

Preferential Public Procurement for Small and Medium Enterprises



Benefits and obstacles

Public procurement refers to the acquisition of goods, construction or services by a procurement entity, with the procuring entity being the government. This includes government purchasing everything from printer paper, to police vehicles, to highways.

Public procurement policies can create new market opportunities for supporting the development of small and medium-sized enterprises (SMEs). But while public procurement makes up a major portion of government spending, SMEs consistently struggle to win government contracts. This is due to a series of pervasive obstacles experienced by SMEs.

Overcoming these obstacles can lead to economic and socio-economic benefits. However, there is a lack of knowledge surrounding preferential public procurement policies for SMEs.

Preferential public procurement

Public procurement makes up a major part of any country's economy, measuring anywhere from ten to over 30 per cent of Gross Domestic Product. Globally, this amounts to trillions of dollars spent annually by governments. Given this scale and the potential impact on the economy, many countries have begun to use public procurement to achieve certain social and environmental policy objectives, directing their spending towards the disadvantaged groups they wish to strategically support to help overcome obstacles to participation in the procurement process. This serves to achieve simultaneous goals of procuring necessary goods and services while doing so in a way that aligns with other government initiatives, such as achieving the Sustainable Development Goals. This is referred to as 'preferential public procurement'.

Many governments, in both developing and developed economies, have introduced preferential procurement policies and programmes to support SME development. Indeed, the World Bank's 2017 Benchmarking Public Procurement report, which surveys 180 economies, shows that 47 per cent of countries indicate they provide SME specific public procurement incentives.

At a glance

Public procurement can be a powerful instrument for promoting market opportunities to support SME development.

Preferential procurement policies and procedures can boost the participation of SMEs in new markets.

The impacts of policies, beyond increasing SME engagement and contracts won as well as potentially better functioning government, are often unclear or unknown.

Across cases of previously implemented preferential policies, some standard good procurement practices are evident such as transparency, anti-corruption, and the use of e-procurement platforms.

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How public procurement can support SME development

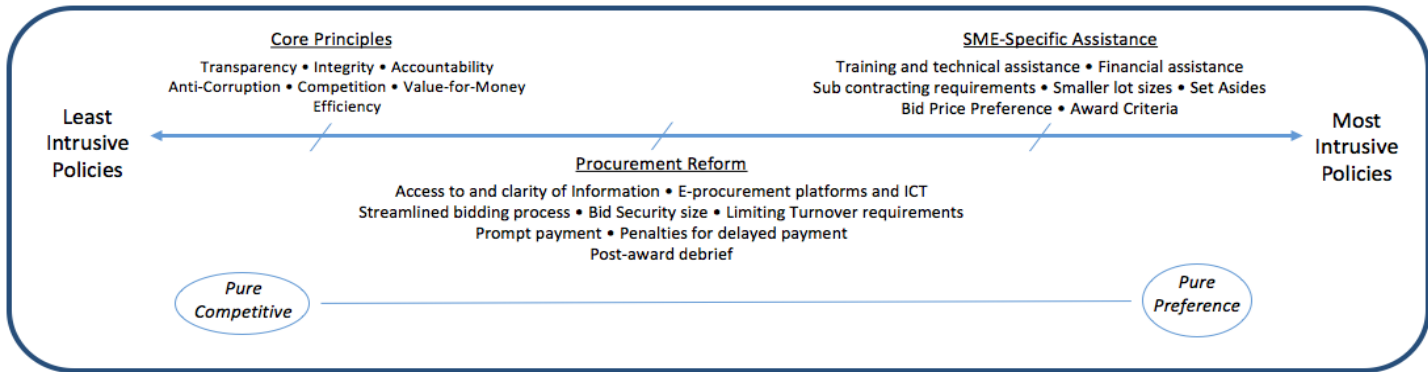
Effective preferential procurement policies address the obstacles many SMEs experience when attempting to participate in public procurement processes. These are summarised in the figure below.

Figure 1: SME barriers to participation in public procurement processes

Pre-bidding stage	Restricted communication and publication of contract opportunities
	Overly narrow pre-qualification criteria, placing too much emphasis on past experience or firm size
	Uncompetitive bidding processes
	Difficulties due to size of contracts
	Quality and the 'understandability' of information provided is limited
Application stage	Excessive bureaucracy and documentation requirements
	Excessive requirements of financial guarantees (i.e. bid security deposit)
	Grant enough time to prepare quotations
	Lack of capability in writing a formal bid proposal
	Unclear selection criteria – how best to meet government's needs unclear
Selection stage	Preference for large bidders with long track records
	Institutionalized discrimination
	Too much focus on the price, and not on value for money
Post-selection stage	Absence of rationale for awards
	Payment terms are not complied with i.e. delayed payments
	Unsuitable payment terms offered
	No feedback shared for future learning
	Difficulty in business complaints being heard and addressed

Preferential procurement models can be organised along a spectrum, differentiating the extent to which the policies disrupt the existing conditions with less intrusive policies being designed for pure competitive purposes, while more intrusive policies provide pure preference to SMEs. See Figure 2 overleaf.

Figure 2: Spectrum of Procurement policies



Three broad categories of instruments have been identified:

- 1. Core principles:** relevant to nearly all aspects of the procurement process and support good governance;
- 2. Procurement reforms:** do not directly target SMEs, instead aim to level the playing field and in doing so, disproportionately benefit SMEs; and
- 3. SME-specific assistance:** provide direct support to SMEs and only SMEs in order to help them participate in more public procurement contract opportunities.

Implementing preferential public procurement policies

While purchasing of goods and services, the public procuring entity must balance a wide range of objectives (e.g., cost effective purchasing, competitive bidding, transparency of processes and government contract availability, local market conditions, national procurement laws, specific social and environmental policy objectives). These public procurement agendas can be broken into three sometimes conflicting policy goals: regulatory, commercial and socio-economic.

Other factors influencing implementation and impacts achieved include:

- How well the system functions—including legal, regulatory, institutional frameworks and government capacity while also balancing agendas within the existing political climate.
- The use of centralised or de-centralised procurement systems and how the increasing use of information and communications technology changes the potential pros and cons.
- Where and if strategic support and focus is needed as some sectors or types of SMEs may deserve more or less public support.
- Clarity in the definitions of SMEs and procurement criteria helps reduce the potential for corruption compared to when criteria is left up to interpretation.
- Existing international commitments, such as Free Trade Agreements and the World Trade Organisation’s Agreement on Government Procurement, that may restrict the ability of governments to promote domestic SMEs.
- The barriers and risks to the preferential policy, including protecting against corruption, collusion and lack of adoption.
- Recognition of, and engagement with, the various policy stakeholders helps ensure its successful implementation.

What we have learned about policies implemented to date is meaningful, yet limited

1. Public procurement can be used to address socio-economic policy agendas, with varying results being achieved. In some cases, aspects of corruption or business informality pose greater obstacles to successful policy implementation.
2. Data and studies on impact of SME and women-specific preferential procurement policies are very limited. A new policy needs to be coupled with monitoring, evaluation and enforcement mechanisms as many times the policies implemented are not effectively evaluated.
3. Procurement reforms are best by efficiency standards, but direct SME-targeted assistance is best for maximising engagement with SMEs albeit at potentially higher costs.
4. Winning a procurement contract provides growth and employment benefits to the SME in short term and potentially longer terms as well.
5. Policies used in developed countries are not necessarily effective in developing countries.
6. Set-asides, financial assistance and small lot sizes are the most commonly used preferential tools for SMEs and have all been found to be beneficial to SMEs, with varying cost effectiveness for the government.
7. The gender component of public procurement is often ignored or forgotten, but worthy of addressing.

Good practices when supporting SMEs through public procurement

1. Establish a coherent, comprehensive and coordinated legal and regulatory framework to support functioning of the system as a whole including effective policy implementation, rule of law, balancing of agendas and shared understanding across government;
2. Centralised e-procurement portals;
3. Minimise 'size' discrimination (i.e., those aspects of the procurement process that inherently favour a larger company);
4. Evaluate the use of public procurement as a tool for targeted socio-economic policy agendas;
5. Align specific procurement policies with core procurement principles and other procurement objectives; and
6. Understand the sectors SMEs tend to work in and capabilities they have or require when determining if preferential treatment will be beneficial.

Good practices for donors and development agencies

Donor funded advisory and advocacy programmes can be focused on one or more of the above good practices, assessing the potential for policy implementation, facilitating a well-rounded policy development that will align with both government and SME interests. This could include research and survey support to better understand existing SME markets, existing government procurement processes, local obstacles for SMEs, technical capacities (e.g., implementing e-procurement platforms), and political economy analysis.

This Policy Brief is based on a technical report prepared by William Nielsen. The full report is available here: <https://www.enterprise-development.org/wp-content/uploads/DCED-BEWG-SME-Procurement-Report.pdf>

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