplier is a micro, small or medium-sized national enterprise.

- In cases of evaluation by points and percentages, agencies must give extra points to small and medium-sized enterprises that produce goods using innovative technology, in accordance with the Mexican Institute of Industry Property.

- Where candidates are equal, preference will be accorded to persons who are part of national SME’s.

*Source: Country responses to the 2017 OECD Survey on strategic use of public procurement to support SMEs.*
In countries where support for SMEs is not explicitly mentioned in legal or regulatory frameworks, it is typically reflected in provisions related to competition and equal and fair treatment of bidders and suppliers so as to facilitate SME participation in public procurement. For instance, the 2014 EU directives on public procurement include new rules that aim to simplify procedures and make them more flexible, which will be of particular benefit to SMEs. These rules had to be transposed into the national laws of Member Countries by April 2016. In line with this obligation, Sweden for instance has adopted a National Procurement Strategy, which includes the objective of ensuring a multiplicity of suppliers and well-functioning competition. In this strategy, the Swedish Government encourages contracting authorities to ensure that they actively strive to provide a real chance for small enterprises to participate in public procurement, for example by removing barriers such as excessive criteria for economic and financial capacity where they are unjustified. This is also the case in Switzerland, where the government has put particular emphasis on ensuring non-discriminatory, open and transparent competition in public procurement markets, and on addressing SMEs’ needs in participating in domestic and international markets.

The policies and strategies to support SMEs in public procurement reflect the political will to do so, as well as the wide recognition of public procurement as a key policy area to advance this objective. In developing them, lack of political support has not been a critical issue. Governments however did face certain challenges, especially regarding the potential conflict of such policies and strategies with the primary procurement objective, which is to deliver goods and services necessary to accomplish the government’s mission in a timely, economical and efficient manner. As such, while the need to develop the policies and strategies had been widely agreed, establishing the exact measures to develop and the means for implementing them have been more challenging issues (Figure 1.12).

**Figure 1.12. Challenges in developing strategies / policies to support SMEs in public procurement**

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Very relevant</th>
<th>Relevant</th>
<th>Somewhat relevant</th>
<th>Not relevant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Potential conflict with primary procurement objectives</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of clear knowledge about what measures are most effective, addressing the constraints SMEs face</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insufficient incentives</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of adequate legal provisions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of political support</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Note: The survey respondents were asked to indicate how relevant each challenge is in their country context – from 1 (not relevant) to 4 (very relevant).*  
*Source: 2017 OECD survey on strategic use of public procurement to support SMEs.*
1.6. Supporting SMEs to reinforce the strategic use of public procurement

Strategic public procurement initiatives aiming at using public procurement to, for instance, promote innovation, protect the environment and strengthen social cohesion (through addressing gender inclusiveness and socially disadvantaged groups) give special attention to SMEs. As shown in Figure 1.11 above, public procurement strategies for green public procurement and public procurement for innovation commonly reflect the objective of supporting SMEs in those procurements; such was the case for 44% of the countries responding to the survey. This section analyses SMEs’ particular contribution to promoting innovation and environmental protection, and provides an overview of how they are addressed in such initiatives.

1.6.1. SMEs are large contributors to innovation

Innovation is a key driver of productivity and long-term growth. Innovation in SMEs in particular is at the core of inclusive growth strategies. While SMEs are, on average, less innovative than large companies, they are often the source of radical innovations and constitute the bulk of high-growth firms (OECD, 2018[26]). One reason may be that in small companies there is little organisational or hierarchical overhead, and new ideas can be tested spontaneously without being subjected to long approval procedures. Another reason is that innovative ideas are often the genesis from which a company is founded. The innovative idea is then developed as a business, though initially this may only have limited scope (OECD, 2017[27]).

Innovative SMEs could find additional challenges in accessing the public procurement market due to, for instance, the risk-averse nature of public procurement officials. In fact, the participation of innovative firms in public procurement market is more common for large firms than SMEs (Appelt and Galindo-Rueda, 2016[6]). At the same time, participation in public sector markets provide a major source of demand for innovative SMEs. Indeed, the level of innovative SME participation in public procurement markets, though being still relatively low, is higher than that for general SME population (OECD, 2017[28]).

Recognising the key role of SMEs in public procurement for innovation and the benefits of engaging them in public procurement, governments provide various forms of support for them to participate, including direct financial incentives and guarantees. Or, they may employ an indirect measure such as an SME participation quote, administrative assistance, training offers or other means to facilitate access to public tenders on different levels (OECD, 2017[27]). Some examples can be found in Table 1.3.
Table 1.3. Support for SMEs in public procurement for innovation policies and strategies

<table>
<thead>
<tr>
<th>Country</th>
<th>SME inclusion in public procurement for innovation policies and strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>The Austrian Action Plan on Public Procurement Promoting Innovation deals with the issue of supporting SMEs in public procurement. For example, it stipulates that public authorities should tender/procure in lots and define qualification and award criteria in a way that gives SMEs a chance to participate in competitions, etc.</td>
</tr>
<tr>
<td>Belgium</td>
<td>In order to encourage innovation for contracts below publication threshold, a working group is analysing possibilities for attracting very small firms and start-ups more easily. As a first step, the scope aims at procurements in the IT sector below the national publication threshold and for which an innovative solution is needed.</td>
</tr>
<tr>
<td>Canada</td>
<td>The Build in Canada Innovation Programme provides procurement opportunities for SMEs with innovations ready for testing or commercialisation, by making the Government of Canada their first client.</td>
</tr>
<tr>
<td>Germany</td>
<td>The Competence Centre for Innovative Procurement (KOINNO) was created to help the contracting authorities on the federal level as well as on the local and regional levels to put the policy goal of furthering innovation by way of public procurement and of supporting innovative goods and services into practice. KOINNO gives guidance in different ways, e.g. on its homepage (de.koinno-bmwi.de), at workshops, by providing best practice examples and by giving advice on concrete, practical questions.</td>
</tr>
<tr>
<td>Ireland</td>
<td>Ireland established Small Business Innovation Research (SBIR), the national innovative pre-commercial procurement initiative administered by Enterprise Ireland.</td>
</tr>
<tr>
<td>Korea</td>
<td>Korea has established priority purchase for SME-developed technology products, which needs to constitute at least 10% of SME purchases.</td>
</tr>
</tbody>
</table>

Source: Country responses to the 2017 OECD survey on strategic use of public procurement to support SMEs.

1.6.2. SMEs’ role in green public procurement

The green transition also opens up business opportunities for SMEs as important suppliers of green goods and services. In many OECD countries, innovative SMEs play a pivotal role in the eco-industry and clean tech markets. For instance, in the United Kingdom and Finland, SMEs represent respectively over 90% and 70% of clean technology businesses. SMEs are especially well positioned to seize opportunities from greener supply chains in local clean tech markets that may be unattractive or impenetrable for large global firms, including in emerging economies and low-income countries. Furthermore, small “green entrepreneurs”, driven by financial profit in equal mix with environmental consciousness, can drive a bottom-up transformation and job creation by developing new business models and pioneering green business practices. Such developments can influence mass markets and are eventually adopted by the wider business community (OECD, 2017[29]). Recognising the important role that SMEs can play towards environmental goals, Table 1.4 presents some of the approaches adopted by countries to provide support to SMEs in the case of green public procurement.
Table 1.4. Supporting SMEs through green public procurement policies and strategies

<table>
<thead>
<tr>
<th>Country</th>
<th>SME concerns included in green public procurement policies and strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>The Austria Action Plan on Sustainable Public Procurement aims at supporting the participation of SMEs in public procurement</td>
</tr>
<tr>
<td>Germany</td>
<td>The strategy and policy on sustainability, under the responsibility of the Bundeskanzleramt (Federal Chancellery), includes public procurement actions conducted by the federal government itself. The Competence Centre for Sustainable Procurement (KNB) was created to help those responsible for public procurement – also on the regional and local levels – to actually put policy goals on sustainability into practice. It advises all contracting authorities in Germany with regard to environmental, economic and social criteria.</td>
</tr>
<tr>
<td>Greece</td>
<td>The adoption of a strategy/policy for green public procurement is included in the National Strategy for Public Procurement, which in turn includes several actions aimed at supporting SMEs</td>
</tr>
<tr>
<td>Mexico</td>
<td>The Production and Sustainable Consumption Programme has the objective of increasing sustainable public procurement. To achieve this objective it implements a strategy promoting economic instruments that encourages green and inclusive growth. One line of action of this strategy is to promote the procurement of sustainable goods and services from SMEs.</td>
</tr>
<tr>
<td>Slovenia</td>
<td>Based on the conception of the recently renewed Decree on Green Public Procurement (Official Gazette no. 51/17; hereinafter decree), entering in force 1 January 2018, green public procurement will be simplified. The decree itself will allow the requirements of the contract to be adapted to the circumstances of the individual case and encourage diversified practices and innovations. As SMEs are generally more flexible and capable of adapting their production processes to the market demands quickly, green public procurement is an important business opportunity for them.</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>The General Directorate for SME’s from the Ministry of Economy, Trade and Industry, is part of the National Commission for sustainable public procurement. However, the use of ecological factors is not widely applied, and is subject to the policies applied by each entity of the public administration.</td>
</tr>
</tbody>
</table>

*Source*: Country responses to the 2017 OECD survey on strategic use of public procurement to support SMEs.
References


PwC, ICF GHK and Ecorys (2014), “SMEs' access to public procurement markets and aggregation of demand in the EU”.


