

# Technical Report: Policies that Promote SME Participation in Public Procurement



**Business Environment Working Group**  
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## EXECUTIVE SUMMARY

This study seeks to analyze the various models of preferential treatment of SMEs in public procurement, provide an assessment of the impact such policies have had as well as identify lessons learnt based on a series of country level case studies.

### INTRODUCTION

- **Global spending on public procurement amounts to USD trillions spent annually** and covers a wide range of goods, services, and infrastructure, everything from office paper to highways, in some countries reaching 30% of total government expenditure. Given this scale and scope, many countries have begun to **use public procurement to achieve certain policy objectives**, directing their spending towards businesses they wish to strategically support through preferential policies. This serves to achieve simultaneous goals of procuring necessary goods/services while doing so in a way that aligns with other government initiatives.
- These **preferential policies exist along a spectrum** ranging from least intrusive to most intrusive for the existing market conditions. For example, a policy for 'leveling the playing field' compared to a policy that specifically targets firms with given characteristics. Furthermore, each policy impacts a particular aspect(s) of the procurement process, for example reducing the difficulty in submitting a bid. In many cases, debate continues about the effectiveness of using preferential policies in procurement.
- This report will focus on preferential procurement policies targeting small and medium sized enterprises (SMEs) and where possible include discussion on gender specific preferential policies.

### RATIONALE FOR SME PREFERENTIAL PROCUREMENT

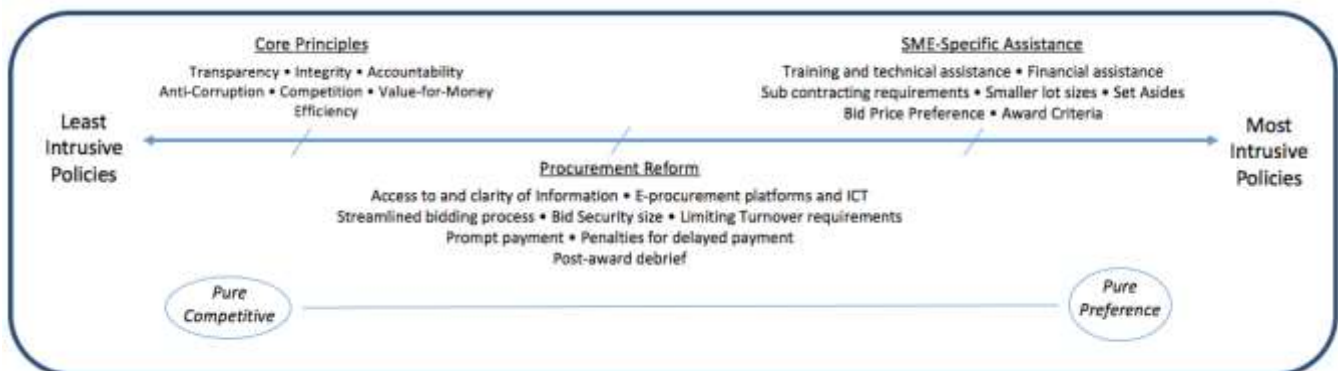
- SMEs may receive preferential support through public procurement due to their prevalence in nearly all economies and the benefits from engaging with them. **SMEs commonly make up the vast majority of businesses**, for example, in the EU they account for 99% of businesses but generally receive a comparatively small share of government procurement spending. The range of benefits noted from engaging with them include **increased competition, improved value, increased innovation, increased job creation, improved social and economic equity, industry de-concentration**, among others.
- SMEs may also be deserving of preferential treatment due to the unique barriers they face to participate in the procurement process, particularly in comparison to large companies. **Barriers may take the form of information, finance, regulatory and capacity obstacles** that can occur throughout the procurement process, from the initial preparatory stage to the post-award and conflict resolution stages.
- Incorporating gender into the preferential procurement policy can be done through criteria such as women-owned businesses and/or women led businesses. **Women often face their own unique barriers that are not covered by giving preference to SMEs**. Supporting women's engagement in the economy has also been proven to be a matter of efficiency and improved economic growth, with McKinsey (2015) estimating that equal participation of women and men in the economy would add \$28 trillion to the global GDP by 2025.

## INITIAL POLICY DESIGN CONSIDERATIONS

- The design of a preferential procurement policy must take into account several initial considerations in order to maximize the beneficial impacts achieved. These considerations include:
  - The **functioning of the system** including legal, regulatory, institutional frameworks and government capacity while also balancing agendas within the existing political climate.
  - The existing **centralization vs. de-centralization of the procurement system** and how the increasing use of ICTs 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/less public support.
  - **Clarity in the definitions** of SMEs and procurement criteria help reduce the potential from corruption compared to when criteria is left up to interpretation as well as standardize implementation of the policy.
  - Existing **Free Trade Agreements** 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 stakeholders** of the policy will help ensure its successful implementation.

## PREFERENTIAL PROCUREMENT MODELS

- As previously mentioned, **preferential procurement models can be organized along a spectrum** (as shown below), 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.
- Three broad categories of instruments have been identified for the purpose of this report and are: 1) **Core Principles** which are relevant to nearly all aspects of the procurement process and support good governance; 2) **Procurement Reforms** which serve to level the playing field and in doing so, disproportionately benefit SMEs; and 3) **SME-Specific Assistance** which is designed to provide direct support to SMEs and only SMEs in order to help them participate in more public procurement contract opportunities.





The following table summarizes all preferential instruments/policies discussed in this report.

	Specific Instrument/ Policy	Stage of Procurement Process	Description	Country Example(s)
<b>Core Procurement Principles</b>	<b>Transparency and Anti-Corruption</b>	Institutional Procedures; Eligibility of Suppliers; Advertisement of Tender; Bid Opening, Evaluation & Awarding	Making relevant information available on tender opportunities, open bidding process, monitoring systems, clear evaluation procedures, etc.	Philippines, Peru, Cabo Verde, Republic of Korea
	<b>Integrity and Accountability</b>	Institutional Procedures; Bid Opening, Evaluation & Awarding; Post-award & Execution	Include codes of conduct, conflict of interest policies to promote trust and responsiveness with fairness to the public and stakeholders.	Republic of Korea
	<b>Value for Money</b>	Institutional Procedures; Bid Opening, Evaluation & Awarding; Post-Award & Execution	Take into account the whole life cost of goods/services procured.	United Kingdom
	<b>Efficiency of the procurement process</b>	Institutional Procedures	Improve simplicity, speed, certainty, and reduce costs of process.	Republic of Korea
<b>Procurement Reform Policies</b>	<b>E-Government and E-Procurement</b>	Advertisement of Tender; Bidding Process & Bid Submission; Bid Opening, Evaluation & Awarding	Use of online tools for rapid communication, transparent processes, broader reach.	Republic of Korea, Brazil, Mexico, India, Chile, Greece, Georgia
	<b>Streamlining application process</b>	Bidding Process & Bid submission; Bid Opening, Evaluation & Awarding	Minimizing administrative costs to the business.	European Union, Cabo Verde, Mexico
	<b>Bid Security</b>	Preparation Stage & Eligibility of Suppliers; Bidding Process & Bid Submission	Determine reasonable financial security for SME bidders.	Russia
	<b>Limiting Turnover Requirements</b>	Preparation Stage & Eligibility of Suppliers	Setting a sales turnover figure that allows SME bids.	European Union
	<b>Prompt Payment Reform</b>	Post-Award & Execution; Institutional Procedures	Shorter payment times allow SMEs with limited liquidity to participate.	Republic of Korea, Mexico, U.S.
	<b>Penalties in case of delayed payments</b>	Post-Award & Execution	Payments made to the businesses who suffer from delayed payments.	Canada
	<b>Simplified contract complaint resolution</b>	Compliance & Conflict Resolution	Minimize legal resources needed while presenting fair, timely resolution.	India
	<b>Post-award debriefing</b>	Post-Award & Execution	Providing feedback to bidders on why they did or didn't win.	
<b>SME-Specific Assistance Policies</b>	<b>Marketing Support</b>	Preparation Stage & Eligibility of Suppliers	Supporting SMEs through visibility of their products/services	Republic of Korea
	<b>Training and technical assistance</b>	Preparation Stage & Eligibility of Suppliers; Bidding Process & Bid Submission	Providing a range of services to SMEs to enable their better participation in procurement process.	Italy, Peru
	<b>Financial assistance</b>	Preparation Stage & Eligibility of Suppliers; Bidding Process &	Providing access to capital and/or advanced payments	U.S., Kenya, Republic of



		Bid Submission; Institutional Procedures; Post-award & Execution		Korea, Croatia, Macedonia
	<b>Performance Guarantee Flexibility</b>	Preparation Stage & Eligibility of Suppliers; Bidding Process & Bid Submission; Institutional Procedures; Post-award & Execution	Reforming requirements of performance guarantees to reduce difficulties for SMEs	Australia, China
	<b>Framework agreements for SMEs</b>	Preparation Stage & Eligibility of Suppliers; Bidding Process & Bid Submission	Use of predetermined agreements to facilitate continued and more engagement by SMEs	U.S., Republic of Korea
	<b>Subcontracting requirements or SME consortia formation</b>	Preparation Stage & Eligibility of Suppliers; Bidding Process & Bid Submission	Promote SME engagement even when the size of the contract is not suitable for a single SME to pursue.	Italy, India
	<b>Smaller lot sizes</b>	Preparation Stage & Eligibility of Suppliers	Splitting contract sizes into smaller sizes to allow more SMEs to bid.	European Union, Egypt, Albania, Sweden
	<b>Award Criteria</b>	Bid Opening & Evaluation; Preparation Stage & Eligibility of Suppliers	Providing opportunities for SMEs to improve their bid based on characteristics of their firm or work.	South Africa
	<b>Set Asides</b>	Preparation Stage and Eligibility of Suppliers	A designated portion of the procurement budget reserved for SMEs	U.S., China, Algeria, Dominican Republic, Morocco, Kenya
	<b>Contract Thresholds and Reserved Products</b>	Preparation Stage & Eligibility of Suppliers	Either contract sizes or specific products are reserved for SMEs to bid on.	Indonesia, Colombia, India, Republic of South Korea
	<b>Bid Price Preferences</b>	Bid Opening & Evaluation	Discounting bids by SMEs to make them more competitive with larger firms.	India

## EVIDENCE OF IMPACT

- Rigorous studies of the impacts generated from preferential procurement policies for SMEs are limited.
- In a preliminary study of the World Bank’s Benchmarking Public Procurement (BPP) data (2016) conducted for the purpose of this report, it was found that **there is a positive correlation between BPP scores**, a measure of private firms’ ability to do business with governments, **and the existence of SME specific incentives** in that same country. However, the correlation disappears when comparing BPP scores with participation rates of SMEs in government contracting.
- The **broader economic impacts of preferential procurement are often unclear or unknown**, largely because the necessary data is limited or non-existent. What has more recently **become clear are the benefits to an SME from winning a government contract** as a recent study in Brazil discovered (Ferraz et al. 2017). This study was not about a preferential procurement policy but was specific to SMEs and found that there are significant growth and employment benefits. For example, winning at least one contract in a given quarter was found to increase firm growth by 2.2 percentage points.

- Regarding preferential policies, studies have been done in individual countries considering the impact of the policy, and **in both the cases of procurement reforms and SME-specific assistance, SMEs engagement was found to increase although at varying levels.** Transparency and E-procurement policies generally prove to be beneficial to SMEs although were most effective when combined with training and improved access to ICT technologies. The number of times a contract is divided i.e. smaller lot sizes, influenced the size of firms participating with varying impacts on micro, small and medium sized enterprises. Finally, reserved products, contract thresholds and set-asides were all shown to effectively increase the number of SMEs engaged and the value of contracts awarded although the cost effectiveness of these policies is continually debated.

## COUNTRY CASE STUDIES

Three country case studies are built out in the body of this report and summarized in the following table.

	Republic of Korea	India	Mexico
SME Definition	Average sales over past three years with unique figure for each industry. Example: Manufacturing \$130 million	Investment ceiling categorizes micro, small and medium sized enterprises separately and divided by manufacturing or service enterprises.	Combined criteria of workforce size and annual sizes establish micro, small or medium size status and subdivided by commerce, industrial or service sectors.
Institutions	<ul style="list-style-type: none"> <li>• Centralized and Decentralized procurement process</li> <li>• Korean Small and Medium Business Administration supports SMEs</li> <li>• Public Procurement Services (PPS) central government agency in charge of procurement</li> </ul>	<ul style="list-style-type: none"> <li>• Largely decentralized procurement process</li> <li>• National Small Industries Corporation coordinates efforts to support SMEs</li> <li>• Public Procurement Bill (2012) at central government level established set-aside goals</li> </ul>	<ul style="list-style-type: none"> <li>• Ministry of Public Administration handles nationwide public procurement</li> <li>• Ministry of Economy establishes policy goals regarding SMEs and facilitates information access for SMEs</li> </ul>
Instruments / Policies	KONEPS E-Procurement platform, Prompt Payment Reform, Financial assistance, Advanced Payments, SME marketing support, Training services, Contract thresholds, Reserved Products, Multiple Award Schedule for SMEs	E-procurement, Prompt Payment Reform, SME Consortia Formation, Training and Technical Assistance, Reduction of Transaction Costs, Setting up Grievance Cell, Penalties for Payment Delay, Set-asides, Reserved Products, Bid Price Preferences	Streamlining processes, E-procurement, Transparency initiatives, Social Witness (anti-corruption), Prompt Payment Reform, SME online support, Training programs, Financial Assistance, Advanced payments, Public Procurement Fair (marketing), Reserved Contracts, Award Criteria
Gender-specific	Contracting goals for women-owned businesses, Contract thresholds	Reserved products, indirect support through previously disadvantaged populations support programs	Support for women owned enterprises but not specific to procurement
Impact	Share of PPS purchases from SMEs up to 73.9%, 75% of KONEPS contracts won by SMEs.	Expected \$260 billion in public spending directed to SMEs from public sector by 2020.	Six-fold increase in contracts awarded to SMEs since 2009, 67% of contracts (not subject to free trade agreements) won by SMEs, 80% of E-procurement contracts won by SMEs

## LESSONS LEARNT

Based on the previous sections of this report, a series of lessons can be extracted to inform and guide policymakers interested in implementing and/or refining preferential procurement policies for SMEs.

1. Improved data collection is needed and will need to be coupled with monitoring, evaluation and enforcement mechanisms.
2. Public procurement can be used to address socio-economic policy agendas, with varying results being achieved. In some cases, aspects of corruption or informality of the private sector pose greater obstacles. Balancing agendas must be considered and in some cases prioritized.
3. Procurement reforms are best by efficiency standards, but SME-specific assistance is best for maximizing 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 term 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 based on Benchmarking Public Procurement surveys. They have all been found to be beneficial to SMEs as well with varying cost effectiveness for the government.
7. The gender component of public procurement is often ignored, but worthy of addressing.

## GOOD PRACTICES FOR ENGAGING SMEs

These good practices help to better enable the efficient and effective inclusion of SMEs in public procurement, maximizing their benefits, and in many cases, also improve the functioning of the government itself.

- Coherent, comprehensive, coordinated legal and regulatory framework
- Centralized, E-procurement portals
- Minimizing 'size' discrimination i.e. those aspects of the procurement process that inherently favor a larger company
- Evaluate use of public procurement as a tool for targeted socio-economic policy agendas
- Understand the sectors SMEs tend to work in and capabilities they have/need to determine if preferential treatment will be beneficial
- Align any preferential procurement policies with core procurement principles and other procurement objectives

## FUTURE RESEARCH NEEDS

- There is a lack of studies attempted in this area, making concrete claims about efficacy and positive impacts more difficult. More experimental studies of the costs-benefits of SME preferential treatment are needed and will require more time to better understand the results of policies. There is also a greater need for understanding how the procurement process relates to SME participation.
- There is very little study of women specific preferential procurement policies and the corresponding impacts of such policies.
- In focusing on the SME as a singular economic sector, studies have often overlooked the disparities in capabilities and behaviors within the SME sector. It is unlikely that a single policy remedy for SMEs will have the desired effects across the entire sector.

# 1. Introduction

This study seeks to analyze the various models of preferential treatment of SMEs in public procurement, provide an assessment of the impact such policies have had as well as identify lessons learnt based on a series of country level case studies.

According to the UN Commission on International Trade Model Law 1994, public procurement refers to “the acquisition of goods, construction or services by a procurement entity,”<sup>1</sup> with the procuring entity being the government. Public procurement makes up a major part of any country’s economy, measuring anywhere from 10% to over 30% of GDP.<sup>2</sup> On the global level, this amounts to trillions of dollars spent annually governments. Given this scale and potential impact on the economy, many countries have begun to use public procurement to achieve certain social and/or environmental policy objectives, directing their spending towards disadvantaged groups they wish to strategically support. This serves to achieve simultaneous goals of procuring necessary goods/services while doing so in a way that aligns with other government initiatives.

This strategy is referred to as ‘preferential public procurement’ and has been applied across a range of agendas including giving preference to small and medium sized enterprises (SMEs), women owned enterprises, previously disadvantaged populations, sustainable/green goods and services, and a range of other more specific social and environmental criteria. In all cases, preferential procurement is meant to help overcome obstacles to participation in public procurement that these groups face.

This report will focus specifically on those procurement models giving preference to SMEs with special emphasis on the aspect of gender. The term SME often refers to a business with less than 250 employees but the specific criteria will vary from country to country with some countries relying on sales turnover figures or invested capital rather than number of employees. The qualifying criteria may also vary across business sectors with industry, services, retail, etc. often being defined individually. Criteria can also distinguish small enterprises from medium sized enterprises and in some cases, include an additional category for micro enterprises, extending the term to MSME – micro, small and medium sized enterprises. For simplicity, the term SME will be used throughout this report and various country examples will detail the specific criteria used.

Following a brief discussion on the scale of public procurement and its use as a tool for promoting engagement with SMEs, the report will dive deeper into the rationale for supporting SMEs, important policy design considerations, the wide ranging models that can be used to support SMEs, the evidence on impact of preferential procurement for SMEs, a few key country cases studies displaying a range of models implemented, and finally a look at lessons learnt and best practices to carry forward.

## 1.1 Scale and Uses of Procurement

The public procurement market is massive. In developing countries, governments spend an estimated \$820 billion a year, about 50% of their budgets, on procuring goods and services.<sup>3</sup> Public procurement is large in high-income countries as well, reaching about 29% of total general government expenditure and

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<sup>1</sup> Kirton (2013)

<sup>2</sup> Kirton (2013)

<sup>3</sup> World Bank Group (2016a)

averaging 13% of GDP in OECD countries.<sup>4,5</sup> In the past decade, public procurement has increased 10 fold and this growth trajectory is expected to continue.<sup>6</sup>

In public procurement, taxpayers' money is spent by governments on goods, services and infrastructure. Table 1 gives a sampling of the range of items typically procured, everything from office paper to highways.

**Table 1: Areas of Frequent Government Spending**

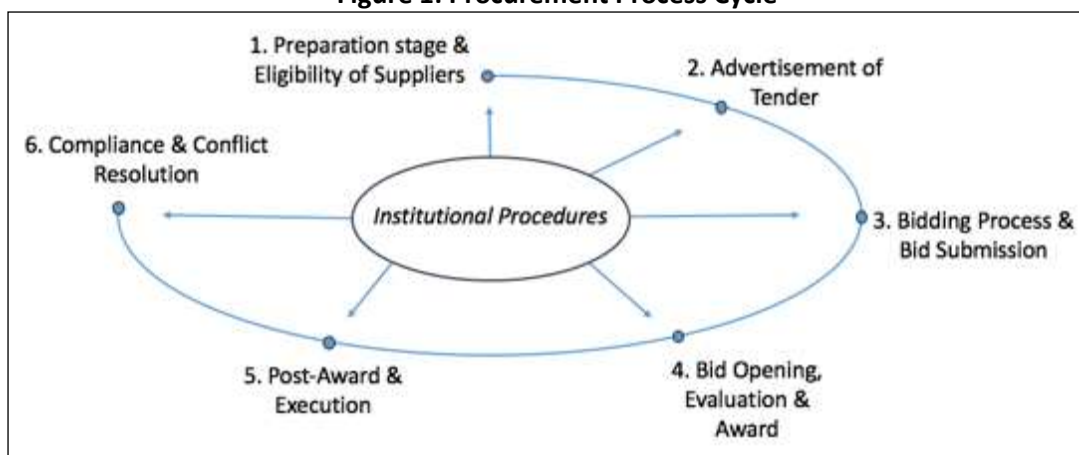
Products	Services	Works
Air conditioning and electronic equipment	Management consultancy services	Buildings, including housing, offices and public amenities
Office IT	Software and electronics	Roads
Vehicles	Servers and data centres	Airports
Outdoor lighting	Couriers and postal	Railways
Paper	Fleet and vehicles	Hospitals
Office supplies	Waste handling	Schools
Fuel	Catering: food and beverage	Correction facilities
Furniture		Waste treatment plants
Apparel		Electricity infrastructure

Source: Perera (2012)

## 1.2 Procurement Process Cycle

The procurement process can be viewed as a cycle with a series of steps that a business and procuring entity must complete. Each procurement policy to be discussed in this report affects one or more of the stages in the procurement process cycle, in effect helping to make the process easier for SMEs to participate and win contracts. Figure 1 below provides a visual representation of the process cycle and will be referenced later in Section 4 when discussing specific policies.

**Figure 1: Procurement Process Cycle**



Source: Own elaboration

<sup>4</sup> OECD (2013)

<sup>5</sup> However, not all of this money is being spent by central governments. A large share of procurement is carried out by local governments which are responsible for more than half of public procurement expenditure (OECD 2013). As a result, procurement policies can vary across government levels with varying agendas being pursued.

<sup>6</sup> World Bank Group (2016a)

### 1.3 Preferential Procurement

Preferential procurement provides advantages to target business groups to improve their ability to participate in the procurement process. Governments may determine to use preferential procurement policies in response to business groups' difficulty in accessing the public market with the understanding that this public market can be an important source of demand that could foster targeted business sectors. Additional reasons governments will use preferential procurement include:<sup>7</sup>

- Pursuing value broader than financial costs such as potential social and/or environmental costs
- Pursuing increased economic inclusion so as to promote government interaction with more than just large, established commercial entities
- Promoting fair competition to support disadvantaged businesses' participation
- The public sector desires to be seen as a leader in areas of socio-economic inclusion
- The large scope and scale of public procurement can lead to significant changes within the private sector to meet the government's needs

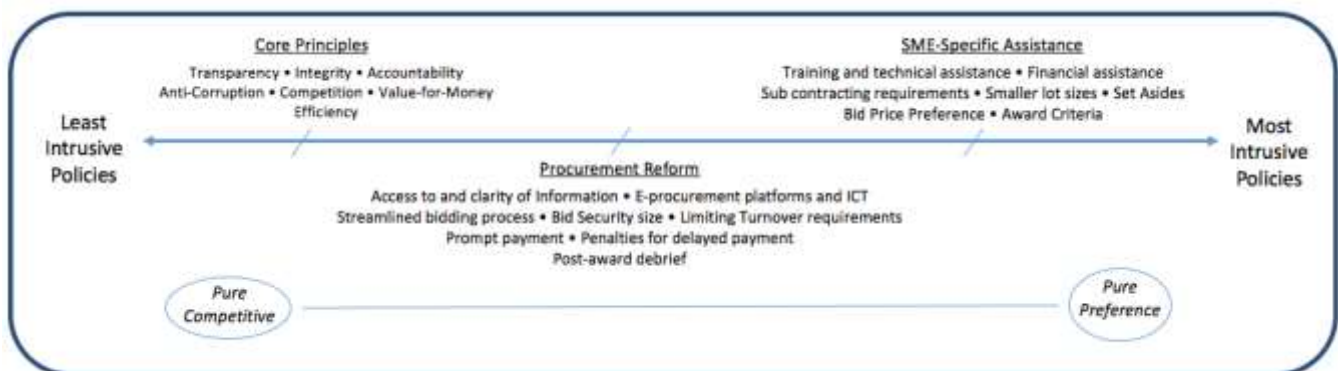
#### 1.3.1 Preferential Procurement Model classification

Existing literature on preferential procurement has used a variety of terminologies for classifying the type of support provided. Examples of the most common terms include:

- Procurement Reform vs. Targeted Assistance
- Indirect support vs. Direct Support
- Purely Competitive procurement vs. Purely Preferential procurement
- Interventionist vs. Level playing field

While each of these terminologies has a very similar message, the distinction between the two sides is often not clear cut and as a result, the representation for the different types of models discussed in section 4 will be a spectrum, ranging from least intrusive policies to the most intrusive policies (in terms of impacting market conditions), along which each model exists. Three categories will be used along this spectrum to group the policies for the sake of conceptual understanding. These categories are: 1) Core Principles to follow for the procurement process, 2) Procurement Reforms that facilitate SME access to public procurement but do not specifically target SMEs, and 3) SME-Specific Assistance which includes policies that apply exclusively to SMEs. Figure 2 below provides a visual of this classification system.

**Figure 2: Spectrum of Procurement Policies**



Source: Own elaboration

<sup>7</sup> Erridge (2005)

The purely competitive procurement policies (left side of spectrum) do not necessarily direct government purchasing to SMEs. Instead they allow for improved access to government purchasing opportunities through policies and regulations that ensure there is equality of opportunity in the pursuit of contracts.<sup>8</sup> The size of the firm or the gender of the owners alone should not unwittingly exclude businesses from competing. Alternatively, pure preference policies (right side of spectrum) guarantee a certain amount of government spending will be directed to SMEs. Later sections of this report will provide detail on the range of specific models that exist along this spectrum.

### 1.3.2 Where preference is given

While this report will focus on preferential treatment of SMEs with a special focus on gender, there are several prominent preferential procurement agendas that are in use around the world and may overlap with the SME agenda.

Leading examples of preferential agendas/target groups include:

- Small and Medium Enterprises
- Preference for Innovation
- Sustainable Public Procurement
- Green i.e. Environmentally oriented Procurement goals
- Local Content requirements
- Social criteria
  - Women
  - Disadvantaged groups (by race, ethnicity, etc.)
  - Labor standards
  - Pay standards – Equal pay
  - Family oriented
  - Fair trade
- Other more specific agendas may exist as well, particularly at local levels

These agendas can often be combined through various strategies. For example, policies designed to target SMEs may readily be used to also target small minority-owned businesses, given the well documented disparity in minority-owned firms' ability to access capital.<sup>9</sup> Further, the concept of public procurement for innovation has begun to receive increasing attention. This goal of fostering innovation can be combined with an SME agenda given that small businesses are often innovative in their products/processes.<sup>10</sup>

### 1.3.3 Debate about giving preference

Public procurement can reduce the uncertainty of demand for potential suppliers,<sup>11</sup> and while giving preference to SMEs and other target groups may appear to be an easily supportable initiative, the decision is often not so clear cut. The effects of choices made in the design of procurement policies are complex as policymakers work to best enable the target population to participate in procurement. Further, these choices may require a trade-off between costs (e.g. the administrative cost of running a

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<sup>8</sup> Kirton (2013)

<sup>9</sup> U.S. Dept of Commerce (2010)

<sup>10</sup> European Commission (2014)

<sup>11</sup> Yeo et al. (2015)



tender with more bidders) and benefits (e.g. the expected reduction in price as a result of more intense competition).<sup>12</sup>

For example, excluding SMEs in cases with potential for strong economies of scale or scope, or where size and reputation are essential to the public sector, competition would not be significantly reduced. However, when SMEs are in a comparable position to larger competitors, excluding them could potentially reduce competition significantly.<sup>13</sup> Additionally, Nicholas and Fruhmann (2014) point out, “It may be considered that supporting all SMEs is the appropriate policy goal, given their aggregate contribution to economic performance. However, it is trite but true to say that policies cannot target 99% of the market. If they do, SME policies are merely pro-growth policies clothed in politically encouraging language.”

Further discussion on these costs and benefits will occur later in this report. The message here is that the debate for and against preferential treatment is present and multi-faceted.

## 2. Rationale for SME preferential procurement

### 2.1 Prevalence of SMEs in economy and public procurement

SMEs are by far the most common businesses around the world. Over 99% of all companies in the EU are SMEs,<sup>14</sup> accounting for 56% of gross value added and 67% of employees within the business sector (excluding ag, fisheries and financial services). Similarly, in Mexico they generate 52% of GDP and 72% of jobs.

The share of public purchases as a percentage of GDP are also reflected in the significant participation of SMEs in public procurement, particularly in Europe as shown in Table 2.<sup>15</sup> By value, SMEs in Europe secured 29% of all public procurement contracts awarded above threshold<sup>16</sup> in the 2009-2011 period.<sup>17</sup> However, with a total gross value added in the economy of 56%, their public procurement contract values are much lower than would be expected, suggesting difficulty participating in the procurement process. A similar disparity is found in Latin America and the Caribbean (LAC) where SMEs are also the leading bidders on goods and services, but underperform by value of contracts secured. In Ecuador, they represent 99% of registered suppliers (2013), but receive just 55% of contracts by value.<sup>18</sup>

Table 2 below gives a sampling<sup>19</sup> of the varying participation rates SMEs can have in a country's purchasing in terms of value of contracts awarded.

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<sup>12</sup> Econ. (2004)

<sup>13</sup> Ibid.

<sup>14</sup> Kaspar and Puddephatt (2012)

<sup>15</sup> SELA (2015); PwC et al. (2014)

<sup>16</sup> Contract values triggering EU wide rules as opposed to national level rules

<sup>17</sup> PwC et al. (2014)

<sup>18</sup> SELA (2015)

<sup>19</sup> Data only available for select EU and LAC countries

**Table 2: Share of SME Participation in Public Procurement by Country by value<sup>20</sup>**

<b>Country</b>	<b>SME Percentage share</b>
<b>Austria</b>	48%
<b>Belgium</b>	39%
<b>Brazil</b>	30%
<b>Chile</b>	50%
<b>Czech Republic</b>	59%
<b>Denmark</b>	41%
<b>Ecuador</b>	55%
<b>Estonia</b>	41%
<b>Finland</b>	51%
<b>France</b>	35%
<b>Germany</b>	37%
<b>Greece</b>	78%
<b>Hungary</b>	68%
<b>Ireland</b>	65%
<b>Italy</b>	50%
<b>Latvia</b>	67%
<b>Lithuania</b>	43%
<b>Luxembourg</b>	64%
<b>Mexico</b>	15%
<b>Netherlands</b>	41%
<b>Paraguay</b>	45%
<b>Poland</b>	53%
<b>Slovakia</b>	77%
<b>Slovenia</b>	78%
<b>Spain</b>	35%
<b>Sweden</b>	44%
<b>United Kingdom</b>	31%
<b>United States</b>	23%
<b>Uruguay</b>	42%

## 2.2 Prevalence of SMEs incentives in public procurement

Many governments around the world are pursuing various methods of incentivizing SMEs to partake in the public procurement market. The World Bank produces the Benchmarking Public Procurement (BPP) report, presenting a cross-country analysis in 180 economies on how regulatory environments affect how private sector does business with the government. In the most recent BPP report (2017), out of the 180 economies measured, less than half (43%) have set up specific legal provisions and/or policies to promote the access of SMEs to government contracts.<sup>21</sup> Of note, this figure likely does not capture the procurement reforms previously mentioned that can disproportionately benefit SMEs – instead focusing on SME-specific assistance mechanisms. These will be discussed in detail in section 4.

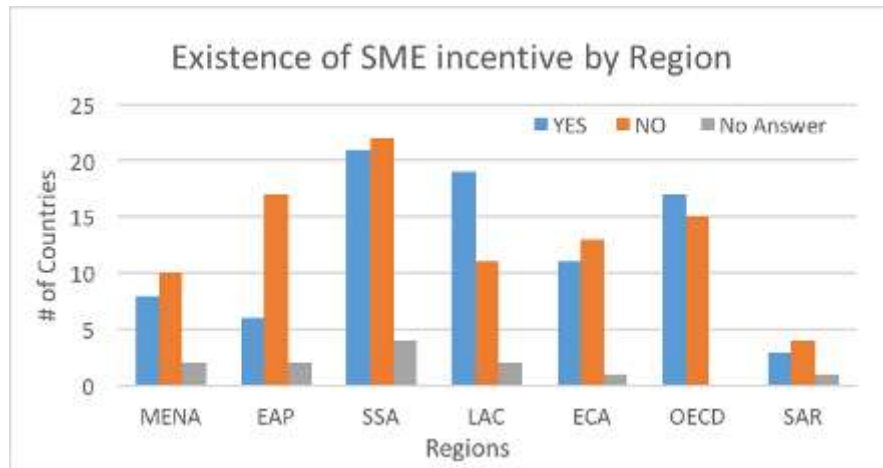
Figure 3 below shows how the existence of SME incentives vary by world region with incentives present in every region. As a result, the subject is one of global interest.

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<sup>20</sup> Silva and Scott (2014); GHK and Technopolis (2014); Belaustegui (2011); SELA (2015)

<sup>21</sup> World Bank Group (2016b)

**Figure 3: Existence of SME incentive**



Source: Adapted from World Bank (2016b)

### 2.3 Benefits of procuring from SMEs

Given the proportion of the economy that SMEs take up, their role in economic development is crucial. SMEs provide a disproportionate share of gross and net new jobs and high growth new firms provide the majority of new firm jobs.<sup>22</sup> In the United States, over 57% of job creation has been attributed to SMEs, with 33.5% of US job creation attributed to firms with 25 employees or less.<sup>23</sup>

Given the magnitude of the SMEs share in the economy, the potential benefits of including SMEs in public procurement are numerous. Despite their importance, however, the extent to which such benefits are understood is an often under-studied subject. Nevertheless, benefits may include:<sup>24</sup>

- 1) Fostering competition by helping more firms enter the market, helping to grow the market and push innovation
- 2) Achieving better value for money<sup>25</sup> such as through more suppliers resulting in more competition, SMEs fostering local benefits, etc.
- 3) Achieving better quality of service given that SMEs have short management chains so they may respond more quickly and with more flexibility and potentially more willing to tailor product/service to government needs
- 4) Promoting innovation given that SMEs can bring innovation through early exploitation of new technology, products and services to new or underdeveloped markets<sup>26</sup>
- 5) Fostering job creation and greater employment as SMEs employ a large percentage of the economy

<sup>22</sup> Kaspar and Puddephatt (2012)

<sup>23</sup> ICP (2012)

<sup>24</sup> GHK and Technopolis (2014); Loader (2013); ADB (2012); World Bank Group (2016a); Linarelli (2000)

<sup>25</sup> 'Value' here can be broadly interpreted, potentially including all benefits accrued – social, environmental, economic, etc.

<sup>26</sup> This can serve as a sub-category to the fostering of competition component – large firms will be pushed to innovate by the small firm that finds demand with the government. Survival breeds innovation. Furthermore, the purchase of innovative solutions offers a strong potential for improving public infrastructure and public services in general. (Edlar and Georghiou 2007) "A study conducted by Zoltan Acs and David Audretsch found that about half of all innovative output comes from small firms. They measure innovative output based on a unique dataset collected and published by the US Small Business Administration that tracked approximately 8,000 US innovations." (ICP 2012) In fact, evidence indicates that government contracts can generate more innovation impulses than R&D subsidies over the long run (Rothwell and Zegveld 1981, Geroski 1990, and Uyerra and Flanagan 2010).

- 6) Decreasing industry concentration and influence of established networks of larger firms, i.e. oligopolies
- 7) Promoting equity, social cohesion as well as remediation of past discrimination and disadvantage
- 8) Redistribution of wealth by driving demand in areas of the economy not historically reached
- 9) Improving access to large markets, technology transfer, market linkages and export development

Furthermore, the SME's experience with the public procurement process can serve as a barometer of the functioning of many aspects of government. Of the specific efforts to be discussed in the following sections of this report, many of them, while tailored to support SMEs, also support better functioning of the government.

### 2.3.1 Increased Threat of Corruption with SMEs

In addition to the aforementioned benefits, SME's are more likely to make illegal payments in order to circumvent administrative burdens compared to larger companies. This is due to the often greater degree of informality, often limited financial resources, short term vision with less concern for reputation and negative impacts of corruption, as well as the inability to influence officials requesting illegal payments.<sup>27</sup> As a result, facilitating their legal engagement with the government through preferential procurement could help minimize the prevalence of corrupt activities and help build trust between SMEs and their governments.

## 2.4 SMEs face unique barriers

While a weak national legal and regulatory framework is often the root of challenges facing SMEs in public procurement,<sup>28</sup> the specific barriers and market failures faced by SMEs (shown in Table 3) occur throughout the procurement process and can be targeted by preferential policies.

**Table 3: Barriers for SMEs by stage of procurement process<sup>29</sup>**

<b>Pre-bidding stage</b>	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
	Access to relevant information
	Quality and understandability of information provided is limited
<b>Application stage</b>	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
	Excessive information requirements (although this could hurt government not having enough information)
<b>Selection stage</b>	Preference for large bidders with long track records
	Institutionalized discrimination
	Too much focus on the price, and not on value for money

<sup>27</sup> OECD (2015)

<sup>28</sup> Kaspar and Puddephatt (2012)

<sup>29</sup> Kaspar and Puddephatt (2012); SELA (2015); Econ (2004); Obanda (2012)

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

## 2.5 Incorporating Gender into SME Procurement

As previously mentioned, the inclusion of SMEs is not the sole interest of this report, but also the inclusion of women. Women-owned enterprises can make up a significant part of the economy. For example, in Uganda, Rwanda and Lao People’s Democratic Republic, women make up 38%, 60% and 68% of the registered small businesses.<sup>30</sup> Similarly, in the U.S., women own approximately 10 million businesses, compared to 15 million owned by men.<sup>31</sup>

However, women-owned businesses and women entrepreneurs currently win only 1% of public procurement contracts worldwide.<sup>32</sup> The evidence base regarding this aspect is still relatively limited, as little gender differentiated data is available for contractors, further emphasizing the need for increased attention. Given this limited data, policy-makers are unlikely to know the extent to which women who own or run small or medium-sized businesses are able to successfully win government contracts.<sup>33</sup>

### 2.5.1 Women may face unique obstacles

While many of the policy initiatives that support SMEs inherently support women-owned businesses as well, the gender aspect is an obstacle often times built into long standing cultural traditions. For example, women are often not included in or only marginally included in decision-making processes of governance institutions, making it more difficult to hear their views. Furthermore, women-owned businesses tend to be smaller, less experienced, operate in less profitable sectors (such as retail sales and services), and have owners with more family and care responsibilities compared to male-owned businesses.<sup>34</sup> In the U.S. for example, firms with less than 5 employees are more likely to be female-owned than male-owned.<sup>35</sup> As a result, gender-neutral laws often do not create a neutral playing field. Implementing a public procurement policy that is gender sensitive may also run up against pressure to maintain the status quo of a patriarchal operation.<sup>36</sup>

### 2.5.2 Rationale for Gender Equality

While closing gender gaps is a matter of human rights and equity, it is also one of efficiency. According to the WEF's Gender Gap Report there is a positive correlation between gender equality and a country's level of competitiveness, GDP per capita and its rank in the Human Development Index.<sup>37</sup> While correlation does not prove causality, supporting women means increased human capital endowment for a country, thereby enhancing productivity. Promoting gender equality is, in the words of former World Bank President Robert Zoellick, ‘smart economics’.<sup>38</sup> Furthermore, a 2015 report from McKinsey and Co

<sup>30</sup> International Trade Center (2014)

<sup>31</sup> McManus (2017)

<sup>32</sup> <http://www.intracen.org/itc/women-and-trade/The-Procurement-Initiative/>

<sup>33</sup> Kirton (2013); International Trade Center (2014)

<sup>34</sup> International Trade Center (2014)

<sup>35</sup> McManus (2017)

<sup>36</sup> International Trade Center (2014)

<sup>37</sup> Kirton (2013); International Trade Center (2014)

<sup>38</sup> International Trade Center (2014)

found that equal participation of women and men in the economy would add up to \$28 trillion (26%) to the annual global GDP by 2025.<sup>39</sup>

Promoting women-owned enterprises through public procurement policy then becomes a reasonable starting point. Increasing the opportunities for more businesses, regardless of the size of the business or gender of the owner, can result in improved outcomes for the alleviation of poverty and increasing gender equality.<sup>40</sup>

### 3. Initial Policy Design Considerations

Section 3 will outline a series of initial considerations policy makers should take into account prior to implementing a preferential procurement policy. In some cases, these considerations may help identify priority tasks needed to be addressed before a preferential policy can be successfully implemented.

#### 3.1 Functioning of the System

There is a lot to be said for a procurement system that functions as it is supposed to, where implementation matches written policy and the rule of law is upheld.

The Benchmarking Public Procurement report put out annually by the World Bank includes several measures of the Procurement Life Cycle (such as bid preparation, bid submission, bid evaluation, etc.) as well as the handling of Complaint and Reporting systems. One of the main objectives of these mechanisms is to enforce public procurement laws so that the authorities can correct mistakes and noncompliance. The system should provide timely access, independent review, efficient and timely resolution of complaints and adequate remedies all while pursuing sound financial management.<sup>41</sup>

In order to achieve these objectives, system level features that must be taken into account include:

1. Legal and regulatory framework features such as compliance with national and international requirements as well as availability of regulations, documentation and tools to support implementation.
2. Institutional framework and management capacity features such as the level of integration into the broader governance structure including the public financial management system, the existence of a functional management/regulatory body specific to procurement, and the existence of institutional development capacity.<sup>42</sup>

Throughout the system, structures and incentives should promote coordination and cooperation across government.<sup>43</sup> The complexity of the system however can lead to various ideas of how exactly the system should function, especially when regulatory and legal frameworks leave room for interpretation.

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<sup>39</sup> Woetzel et al. (2015)

<sup>40</sup> Kirton (2013)

<sup>41</sup> World Bank Group (2016a); EBRD (2013)

<sup>42</sup> Agaba and Shipman (2007)

<sup>43</sup> Uyarra and Flanagan (2009)

### 3.1.1 Professionalization – Capacity for implementation

Public procurement professionalism can also be of benefit to SMEs, helping keep selection criteria standardized, improving fair and efficient processes. While being a professional does not eliminate the possibility of corruption, it helps control improper behavior by allowing action to be judged against standards accepted by the profession. Thus professionalism has a positive significant impact on SMEs accessibility to public procurement contracts.<sup>44</sup>

In many countries, public procurement is still organized as an administrative rather than a strategic function of government and as a result, implementation is often not professionalized with the necessary combination of competencies so as to develop a coordinated, efficient procurement process. The often limited capacity of procuring entities means that policies, no matter how well designed or well intentioned, will not be able to reach their potential. Part of this can be addressed through having a designated government entity responsible for carrying out the procurement process.

**The OECD (2012)** studied professionalization of procurement in OECD countries and four key findings emerged:<sup>45</sup>

- 1) Lack of professionalization remains greatest weakness to procurement process
- 2) Procurement is not approached as a cycle of measures to ensure efficiency and integrity
- 3) Performance based monitoring of procurement systems is the exception rather than the rule
- 4) In half of OECD countries there is no prior risk or opportunity cost assessment to verify that public procurement is an effective tool to achieve socio-economic and/or environmental objectives

### 3.1.2 Balancing Agendas

While undertaking the purchasing of goods and services, the public procuring entity must balance a wide range of objectives, for example, cost effective purchasing, transparency of government contract availability, local market conditions, national procurement laws, specific social and/or environmental policy objectives, etc.<sup>46</sup>

These public procurement agendas can be broken into three sometimes conflicting policy goals:<sup>47</sup> Regulatory, Commercial and Socio-Economic. Regulatory policy includes compliance mechanisms, transparent processes, and fairness. Commercial policy consists of market mechanisms, such as competitive bidding. Socio-economic policy looks to use public procurement to support wider government policy and includes any efforts to improve the social welfare,<sup>48</sup> such as through supporting SMEs.

Examples of potential conflicts between agendas include:<sup>49</sup>

- Conflicts between regulatory and socio-economic goals: Proponents of a strict interpretation of the regulations argue that allowing the use of public procurement for socio-economic purposes carries a greater risk of rules being broken.
- Conflicts between commercial and socio-economic goals: Those who argue that solely commercial considerations should be taken into account argue that allowing socio-economic criteria to be considered is likely to lead to extra costs.

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<sup>44</sup> Obanda (2012)

<sup>45</sup> OECD (2013)

<sup>46</sup> EBRD (2013)

<sup>47</sup> Erridge (2005)

<sup>48</sup> Erridge (2005)

<sup>49</sup> Erridge (2005)



As is evident, there are often tradeoffs between these various procurement requirements and policy goals, making policy decisions difficult.<sup>50</sup> Understanding the extent of these tradeoffs will greatly enhance the ability to design appropriate preferential mechanisms.

### 3.1.3 Political Environment

The aforementioned policy decisions are further complicated by the existing political environment. In a UNEP report it was found that the three largest drivers for a successful preferential procurement system are:<sup>51</sup>

1. National legislation
2. Political and organizational leadership
3. Policy commitments

As the second largest driver, consideration must be given to the existing and opposing political agendas.<sup>52</sup> In terms of the political environment, the level of market distortion pursued and/or lack thereof from preferential treatment of SMEs could create conflict. This necessarily must be considered in the policy design phase to make sure the various political factions are on board.

### 3.1.4 Context Specific

Of importance to note, is the difficulty in picking and choosing specific preferential models to be implemented in a country. The country cases to be discussed exist within a complex policy mix with a range of institutional/regulatory/legal foundations already in place. A successful policy in place in the United Kingdom for example, does not mean it will work similarly well elsewhere. In-depth cases on developing countries must consider these foundations along with the specific, existing policies.

## 3.2 Centralized vs. De-centralized Procurement

An additional consideration is the debate surrounding a centralized vs. de-centralized procurement process and its role in supporting SMEs' involvement. This debate is relevant across procurement models to be discussed. While government procurers may favor fewer, higher value contracts administered in a centralized process to avoid administration of more contracts, it is well recognized that such policies will tend to lower the participation of smaller businesses. However, the argument for centralized vs. de-centralized processes is less clear cut than would be thought from the perspective of SMEs.

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<sup>50</sup> Thai (2008)

<sup>51</sup> Tewes-Gradi et al. (2013)

<sup>52</sup> A further consideration is the structure of the country's political economy.

**Table 4: Potential Benefits of Centralized and De-Centralized procurement processes**

Centralized Benefits	De-Centralized Benefits
Ability to leverage reduced prices	Reduced opportunities for corruption
Better services at lower costs and increased purchasing power	Closer match to end-user requirements
Technical and environmental standardization	Reduction in scope for large scale error and unnecessary over spending
Improved contract management and problem resolution	Less bureaucracy
Lower training costs	Shorter time frames
Easier performance management of procurement staff	More opportunity for SMEs to compete for contracts
Improved transparency, reporting an audit trail	More opportunities for lower prices from local producers
Improved professionalization of procurement staff	More scope for personal responsibility and a service mentality

Source: Adapted from CIPS Australia (2006)

Much of these potential benefits are difficult to discern. As a result, the preference for centralized vs. de-centralized may be a choice of 'perceived effectiveness' over 'perceived efficiency'.<sup>53</sup> The biggest factor to note in the past decade is the role of ICTs. Some of the contextual complexities once resolved through a decentralized approach are now able to be addressed through improved access to information and communication.<sup>54</sup> Additionally, there is some concern that a de-centralized procurement approach would lead to decreased competition as contracts would be primarily awarded to local SMEs.<sup>55</sup>

### 3.3 Sectors of Focus/ Strategic support

Being strategic about how preferential treatment is provided can improve the effectiveness of any policy initiative. Aspects to consider for where strategic support is provided include:<sup>56</sup>

- Consider the availability of data on SMEs and women-owned enterprises, and how this information could be used to benefit the SMEs and track their progress going forward.
- Consider the potential for future development. SME purchasing can target services at an early stage of their development and rather than trying to change characteristics of mature sectors.
- The sectors/products/services where government spending is large enough that it can significantly impact market demand.
- SME preference in some sectors is not always practical e.g. utilities.
- Consider overlap with other social and/or environmental agendas such as promoting women owned enterprises.
- Consider the extent of the informal economy compared to the formal economy. What proportion of SMEs will be reachable via formal policies?

### 3.4 Clear Definition of SME and/or women-owned enterprise

It is important to provide clear and consistent eligibility rules for determining what is and what is not a small or medium enterprise as well as level of ownership needed to qualify as woman-owned. This

<sup>53</sup> CIPS Australia (2006)

<sup>54</sup> CIPS Australia (2006)

<sup>55</sup> Jones (2007)

<sup>56</sup> EBRD (2013)

criteria must be immune from the potentially discriminatory decision making of public officials.<sup>57</sup>

A generic definition for SME is not easy to find, and will vary country to country. The three most common parameters are: 1) number of workers employed, 2) firms level of capital investment or assets, 3) volume of production or business turnover, sometimes measured in average annual receipts over a predetermined period of time.<sup>58</sup> These parameters will tend to be industry and context specific, based on national level business make up and business environment conditions. Because the definition will vary, policymakers must understand the size of company they are targeting and how that will differ from other countries' policies they may be referencing and the resulting potential variance in impact generated.

Similarly, the level of ownership needed to be considered a women-owned enterprise can vary from country to country and include additional parameters to ensure the involvement of women.

In either case, no matter the specific parameters used, they must be made clear, must be widely understood so as to best promote businesses ability to take advantage of potential preferential treatment, and must then be applied across public sector departments and agencies.

**In Indonesia**, a business that has a sales turnover of less than Rp1billion (~\$75,000) in the previous twelve months (including government contracts) is classified as an SME. As soon as this sales turnover threshold is surpassed, the firm is denied the SME preferential treatment.<sup>59</sup>

**In the U.S.** to qualify as a women-owned small business under the Small Business Act, a business must be at least 51% unconditionally and directly owned and controlled by one or more women who are US citizens. Ownership must be direct, cannot be subject to conditions and a woman must manage the day-to-day operations of the business as well as make the long-term decisions for the business.<sup>60</sup>

### 3.5 Trade Agreement restrictions

The opening of markets can help create transparent and fair procurement processes that help previously excluded groups, including SMEs and women-owned enterprises, access information and have a better chance to compete for government contracts.<sup>61</sup> However, free trade agreements can pose a potential obstacle to giving preference to SMEs and women-owned enterprises given that, depending on the agreement, a country may not be able to choose a domestic company over a foreign company solely because it is domestic – it must outperform the foreign company through costs and services provided. In many cases, this restriction will only apply above a given contract size, thereby allowing more flexibility for preferential treatment below that threshold.

One of the most recognized agreements is the Agreement on General Procurement (GPA), a plurilateral agreement within the framework of the WTO. At present, the Agreement has 19 parties comprising 47 WTO members. Another 29 WTO members participate in the GPA Committee as observers. However,

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<sup>57</sup> EBRD (2013)

<sup>58</sup> Linarelli (2000); SELA (2013)

<sup>59</sup> Jones (2011)

<sup>60</sup> International Trade Center (2014)

<sup>61</sup> International Trade Center (2014)

most of the developing countries who are WTO members still oppose the GPA.<sup>62</sup> The GPA does support developing countries' efforts to support their domestic economies, as described in Article V below.

**Article V of the GPA states:<sup>63</sup>**

*Parties shall... duly take into account the development, financial and trade needs of developing countries, in particular least-developed countries, in their need to: a) safeguard their balance of payments position and ensure a level of reserves adequate for the implementation of programs of economic development, b) promote the establishment or development of domestic industries including the development of small-scale and cottage industries in rural or backward areas and economic development of other sectors of the economy, c) support industrial units so long as they are wholly or substantially dependent on government procurement...*

Of note, not all procurement models discussed in the following sections will conflict with free trade agreements. Many are oriented towards 'leveling the playing field' and streamlining the procurement process in general which would not conflict with trade agreements.

### 3.6 Barriers and Risks

There are multiple potential barriers and risks that could limit the effectiveness of a preferential procurement policy. These are often related to the aforementioned legal, regulatory and institutional environments.

#### 3.6.1 Corruption

Corruption, especially in developing countries with weak institutions, can be a major issue in the procurement process.<sup>64</sup> Corruption in public procurement imposes high costs on both the government and the civil society. When the tendering process is rigged because of corruption, competition cannot play its role of driving the prices down and quality up, resulting in loss of taxpayer money and reduced quality of infrastructure and public services provided.<sup>65</sup>

Transparency International's handbook on curbing corruption in public procurement details how each aspect of the procurement process is vulnerable to corruption, and can be exacerbated by increasingly complex award criteria. This complexity of evaluation systems tends to create greater discretion for the actors making the decision, who can use this flexibility for their own benefit.<sup>66</sup>

As mentioned previously, SMEs worldwide are particularly vulnerable to corrupt practices in their effort to win government contracts.<sup>67</sup> For example, in Egypt, 40% of SMEs in Egypt expected to give gifts to secure government contracts, while 25% of large corporations were expected to do so.<sup>68</sup> But with clear criteria and transparent processes, as previously mentioned, this risk can be minimized.

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<sup>62</sup> Kattel and Lember (2010)

<sup>63</sup> Kattel and Lember (2010)

<sup>64</sup> Corruption in general is a major issue for development given that it erodes trust, breaks down the rule of law, distorts market operations, diverts resources from where they are most needed, etc.

<sup>65</sup> World Bank Group (2016a)

<sup>66</sup> Tewes-Gradi et al. (2013)

<sup>67</sup> Kaspar and Puddephatt (2012)

<sup>68</sup> Kaspar and Puddephatt (2012)

### 3.6.2 Increased Cost of procurement by engaging SMEs

Potential inefficiencies from contracting with SMEs that without preferential treatment would not be able to compete may lead to increased costs on the part of the government. There is political risk associated with these potential increased costs of preferential procurement strategies. It will be important for outside stakeholders such as multilateral organizations to support policy makers to address the issue of increased purchasing costs and the need to demonstrate value for money. It should be noted that the extent of these costs may vary considerably or may not even occur. There is limited data on the potential scale of this risk.

### 3.6.3 Risk Aversion

Added to these potential costs is the tendency of government procurers to be risk averse when dealing with companies that have a limited track record. Government procurers may specify more stringent financial or experience requirements that exclude newer and financially weaker SMEs. Through application of such qualification criteria, procurers also reduce work for themselves by not having to evaluate a larger number of bids from SMEs they have not previously done business with.<sup>69</sup>

### 3.6.4 Collusion and Rent Seeking

Preferential procurement schemes can also be manipulated to facilitate ‘market capture’ or ‘rent seeking’ by vested interests, resulting in higher prices for goods and services as well as market behavior that undermines transparency and competition.<sup>70</sup>

### 3.6.5 Lack of Adoption

A further challenge is to ensure that the new written procedures regarding procurement are adopted and implemented as written. Often times this is not the case, as the new laws or regulations do not alter the ingrained day to day behavior of those responsible for procurement.<sup>71</sup> As a result, new processes require a change in the mindset of leadership to make sure the new rules are followed. Still, it can be expected that in countries where poor procurement practices have been used over a long period, the change in thinking and full implementation of new practices will be gradual.

## 3.7 Stakeholders

Important to this policy development process is considering and getting feedback from the range of local stakeholders that would be impacted by any policy reforms and targeted assistance initiatives.

- **Central Government** will create the overarching procurement framework that includes preferential treatment for inclusive businesses.
- **Regional and local governments** will work from the federal level legislation with the potential to adapt requirements based on local context. They must have a clear understanding of the federal level legislation as well.
- **Potential Suppliers and Contractors** will provide context for obstacles they experience and the support they need to be competitive.
- **SME representative associations/Civil Society Organizations** will have in depth information on small businesses and entrepreneurship and the types of obstacles they face, what a procurement policy could do for them and concurrently how it would need to be designed to do it.

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<sup>69</sup> ADB (2012)

<sup>70</sup> ADB (2012)

<sup>71</sup> Jones (2007)

- **Support Networks** can link organizations and SMEs from around the region or country, allowing for a sharing of concerns as well as to share information about what a new policy means for them and how to best take advantage of it.

## 4. Review of preferential procurement models

Section 4 provides a stocktaking of the various preferential procurement models that can be used. Table 5 below summarizes each of the models that will be discussed in detail in this section.

**Table 5: Preferential Procurement Policy Summary**

	Specific Instrument/ Policy	Stage of Procurement Process	Description	Country Example(s)
<b>Core Procurement Principles</b>	<b>Transparency and Anti-Corruption</b>	Institutional Procedures; Eligibility of Suppliers; Advertisement of Tender; Bid Opening, Evaluation & Awarding	Making relevant information available on tender opportunities, open bidding process, monitoring systems, clear evaluation procedures, etc.	Philippines, Peru, Cabo Verde, Republic of Korea
	<b>Integrity and Accountability</b>	Institutional Procedures; Bid Opening, Evaluation & Awarding; Post-award & Execution	Include codes of conduct, conflict of interest policies to promote trust and responsiveness with fairness to the public and stakeholders.	Republic of Korea
	<b>Value for Money</b>	Institutional Procedures; Bid Opening, Evaluation & Awarding; Post-Award & Execution	Take into account the whole life cost of goods/services procured.	United Kingdom
	<b>Efficiency of the procurement process</b>	Institutional Procedures	Improve simplicity, speed, certainty, and reduce costs of process.	Republic of Korea
<b>Procurement Reform Policies</b>	<b>E-Government and E-Procurement</b>	Advertisement of Tender; Bidding Process & Bid Submission; Bid Opening, Evaluation & Awarding	Use of online tools for rapid communication, transparent processes, broader reach.	Republic of Korea, Brazil, Mexico, India, Chile, Greece, Georgia
	<b>Streamlining application process</b>	Bidding Process & Bid submission; Bid Opening, Evaluation & Awarding	Minimizing administrative costs to the business.	European Union, Cabo Verde, Mexico
	<b>Bid Security</b>	Preparation Stage & Eligibility of Suppliers; Bidding Process & Bid Submission	Determine reasonable financial security for SME bidders.	Russia
	<b>Limiting Turnover Requirements</b>	Preparation Stage & Eligibility of Suppliers	Setting a sales turnover figure that allows SME bids.	European Union
	<b>Prompt Payment Reform</b>	Post-Award & Execution; Institutional Procedures	Shorter payment times allow SMEs with limited liquidity to participate.	Republic of Korea, Mexico, U.S.
	<b>Penalties in case of delayed payments</b>	Post-Award & Execution	Payments made to the businesses who suffer from delayed payments.	Canada
	<b>Simplified contract</b>	Compliance & Conflict Resolution	Minimize legal resources needed while presenting fair,	India

	<b>complaint resolution</b>		timely resolution.	
	<b>Post-award debriefing</b>	Post-Award & Execution	Providing feedback to bidders on why they did or didn't win.	
<b>SME-Specific Assistance Policies</b>	<b>Marketing Support</b>	Preparation Stage & Eligibility of Suppliers	Supporting SMEs through visibility of their products/services	Republic of Korea
	<b>Training and technical assistance</b>	Preparation Stage & Eligibility of Suppliers; Bidding Process & Bid Submission	Providing a range of services to SMEs to enable their better participation in procurement process.	Italy, Peru
	<b>Financial assistance</b>	Preparation Stage & Eligibility of Suppliers; Bidding Process & Bid Submission; Institutional Procedures; Post-award & Execution	Providing access to capital and/or advanced payments	U.S., Kenya, Republic of Korea, Croatia, Macedonia
	<b>Performance Guarantee Flexibility</b>	Preparation Stage & Eligibility of Suppliers; Bidding Process & Bid Submission; Institutional Procedures; Post-award & Execution	Reforming requirements of performance guarantees to reduce difficulties for SMEs	Australia, China
	<b>Framework agreements for SMEs</b>	Preparation Stage & Eligibility of Suppliers; Bidding Process & Bid Submission	Use of predetermined agreements to facilitate continued and more engagement by SMEs	U.S., Republic of Korea
	<b>Subcontracting requirements or SME consortia formation</b>	Preparation Stage & Eligibility of Suppliers; Bidding Process & Bid Submission	Promote SME engagement even when the size of the contract is not suitable for a single SME to pursue.	Italy, India
	<b>Smaller lot sizes</b>	Preparation Stage & Eligibility of Suppliers	Splitting contract sizes into smaller sizes to allow more SMEs to bid.	European Union, Egypt, Albania, Sweden
	<b>Award Criteria</b>	Bid Opening & Evaluation; Preparation Stage & Eligibility of Suppliers	Providing opportunities for SMEs to improve their bid based on characteristics of their firm or work.	South Africa
	<b>Set Asides</b>	Preparation Stage and Eligibility of Suppliers	A designated portion of the procurement budget reserved for SMEs	U.S., China, Algeria, Dominican Republic, Morocco, Kenya
	<b>Contract Thresholds and Reserved Products</b>	Preparation Stage & Eligibility of Suppliers	Either contract sizes or specific products are reserved for SMEs to bid on.	Indonesia, Colombia, India, Republic of South Korea
	<b>Bid Price Preferences</b>	Bid Opening & Evaluation	Discounting bids by SMEs to make them more competitive with larger firms.	India



## 4.1 Core Procurement Principles

National procurement processes have shown in recent years a convergence on core principles such as open and effective competition, transparency and value for money.<sup>72</sup> Other interconnected principles include: integrity of the procurement process, efficiency of the process, accountability, anti-corruption practices, among others.<sup>73</sup>

Each of the principles in this section fall into the overarching procurement process cycle of 'institutional procedures', however along with that category, there are areas within the procurement process cycle that the principles are still particularly relevant. These are noted along with the institutional procedures category at the beginning of each description.

International instruments such as the UN Convention against Corruption, the UNCITRAL Model Law on Procurement of Goods, the OECD Principles on Enhancing Integrity in Public Procurement and the APEC Transparency Standards on Government Procurement, provide various standards to support public procurement processes exemplifying the principles.<sup>74</sup>

### **The Model Law on Government Procurement of Goods and Construction of the United Nations Commission on International Trade Law (UNCITRAL)<sup>75</sup>**

The Model Law provides guidelines, particularly for developing countries, to formulate a legal framework for public procurement. It promotes efficiency and competition in contracting, as well as integrity, trust, equality, and transparency in the procurement process. The Model Law includes 57 provisions, 48 deal with the procurement process, such as the use of bidding as the preferred method for public procurement.

#### 4.1.1 Transparency and Anti-Corruption

*Procurement process stage: Institutional Procedures; Advertisement of Tender; Bid opening, Evaluation & Awarding*

Ensuring that suppliers can easily become aware of tendering opportunities, obtain copies of tender documents, and understand how and on what grounds bids are evaluated are important features of transparent procurement processes.<sup>76</sup> This transparency is especially important for SMEs who would otherwise not know that opportunities existed or who to talk to in order to learn about these opportunities, effectively playing an important role in leveling the playing field.<sup>77</sup> This open bidding process is one of the key steps to achieve transparent and efficient procurement process while simultaneously promoting competition.<sup>78</sup> Increased competition from increased participants will mean more SMEs will be among these participants as well.

Transparency is also instrumental in disclosing and discouraging corrupt practices in public procurement,<sup>79</sup> promoting uniformity of the selection process and fair competition for SMEs. Mitigating risks of corruption, for example, through coordinated and integrated internal control and risk

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<sup>72</sup> SELA (2015); EBRD (2013)

<sup>73</sup> SELA (2015)

<sup>74</sup> OECD (2015)

<sup>75</sup> SELA (2015)

<sup>76</sup> World Bank Group (2016a)

<sup>77</sup> Obanda (2012); OECD (2015)

<sup>78</sup> SELA (2015)

<sup>79</sup> Kaspar and Puddephatt (2012)

assessment tools reduce the prevalence of corruption and when coupled with the other key principles mentioned help to level the playing field for SMEs, reducing their need to pay bribes, etc.<sup>80</sup>

Along with transparency must be the clarity with which eligibility and contract details are communicated. The government needs to be able to consistently apply its selection criteria without large subjective gray areas. The clarity in the policy also benefits the bidding companies, so that they may understand what criteria they need to meet and services they must provide.

#### 4.1.2 Integrity and Accountability

*Procurement Process stage: Institutional Procedures; Bid opening, Evaluation & Awarding; Post-Award & Execution*

Integrity is a critical component of good governance and needed for SMEs to maintain trust in government. Specific standards for procurement officials such as codes of conduct, conflict of interest policies, could mitigate the risks related to the specificities of the public procurement process, in addition to wider standards and procedures applicable to public service as a whole.<sup>81</sup>

Built into the concept of integrity is accountability. Fostering accountability in public procurement can occur through, for example, a fair, timely and transparent complaints mechanism and stakeholder participation and scrutiny.<sup>82</sup> Direct accountability to the public and other stakeholders is a fundamental method of increasing transparency and integrity in decision making.

#### 4.1.3 Value for Money

*Procurement process stage: Institutional Procedures; Bid Opening, Evaluation & Awarding; Post-Award & Execution*

The criterion of best ‘value for money’ can be defined as “the optimum combination of whole life cost and quality to meet the customer’s requirements”.<sup>83</sup> In other words, pursuing the greatest benefit given the cost of procurement, including all feasible measurements of cost and benefit. The definition enables it to encapsulate a broad range of criteria including the various benefits SMEs can generate.

While the two aims of pursuing value for money and supporting SMEs may oppose each other when SMEs are not as cost competitive, the aims are not necessarily mutually exclusive. If value for money is interpreted broadly, to include a range of criteria beyond just cost and quality, then smaller, and especially local, firms may be able to use their strengths such as responsiveness, flexibility, local economic impacts, among others.<sup>84</sup> This will include proving these additional sources of value during the contract execution phase.

#### 4.1.4 Efficiency of the procurement process

*Procurement process stage: Institutional Procedures*

Throughout the procurement process, efficiency creates benefits both to the bidding firms through timeliness, minimizing costs, predictability, etc. as well as to the procuring entity through minimizing

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<sup>80</sup> OECD (2015)

<sup>81</sup> OECD (2015); Agaba and Shipman (2007)

<sup>82</sup> OECD (2015)

<sup>83</sup> Erridge (2005); Loader (2007)

<sup>84</sup> Loader (2007)

administrative procedures and associated costs. Key efficiency indicators of the process include: simplicity, speed, cost, certainty, 'fit-to-context'.<sup>85</sup>

## 4.2 Procurement Reform – Pure Competitive policies

The procurement policies described in this section comprise measures to facilitate access to public procurement contracts that disproportionately benefit SMEs without altering the conditions of competition (that is, without providing for favorable treatment).<sup>86</sup>

Procurement reform includes streamlining, eliminating unduly restrictive requirements, electronic commerce, breakouts vs. bundling lots, among others. While such reforms will benefit all private sector firms, it will often have a more significant effect on SMEs. Because SMEs have fewer resources, anything that makes the process easier and lowers the cost of involvement will have a greater relative result for them.

The same logic applies to increasing the number of women owned businesses engaged in the public procurement. Traditional procurement methods may favor established, male dominated businesses. The principal advantage of procurement reform as a method of assisting SMEs is that it is likely the most efficient policy type relative to the more targeted policies discussed later in this section.<sup>87,88</sup>

### 4.2.1 E-Government, E-procurement and other ICT usage

*Procurement process stage: Advertisement of Tender; Bidding process & Bid Submission; Bid Opening, Evaluation & Awarding; Post-Award & Execution*

E-government may be seen as one of the main instruments of modernization of the state.<sup>89</sup> The use of online tools enables cheap and quick communication, particularly of benefit to SMEs with internet access. This can include the use of email to communicate and share information, advertise bid openings, submit bid proposals, websites with information about the procurement process, electronic procurement platforms in which all aspects of procurement occur, among others. The submission of bids through electronic means reduces transaction costs for bidders, no matter the tool used, and increases the potential for SMEs to become suppliers, create linkages to other companies and thereby build capacities, receive transfers of technology and facilitate more business.<sup>90</sup> The centralization of these online tools can greatly reduce information search costs for SMEs, who may otherwise have to search through several different online procurement postings to find one worth bidding for. Submission of payment requests may also occur online, allowing for faster payment times for SMEs that may struggle with liquidity.

But the benefits of increased use of ICTs in public procurement extend beyond just SMEs. These benefits include improved governance through the improved transparency and availability of information, government effectiveness as processes are streamlined through standardization and

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<sup>85</sup> EBRD (2013)

<sup>86</sup> Arrowsmith (2010)

<sup>87</sup> Linarelli (2000); Arrowsmith (2010)

<sup>88</sup> "There are persuasive arguments that procurement reform is likely to produce the most beneficial outcomes when it is approached as an integral part of a broader program of reform, including developing the rule of law, improving the investment climate, reducing corruption, implementing e-government, enhancing service delivery and improving public financial management." (Agaba and Shipman 2007)

<sup>89</sup> SELA (2015)

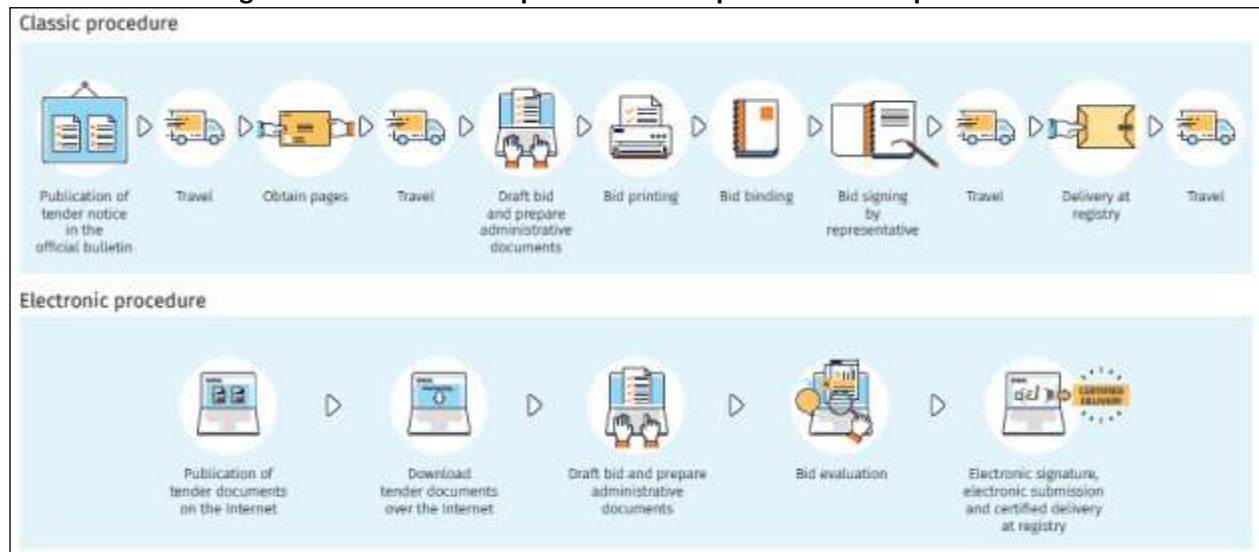
<sup>90</sup> SELA (2015)

paperless operations, and promoting balanced development as information asymmetries are overcome, facilitating wider competition.<sup>91</sup>

Although the use of ICT in public procurement remains a relatively new policy area in most developing and emerging economies, 70% of purchases are already published and advertised on the Internet in Latin America and the Caribbean.<sup>92</sup> However, full e-procurement platforms are still limited. In 13 economies, including Canada, Iceland, Togo, and Uruguay, the only electronic channel available for bidders to submit their bids is via e-mail. In Brazil, Estonia, Indonesia, Kyrgyz Republic, and 52 other economies, the electronic bid submission can be carried out only via an electronic platform (not by email).<sup>93</sup>

Electronic procurement has proven to be one of the most effective and efficient for good governance of the procurement process.<sup>94</sup> E-procurement platforms can include: publication of public procurement notices online; multi-functional search engines; direct downloading of contract notices and accompanying documentation, submission of invoices and receipt of payment, among other features.<sup>95</sup>

**Figure 4: E-Procurement procedures compared to Classic procedures**



Source: World Bank Group (2016b)

In areas with limited access to internet, SMEs and women-owned enterprises may often be the ones left out in the advent of an e-procurement program implementation. In such cases, alternative methods of advertising contract opportunities must be used such as going through regional business organizations that can distribute hard copy details to potential suppliers.

<sup>91</sup> SELA (2015)

<sup>92</sup> SELA (2015)

<sup>93</sup> World Bank Group (2016b)

<sup>94</sup> SELA (2015)

<sup>95</sup> Obanda (2012)

**In Brazil,**<sup>96</sup> after implementing an e-procurement program, the Brazilian Ministry of Planning, Budget and management estimates that savings of 19% of the total contract value done through e-procurement were achieved by the federal Government in 2012.

#### 4.2.2 Streamlining application process

*Procurement process stage: Bidding Process & Bid Submission; Bid Opening, Evaluation & Awarding*

Because of the resources needed to develop a competitive bid for a government contract and the fixed costs associated with administration, it is often recognized that large businesses have an advantage over smaller ones.<sup>97</sup> A 2010 study concluded that, in the United States, costs per employee due to regulation appear to be at least 36% higher in small firms than in medium size and large firms.<sup>98</sup> Beyond the reduction of transaction costs through technological advancements, there are a range of additional policy features that can be streamlined, independent of the electronic nature of the process. The first is to streamline the application process to minimize the administrative costs the business would face to participate.

There are many potential upfront cost-related barriers that could limit the ability of SMEs to participate in procurement process that can be taken into account. Streamlining the process and time needed as much as possible will significantly support SMEs with often limited administrative capacities.<sup>99</sup> Some of the aspects worth addressing include:<sup>100</sup>

- Registration requirements, while important, add costs to SMEs ability to participate in procurement. One option to help minimize these costs to the SME is to provide reduced or even waived fees.
- Burdensome bid information and documentation requirements create time consuming upfront administrative tasks for the SME. This could be overcome by limiting documentation needs for smaller contracts. Another option is through allowing self-certification of selection criteria for initial rounds of bidding and only requiring full certification information in the final stages.
- Long bid qualification, evaluation and award procedures limit the SME's ability and willingness to participate.

As SMEs normally do not have large and specialized administrative capacities, keeping administrative requirements to a minimum is essential.

**In the EU,**<sup>101</sup> new policies favorable to SMEs include simplification of the bidding procedure with a standard 'European Single Procurement Document' based on self-declarations. Only the winning bidder will have to provide original documentation. The European Commission estimates that this should reduce the administrative burden on companies by over 80%, an aspect especially important to SMEs with limited administrative capacity.

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<sup>96</sup> SELA (2015)

<sup>97</sup> ADB (2012)

<sup>98</sup> ADB (2012)

<sup>99</sup> Obanda (2012)

<sup>100</sup> ADB (2012)

<sup>101</sup> OECD (2015)

#### 4.2.3 Bid Security

*Procurement process stage: Preparation Stage & Eligibility of Suppliers; Bidding Process & Bid Submission*

Bid security is an efficient instrument for procuring entities to ensure that they receive only serious offers, which bidders will maintain until the selection is made. Bid security is required in most economies but is not always regulated.<sup>102</sup> While there is no clear good practice as to the amount that should be requested, finding a balance between too high for SMEs and too low to protect the procuring entity is important. Since the amount of bid security adds to the cost of submitting a bid, an expensive bid security can deter SMEs and other bidders with limited resources. For this reason, it is crucial not only for the amount requested to be reasonable, but also for bidders to be able to provide it using different instruments. For example, a high bid security demanded as a cash payment may deter a small or medium enterprise with limited cash flow from participating.

In some economies such as the Arab Republic of Egypt, Bolivia, and the Russia Federation, SMEs are exempted from part or all of a bid security. In the Russia Federation, the maximum amount of bid security shall not exceed 2% of the maximum price of the contract for SMEs.<sup>103</sup>

#### 4.2.4 Limiting Turnover requirements

*Procurement process stage: Preparation stage & Eligibility of Suppliers*

Annual turnover requirements can be used to assess a company's financial capacity and are often used as an eligibility criterion for public contracts. Unsurprisingly this can automatically exclude many potentially suitable SMEs from submitting a bid. In the EU, they support SMEs by limiting their turnover requirement to only twice the contract value.<sup>104</sup>

#### 4.2.5 Prompt Payment Reform

*Procurement process stage: Post-Award & Execution; Institutional Procedures*

Prompt payment reforms work to limit the amount of time needed to receive payment as well as ensure that payments are made on time without delays. Payment timing can prove critical to SMEs as issues with timely payments or long delays in payments from time of service provision can send companies into bankruptcy, and even keep many SMEs from engaging with governments.<sup>105</sup> Making sure contractors are paid as due and on time can help in overcoming liquidity problems for SMEs. Furthermore, in cases of sub-contracting, where SMEs and women-owned enterprises often enter the procurement market, they will be the first group negatively impacted by a delay in payment to the lead contractor.

Payment reform can take place through simplifying the documents necessary for making payments, for example through use of aforementioned electronic tools, enhanced the use of electronic payment, simplified controls, among others.<sup>106</sup>

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<sup>102</sup> World Bank Group (2016b); World Bank Group (2016a)

<sup>103</sup> World Bank Group (2016b)

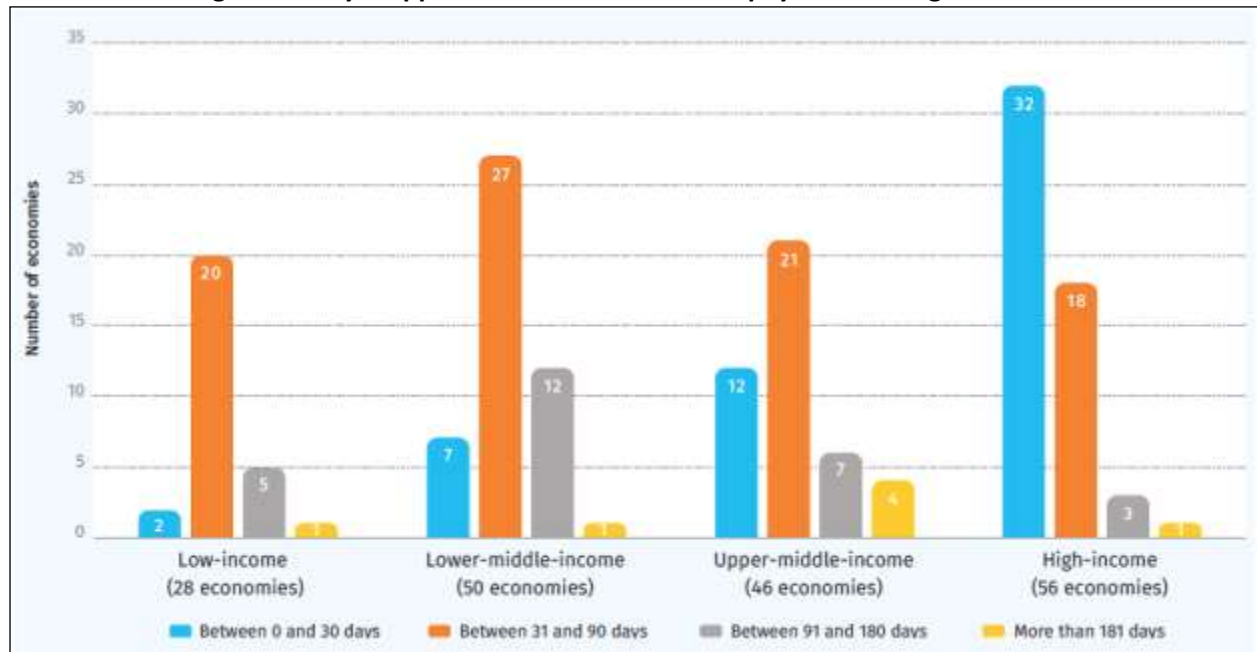
<sup>104</sup> World Bank Group (2016b)

<sup>105</sup> Linarelli (2000); ADB (2012)

<sup>106</sup> Obanda (2012)

The following figure shows the extensive waiting times businesses in various economies must wait for payment.

**Figure 5: Days suppliers must wait to receive payment from government**



Source: World Bank Group (2016b)

#### 4.2.6 Penalties in case of delayed payments

*Procurement process stage: Post-Award & Execution*

To help encourage governments to make payments on time as well as to compensate suppliers for waiting, some economies require the procuring entity to pay penalties to suppliers. This does not necessarily help overcome short term liquidity issues on the part of the SME but it can still be of some consolation to the SME that they are entitled to additional payment. In Benchmarking Public Procurement 2016 report, it was found that in about two-thirds of economies surveyed, procuring entities must pay a penalty to the supplier.<sup>107</sup>

The procedures for payment of these penalties vary from country to country. For example, Benchmarking Public Procurement (2016a) reports that in Canada a supplier will automatically receive interest on overdue accounts, while in Guatemala the supplier has to submit a request to receive the accrued interest. Implementation is often an issue of these penalty payments, as half of those economies that include legal provisions for penalties do not follow the law in practice.

#### 4.2.7 Post-award Debriefing and Standstill period

*Procurement process stage: Post-Award & Execution*

Providing feedback to bidders, regardless of whether they were awarded the contract or not is an important component to facilitate SME learning. While it may add administrative costs to the procuring entity, this feedback is especially important for those suppliers that did not win and may have less

<sup>107</sup> World Bank Group (2016a)



experience bidding than the winners. The losing bidders need to understand why it was they lost in order to make the necessary improvements for following bids. Otherwise firms are left without knowing what they did wrong, learning little from the bidding process and possibly decide to avoid the procurement process entirely going forward, assuming the system to be rigged.

Debriefing also allows for challenges to the tendering process to develop which necessitate a standstill period, i.e. a time between when the contract is awarded and when the contractor begins to execute the contract, to allow for complaints and remedies to be processed.

#### 4.2.8 Simplified Contract Complaint Resolution procedures

##### *Procurement process stage: Compliance & Conflict Resolution*

Complex tendering processes and contract dispute resolution procedures are an obstacle for SMEs should any issues arise in the tendering process or execution of the contract/payments. SMEs will often have limited legal resources to successfully navigate the resolution procedures. Additionally, complaint mechanisms will differ between those submitted to address the tendering process compared to those submitted regarding a contractual engagement, requiring further legal understanding on the part of the SME.

Effective methods for challenging procurement decisions are essential to build SMEs' confidence in the integrity and fairness of the procurement system.<sup>108</sup> Independent review, timely resolution of complaints, as well as the presence of legal time limits, help suppliers feel confident that their complaints will be resolved without delay. If a company is unable to predict how long it will take for its complaint to be resolved, or if the period for review is excessively long, many suppliers may avoid filing a complaint at all and going forward avoid working with the government.<sup>109</sup>

### 4.3 SME Targeted Assistance – Pure Preferential policies

There are potentially many ways to provide direct assistance to enable SMEs' participation in the procurement process and determining which aspects provide the greatest obstacles will vary from country to country and sector to sector. A thorough understanding of these obstacles and work to address them will enhance the benefits experienced by SMEs.

For each of the following SME-specific preferential procurement schemes, their implementation must be objective, targeted and with an exit strategy to ensure that they do not become a mechanism to subsidize inefficient or corrupt SMEs.<sup>110</sup>

#### **Existence of Pure Preferential Policies in Sub-Saharan Africa**

A survey of procurement specialists from Cameroon, Malawi, Mozambique, Namibia, Nigeria, Seychelles, Sierra Leone, Uganda and Zambia found:<sup>111</sup>

- 1) 50% had regulations which do not allow for preferential treatment on the basis of diversity
- 2) 20% had public procurement laws which mandate the reservation of contracts for supported types of businesses/sectors

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<sup>108</sup> OECD (2015)

<sup>109</sup> World Bank Group (2016b)

<sup>110</sup> ADB (2012)

<sup>111</sup> Kirton (2013)

- 3) 90% stated that splitting the tender requirements into smaller lots to encourage more small companies to bid would be appropriate to widen access to government contracts
- 4) One country reported that contracts in the education sector are broken up by gender

#### 4.3.1 Marketing Support

##### *Procurement process stage: Preparation Stage & Eligibility of Suppliers*

Given their small size, SMEs are often much less well-known, particularly amongst potential government purchasers. As a result, governments can help SMEs overcome visibility constraints, by helping them get their products and services in front of procuring entities through various mechanisms. One initiative is a regular event such as an exposition or fair for SMEs to meet and interact with government agencies. Additionally, governments can promote SME products via printed materials such as catalogues, detailing their product info and track record so as to facilitate government entities' knowledge of the various firms that exist.

#### 4.3.2 Training and technical assistance

##### *Procurement process stage: Preparation Stage & Eligibility of Suppliers; Bidding Process & Bid Submission*

Governments can provide technical assistance and training services specific to SMEs and/or women owned businesses interested in participating in the procurement process. This could include managerial training, financial management, understanding the public procurement process, access contract opportunities, etc. This support can be provided independent of the actual tendering process or in tandem.<sup>112</sup>

Technical assistance does not influence the cost competitiveness of the bidder – only supporting the bidder's ability to participate in the procurement process.<sup>113</sup> However, as a disadvantage it can be ineffective in assisting SMEs when governments do not have the necessary expertise due to lack of professionalization and/or systemization of the procurement process.

Training, as opposed to technical assistance, can be used to teach many people at once, however a 'one size fits all' approach may not always be appropriate.<sup>114</sup> Training efforts can also include training of the government officials who will administer the procurement process, enabling the professionalization previously discussed.

**In Italy<sup>115</sup>**, Supplier Training Desks (STDs) provide training and assistance to enterprises and in particular MSMEs on the use of electronic procurement tools. There are now more than 200 training desks active around the country, providing continuous free training and assistance. Around 1,000 enterprises supported by the STDs were qualified in 2013 to the public e-marketplace for low value purchases through e-catalogues.

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<sup>112</sup> Arrowsmith (2010)

<sup>113</sup> Linarelli (2000)

<sup>114</sup> Linarelli (2000)

<sup>115</sup> OECD (2015)

#### 4.3.3 Financial Assistance

*Procurement process stage: Bidding Process & Bid Submission; Institutional Procedures; Post-Award & Execution; Preparation stage & Eligibility of Suppliers*

Financial assistance can take multiple forms including, 1) access to capital offered by governments (i.e. factoring accounts receivables, low interest loans, etc.), and 2) advanced payments for qualifying SMEs.<sup>116</sup>

As mentioned in the discussion on prompt payments, SMEs often face limited liquidity and as a result, governments can provide unique financing opportunities specific to SMEs they engage with in an effort to help them access capital they might otherwise struggle to receive. Low interest loans are a frequently used tool – providing low cost financing opportunities that would otherwise not be available in the private market.

- **In the U.S.**, the Small Business Administration (SBA) provides Advantage Loans through its 7(a) program to qualifying businesses by guaranteeing loans from participating lending institutes.
- **In Kenya**, the Uwezo Fund provides youth and women entrepreneurs with grants and interest-free loans coupled with mentorship opportunities to help build capacity amongst these business demographics.<sup>117</sup>

Advanced payments are another form of financial assistance that can be reserved for SMEs to help overcome issues of the aforementioned lengthy payment timings and/or payment delays. Execution can vary by how much of the contract value is eligible for advanced payment, types of contracts that are eligible for the preferential treatment, and the discretion given to the procuring entity in terms of when the advanced payment option is relevant.

- **In Croatia**, interim payments are the rule in works and supplies contracts, although infrequent in services contracts, and procuring entities are required to pay advance payment of 10 % under works contracts and service contracts that include public works.
- **In Macedonia**, procurers can give advance payments of up to 20% of the total value of the contract, although this is not mandatory.<sup>118</sup>

Still, while financial obstacles may be significant, providing financial relief is not always the best approach for resolving these obstacles. For women-owned businesses in Africa, the biggest obstacle to their participation in procurement was financial criteria, in particular, requirements for audited financial accounts. Government and private sector representatives have agreed that capacity building efforts would be the best tool to support women entrepreneurs, rather than changing procurement requirements.<sup>119</sup>

#### 4.3.4 Performance Guarantee Flexibility

*Procurement process stage: Bidding Process & Bid Submission; Institutional Procedures; Post-Award & Execution; Preparation stage & Eligibility of Suppliers*

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<sup>116</sup> Linarelli (2000); ADB (2012)

<sup>117</sup> International Trade Center (2014)

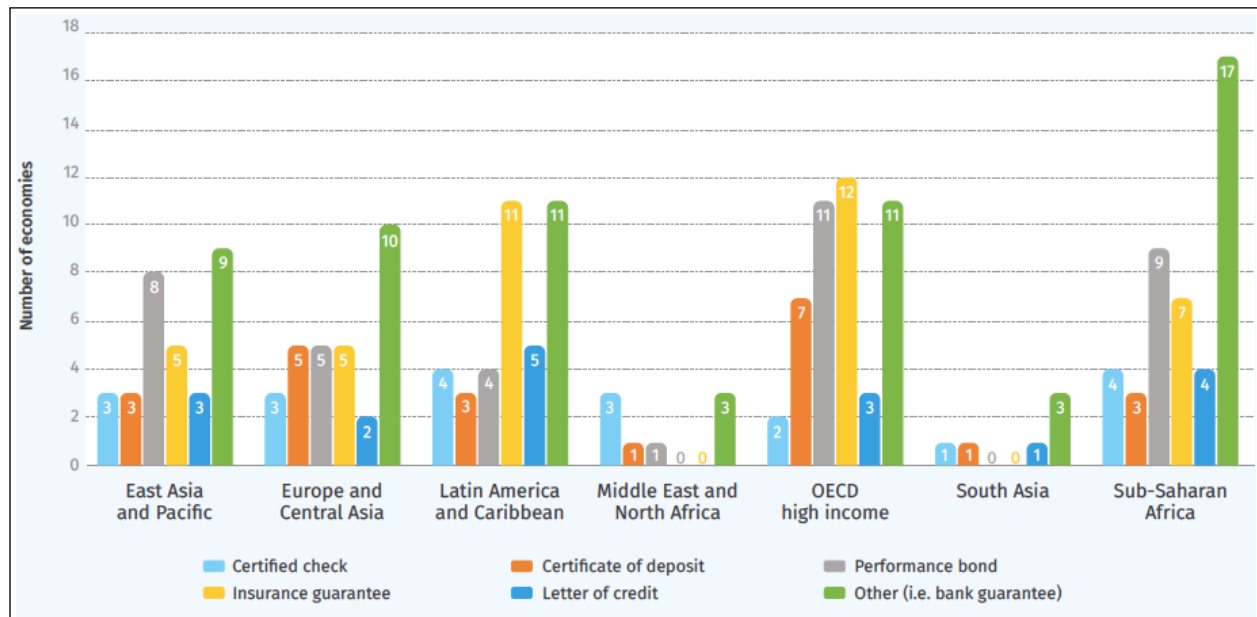
<sup>118</sup> PwC et al. (2014)

<sup>119</sup> International Trade Center (2014)

In addition to needing access to capital, SMEs, as well as all other contractors, are often required to provide a performance guarantee, through an insurance company or bank, to protect the procuring entity from poor contract performance and also help make sure the supplier effectively completes the contract.<sup>120</sup> These guarantees can take a variety of forms; however, acquiring a guarantee can still present an obstacle for an SME with already limited access to credit and potentially limited credit history.

According to the World Bank (2016b), “A recognized good practice for performance guarantees is to require both a low percentage of the contract value as performance guarantee and to provide the supplier with options as to the different type of financial instruments required.” With more options for the financial instrument used as a guarantee, the more likely the SME will be able to comply with the requirement. The range of guarantees used around the world is shown in Figure 6.

**Figure 6: Types of Performance Guarantees by region**



Source: World Bank (2016b)

Performance guarantees are widely used in low income countries. However, in the World Bank’s 2017 Benchmarking Public Procurement report, of the 180 economies surveyed, only 14 economies do not have performance guarantee requirements, including 7 high-income ones: Australia, Hong Kong SAR, China, Ireland, New Zealand, Singapore, Slovak Republic, and Sweden.

#### 4.3.5 Framework Agreements for SMEs

*Procurement process stage: Preparation stage & Eligibility of Suppliers; Bidding Process & Bid Submission*

<sup>120</sup> World Bank (2016b)

In general terms, framework agreements occur between a public procurement entity and a supplier to set the terms for individual government purchases from that supplier during an agreed upon time period.<sup>121</sup> The agreements are not the awarding of the contracts themselves, but they describe the terms under which a contract will be given to supplier in advance. Additionally, the agreement can include more than one business, and the competition for the specific contract is open only to those businesses that are a part of the predetermined agreement. While framework agreements do not have to be specific to SMEs, they can be used to support SME engagement.

Frameworks agreements, once in place, can help reduce administrative costs both for the government and for suppliers when applied to frequently purchased goods/services.<sup>122</sup>

Two types of framework agreements include Indefinite Quantity Contracts and Multiple Award Schedules. In the U.S., Indefinite Delivery, Indefinite Quantity contracts (IDIQ) are used to allow government procuring entities to purchase an unknown quantity (above a specified minimum) of a good/service during a fixed time period.<sup>123</sup> This is used to streamline the contract process to the benefit of both government and suppliers – being of particular benefit to SMEs, as well as increase the speed of service delivery.

Under a Multiple Award Schedule (MAS) contract,<sup>124</sup> procuring entities can award contracts to multiple businesses that will provide similar goods/services at varying prices. Using this method, governments can allow more suppliers to participate in the procurement process. These multiple awards can also be contracted using an IDIQ method, such that multiple companies have access to repeatedly providing an indefinite quantity of the same or very similar service to government entities. This can then streamline the administrative process for many companies simultaneously.

While the process to create an MAS contract may be more complex than that required for a standard procurement contract, once the MAS contract is established it can provide cost savings when applied over multiple purchases from multiple suppliers.<sup>125</sup>

#### 4.3.6 Subcontracting requirements or SME consortia formation

*Procurement process stage: Preparation stage & Eligibility of Suppliers; Bidding Process & Bid Submission*

Subcontracting requirements can be used to encourage use of SMEs by large businesses that win government contracts, for example, by requiring that a certain percentage of the value of the intermediate inputs come from SMEs.<sup>126</sup> One potential advantage to a sub-contracting requirement is that it allows the large company to decide how best to incorporate the SME in their work resulting in a potential gain in efficiency.<sup>127</sup>

Alternatively, if the contract is large, selection criteria can allow for SMEs to form consortia and by

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<sup>121</sup> OGC (2006)

<sup>122</sup> OECD (2016)

<sup>123</sup> GSA (2015)

<sup>124</sup> In the U.S. the MAS can also be referred to as a General Service Administration (GSA) Schedule

<sup>125</sup> OECD (2016)

<sup>126</sup> Linarelli (2000)

<sup>127</sup> Linarelli (2000)

grouping their capabilities together make a competitive bid. With this method, selection criteria applies to a joint tender rather than for every member of the consortium, except for financial health in case individual members experience financial problems/bankruptcy/etc.<sup>128</sup>

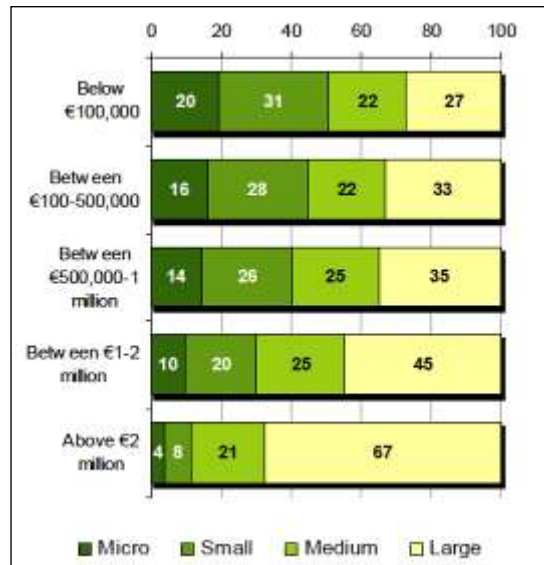
**In Italy**, bidders may satisfy requirements in bidding documents by relying on other entities' capacities. A special agreement must be created between the bidder and this other entity, but all companies are still liable to the procuring entity for the entire contract.<sup>129</sup>

#### 4.3.7 Smaller lot sizes

##### *Procurement process stage: Preparation Stage & Eligibility of Suppliers*

To many SMEs, lot sizes remain the greatest barrier to their ability to participate in public procurement.<sup>130</sup> Many contracts are simply too large for an SME to be able to meet the government's needs on their own, despite being capable of providing a similarly competitive good or service at a smaller scale. Unbundling large centralized procurement contracts into more localized contracts can enhance the ability of SMEs to compete.<sup>131</sup> For example, in the EU the new directives on public procurement enforce the division of large public contracts into smaller batches, allowing SMEs to participate in large tenders.<sup>132</sup> Figure 7 below shows how smaller businesses in the EU become increasingly likely to win smaller contracts.

**Figure 7: Value of Contracts won by size of company in the EU**



Source: GHK and Technopolis (2014)

Unbundling large contracts can occur by dividing up and awarding several small lots at the same time, spreading the contract out over time to allow tendering for small amounts, or may limit the amount of

<sup>128</sup> Kiiver and Kodym (2014)

<sup>129</sup> Garcia (2009)

<sup>130</sup> Morand (2003)

<sup>131</sup> ADB (2012)

<sup>132</sup> World Bank Group (2016b)

work that can be done by a single firm.<sup>133</sup> In both cases additional administrative costs may occur from having to administer a large number of smaller contracts rather than one larger contract and potentially rejecting tenders that offer better prices but for a larger contract size.<sup>134</sup>

#### Examples of breaking up lot sizes

- **In the Arab Republic of Egypt**, 2010 procurement legislation includes breaking tenders into small lots for supply contracts. However, according to the OECD, this practice is weakly implemented.<sup>135</sup>
- **In Albania**, the requirement to divide contracts into smaller lots applies when the original large contract consists of “homogenous works serving similar purpose.”<sup>136</sup>

#### 4.3.8 Award criteria

*Procurement process stage: Bid Opening & Evaluation; Preparation Stage & Eligibility of Suppliers*

Another common approach to supporting SMEs is through specific award criteria that consider the relative merits of different tenders.<sup>137</sup> When bids are processed using award criteria, often times a point scheme will be implemented and the contract awarded to the bidder achieving the highest point total. This allows for many different factors to be taken into consideration, not just the bid price, when deciding on which company will receive the contract.

Points may be awarded for such things as:

- Size of firm such as number of employees, annual turnover, market capitalization
- Women owned or women on board
- Value for money vs. lowest bid
- Local content included
- Provision of professional training services
- Environmental sustainability
- Social value and/or specific social criteria
  - Local economic impacts
  - Disadvantaged minority owner or employees

**In Switzerland**, the Federal Law on Public Procurement, Article 21<sup>138</sup>, allows for a variety of potential award criteria. Notably additional points can be awarded for whether the bidder provides professional training services and/or apprenticeship opportunities. Through this method, the government can effectively foster capacity building and training programs for workforce development directly through its contractors. This can be paired with an SME preference to effectively target local economic development goals.

One problem with award preferences to particular firms, is that they may involve awards to less efficient firms. Award criteria may encourage firms to charge the government a higher price than they charge

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<sup>133</sup> Arrowsmith (2010)

<sup>134</sup> Arrowsmith (2010)

<sup>135</sup> OECD (2014)

<sup>136</sup> OECD (2012)

<sup>137</sup> Arrowsmith (2010)

<sup>138</sup> <https://www.admin.ch/opc/it/classified-compilation/19940432/index.html>



the private sector, knowing that their eligibility for award criteria may offset a higher bid price compared to competitors.<sup>139</sup>

Alternatively, award criteria could be used only as a tie-breaker between bidders if they are otherwise equal after all other aspects have been evaluated.<sup>140</sup> For example, if an SME and a large business have identical bids, then the size of the firm could be taken into account, and the SME given preference.

**The Republic of South Africa** revised its procurement regulations allowing for increased procurement contracts (30%) to be awarded to MSMEs. A core instrument for achieving this goal is the use of award criteria. The criteria are multi-faceted including aspects of size, the company's status level for Broad-Based Black Economic Empowerment (B-BBEE)<sup>141</sup> as well as requiring large tenderers to subcontract at least 30% to small businesses at least 51% owned by black people including women, youth and people with disabilities.<sup>142</sup>

#### 4.3.9 Set Asides

##### *Procurement process stage: Preparation Stage & Eligibility of Suppliers*

Under a set aside—essentially a quota—a certain percentage of designated government procurement contracts or total spending is reserved for a targeted category of bidders that meet the preferential qualification criteria, in this case achieving SME status and/or being owned by a woman.<sup>143</sup> The critical aspect of this approach is that there is a segregation of competition amongst targeted firms, i.e. SMEs can only compete against each other. This approach has been used around the world.<sup>144</sup>

**For example**, Algeria, Cote d'Ivoire, Dominican Republic, India, and Morocco each use a set aside around 20% of the total value of government contracts to SMEs. That percentage increases to 25% in Kenya and Angola and 40% in Taiwan, China.<sup>145</sup> In the Philippines,<sup>146</sup> under the General Government Appropriation Act (annual budget), the government has an SME set-aside component that requires procuring at least 10% of its total annual supplies from SMEs.

**In Kenya**, the government has combined its SME preferential agenda with a women-specific agenda, using a set-aside goal of 30% of spending to be allocated to micro and small enterprises owned by youth, women or persons of disability.<sup>147</sup>

The attraction of the set aside option is that it produces rapid, visible gains and guarantees entry for SMEs into the procurement process.<sup>148</sup> However, there are multiple concerns associated with the set-aside approach. It risks compromising quality, price, and delivery targets because the suppliers may be less efficient than larger companies. It may also distort incentives to become cost competitive if companies know they can participate in the smaller, less competitive SME pool and be protected from

<sup>139</sup> Arrowsmith (2010)

<sup>140</sup> Arrowsmith (2010)

<sup>141</sup> B-BBEE Act (2003); South Africa Preferential Procurement Policy Framework Act (2011)

<sup>142</sup> Republic of South Africa (2017)

<sup>143</sup> ADB (2012); Linarelli (2000)

<sup>144</sup> ADB (2012)

<sup>145</sup> World Bank Group (2016b)

<sup>146</sup> Jones (2011)

<sup>147</sup> <https://agpo.go.ke/pages/about-agpo> ; International Trade Center (2014)

<sup>148</sup> Initial market research must take place in order to conclude that SMEs are available and able to perform the work needed by the government to ensure the set-aside mechanisms still requires competition amongst SMEs.

the prices achieved by larger companies. In this case, the set-aside can be counter-productive in helping SMEs become competitive in the market, instead solidifying their dependence on government support.<sup>149</sup> To overcome the risk of dependency, some economies place limits on the number of years a firm will be eligible for SME status, thus removing government support should the firm fail to grow beyond SME sizes. Despite these concerns, many governments are prepared to pay extra costs knowing they will be able to engage more SMEs.

#### **China: SME Public Procurement Policy**

In 2012, China's Ministry of Finance and Ministry of Industry and Information Technology outlined policy features include requiring government departments:<sup>150</sup>

- (i) to set aside at least 30% of annual procurement budgets for SMEs, with at least 60% of that amount reserved for small and micro enterprises;
- (ii) to apply bid-price preferences of between 6%–10% for SME applicants; and/or
- (iii) to encourage larger businesses to subcontract with and form consortiums with SMEs and to provide bid-price preferences of 2%–3% in those cases.

#### **4.3.10 Contract Thresholds and Reserved Products for SMEs**

##### *Procurement process stage: Preparation Stage & Eligibility of Suppliers*

In some economies, contracts below a certain threshold value are designated specifically for SMEs so that large companies are not able to bid on them. This has a similar effect to the set-aside approach, allowing SMEs to compete solely against other SMEs. The threshold ceiling can be set according to local conditions, the relevant industry and targeted businesses. For example, the ceiling is approximately \$190,000 in Indonesia, \$125,000 in Colombia and \$24,650 in Brazil (specific to micro and small enterprises).<sup>151</sup> However, this contract threshold can mean that the SMEs that can bid on small contracts are not allowed to bid on contracts above the threshold such as is the case in Indonesia.<sup>152</sup>

In a similar vein, countries can reserve particular products for procurement from SMEs. Thus, instead of setting a limit on the size of the contract for which SMEs are eligible, all contracts for a particular product will be designated for SMEs to bid on. This has the same effect in that only SMEs can bid against each other. For example, in India a list of 358 items exists, all of which are reserved for SME suppliers. Items included are: waxed paper, trays for postal use, steel chairs, liquid soap, etc.<sup>153</sup>

#### **4.3.11 Bid Price Preferences**

##### *Procurement process stage: Bid Opening & Evaluation*

Bid price preference strategies can take one of two forms. Under the first form, bids from eligible SMEs could be discounted by a given percentage, such as by cutting their bid price by 5% simply because they are an SME and making it more competitive with other potential bids from large businesses. The other method is to add a percentage of the bid price onto the large bidders.<sup>154</sup> Either method has essentially the same effect although both cases may serve as an acknowledgement that an SME is unable to

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<sup>149</sup> Arrowsmith (2010)

<sup>150</sup> ADB (2012)

<sup>151</sup> World Bank Group (2016b)

<sup>152</sup> Jones (2011)

<sup>153</sup> Ministry of MSME (2012)

<sup>154</sup> ADB (2012); Linarelli (2000)

compete at the same price points as large businesses. The same procedure can be used to give preference to domestic over foreign owned bidders.

From an economic stand point, the consequences of price preferences depend on market structure.<sup>155</sup> According to the WTO (2000), “inefficient firms are more likely to survive when the government segments the market with a price preference margin than when it segments the market with subcontracting program or a set-aside program.”<sup>156</sup>

#### **Angola – Multiple SME initiatives<sup>157</sup>**

- A set-aside of at least 25% of the budget for SMEs
- Payment made to SMEs within 45 days after the date of reception of the invoices
- In case of a tie in procedures and in case of subcontracting, preference should be given to SMEs
- Public entities may establish as pre-selection requirements the qualification of the bidders as SMEs

## 5. Evidence of Impact

Section 5 provides an overview of known impacts achieved through SME public procurement. Types of impact discussed include company growth, market competition, employment gains as well as broader correlations between procurement processes and SME engagement. Of note, the studies here are limited to individual countries with often widely varying institutional frameworks, and look at a range of policies, sometimes several at once, making it more difficult to establish causality and determine which policies are more impactful than others. To facilitate better understanding and acknowledge gaps in information, the studies have been grouped by policy type and their effect on SMEs: non-preferential public procurement, procurement reforms, E-procurement systems<sup>158</sup>, and SME-specific assistance.

As the following cases look at preferential procurement tools used and their impact, it is important to note the potential limitations associated with the studies and the general lack of understanding of the economic impact of preferential procurement policies to date. In most cases, the economic impacts of preferential treatment are unclear or unknown.

The primary outcomes known about the shopping-list of possible policies to support SMEs previously described, is that there are some increases in the contracts awarded to SMEs.<sup>159</sup> Beyond that, the understanding of impacts of SMEs winning the awards is limited with a few exceptions. This is not to say that the policies cannot be impactful, only that their current impact deserves more study. What evidence there is will be fleshed out in this section.

### 5.1 Correlations from available public procurement and SME data

While widespread, national level data on SME policies and the corresponding SME involvement in public participation is limited. Using the World Bank’s Benchmarking Public Procurement data, Enterprise

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<sup>155</sup> Linarelli (2000)

<sup>156</sup> Linarelli (2000); Arrowsmith (2010)

<sup>157</sup> World Bank Group (2016b)

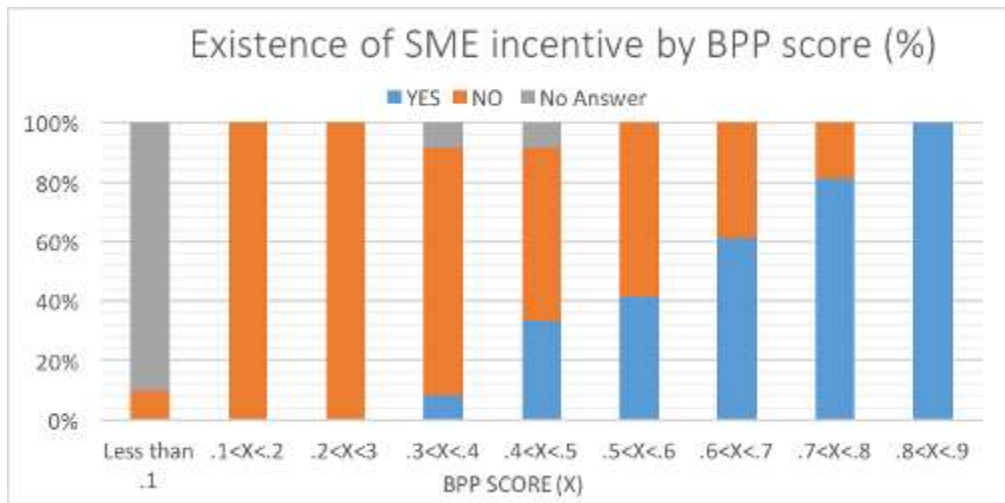
<sup>158</sup> While technically considered a procurement reform, the e-procurement studies are focused on that single policy change, making for easier comparison between countries and so are addressed separately.

<sup>159</sup> Nicholas and Fruhmann (2014)

Survey data, and an aggregation of data published by the European Commission and independent studies (Silva and Scott (2014); GHK and Technopolis (2014); Belaustegui (2011); SELA (2015)), the following original insights have been revealed for the purpose of this report.

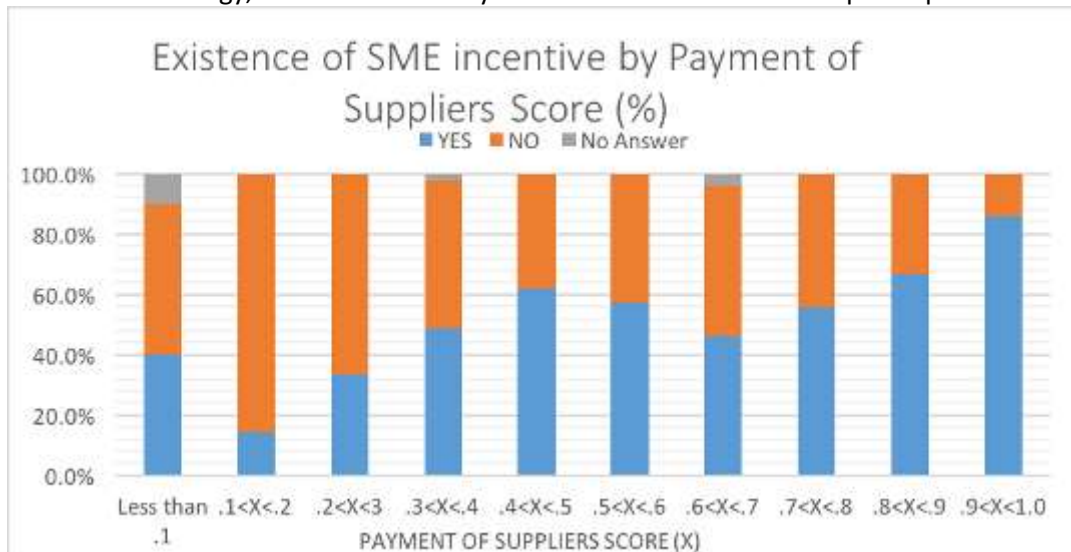
**Figure 8: Existence of SME incentive by BPP score**

Countries with SME incentives for public procurement also tend to have a better functioning public procurement system based on World Bank Benchmarking Public Procurement methodology.



**Figure 9: Existence of SME incentive by Payment of Suppliers Score**

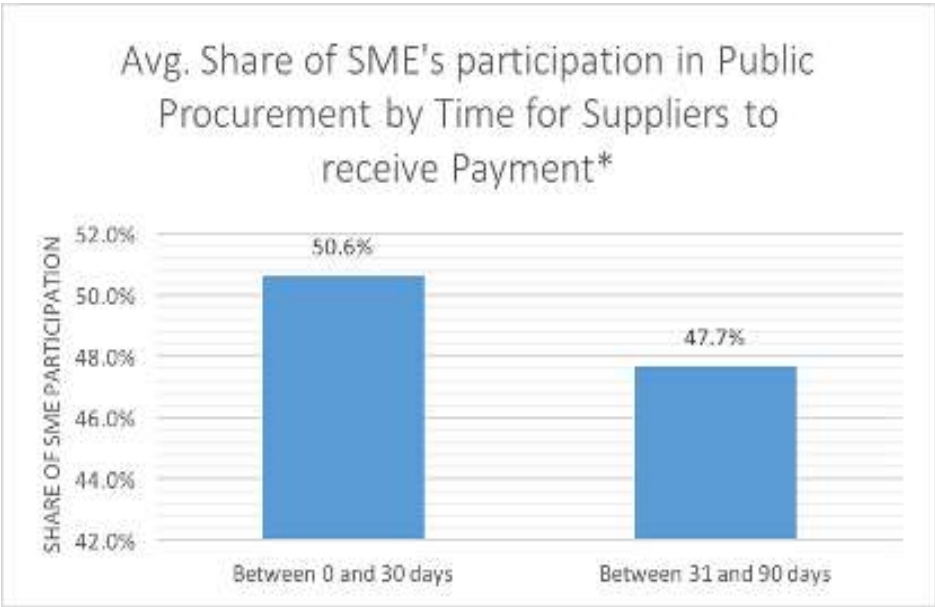
Countries that score higher for Payment of Suppliers, based on the World Bank Benchmarking Public Procurement Methodology, are also more likely to have an SME incentive for public procurement.



Based on Figures 8 and 9, there appears to be a positive correlation between the functioning of the country's procurement system and whether that country has some kind of SME incentive as a part of its procurement process. This however does not show that a procurement system is improved by using SME incentives nor vice versa, but that better functioning systems tend to explicitly support SMEs as well. Given the various institutional needs of an SME preferential procurement previously discussed, it is reasonable to assume that improving the procurement system as a whole is a meaningful first step towards eventually supporting SMEs explicitly.

**Figure 10: Average Share of SMEs participation in Public Procurement by Time for Suppliers to receive Payment**

Countries that pay suppliers more quickly, also tend to have a higher engagement with SMEs in terms of contract value awarded.

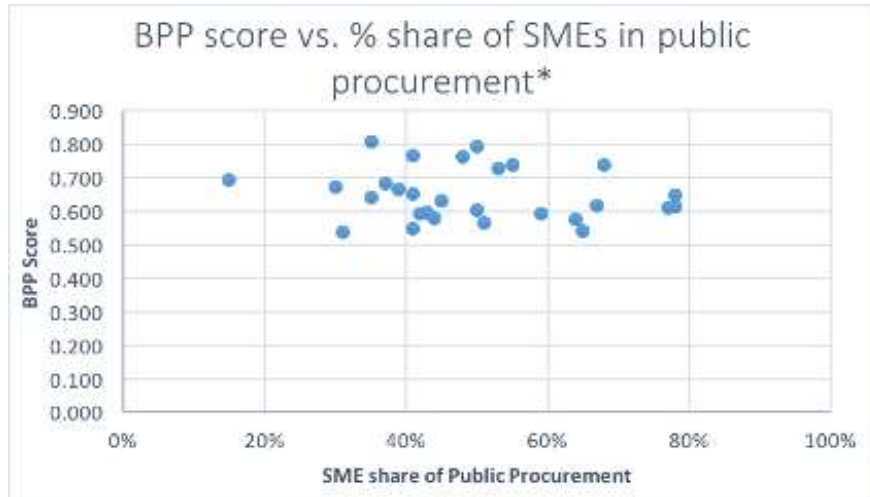


\*Only includes select EU and LAC countries. N=28

While data is much more limited for contract value awarded to SMEs, there is still a correlation visible between it and the time it takes for suppliers to receive payment, a commonly acknowledged obstacle for SMEs. In this instance, there is no reference to a preferential policy for SMEs; as a result, the difference in participation rates suggests paying suppliers more quickly will inherently increase the contracts won by SMEs, perhaps by reducing the obstacle of liquidity and boosting their confidence in the government as a customer. This supports the discussion of Section 4, whereby procurement reforms are capable of benefiting SMEs.

**Figure 11: BPP score vs. Percent share of SMEs in public procurement**

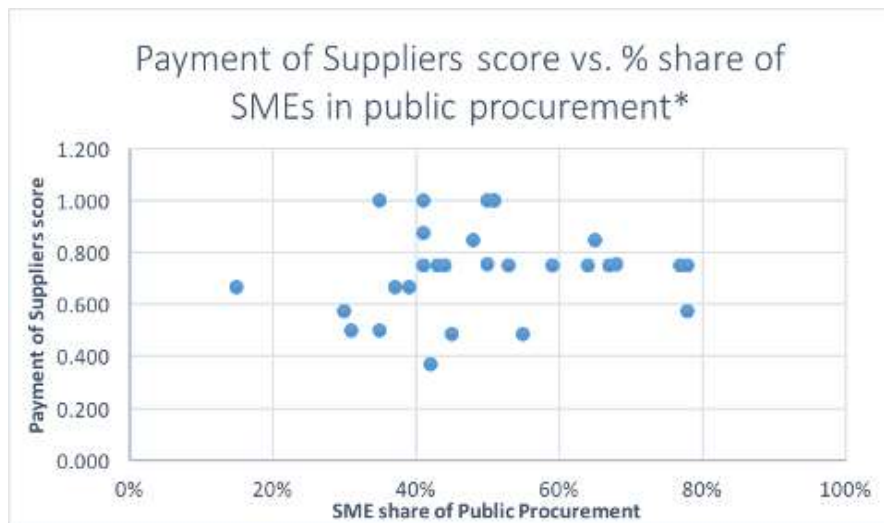
There is little correlation between a country's BPP score and the proportion of SMEs engaged in public procurement in terms of contract value.



\*Only includes select EU and LAC countries. N=28

**Figure 12: Payment of Suppliers score vs. Percent share of SMEs in public procurement**

There is little correlation between a country's score for Payment of Suppliers and the proportion of SMEs engaged in public procurement in terms of contract value.



\*Only includes select EU and LAC countries. N=28

Compared to the first three charts, Figures 11 and 12 shows little correlation between the functioning of the public procurement system and the contracts awarded to SMEs. This could be due to the limited data available for SMEs engaged. Or it could be that there are other factors not built into the Benchmarking Public Procurement scores that have a greater influence on SMEs ability to participate. This includes noting that BPP scores do not include SME preferential policies and as a result, any comparison between these scores and SME participation does not include potential preferential policies that exist which are boosting SME participation.

## 5.2 SME participation in public procurement: Non-preferential treatment

### 5.2.1 Brazil Case: Impact of winning government contract for SMEs

A recent paper by Ferraz et al. (2016) out of Brazil, shows the potential for how the demand shock of public procurement can help small and medium firms grow and generate employment opportunities that are not based on self-employment. This paper is one of the few to evaluate the impact of public procurement on SMEs in a developing country. However, it is not about preferential public procurement for SMEs but instead looks at the impact of SMEs who won a contract vs. those who did not, but were also competitive in their bid.

The authors find that winning a government contract has a significant effect on firm growth both during the quarter in which they win, as well as over the medium horizon. Specifically, they find that:

- Winning at least one contract in a given quarter increases firm growth by 2.2 percentage points over the quarter.<sup>160</sup>
- Increases in firm size are larger for younger firms.
- 93% of growth in new hires comes from individuals who were either unemployed, in the informal sector, or outside the labor force.

In addition to the aforementioned short term economic gains, there are lasting benefits experienced by those that win contracts:

- Firms experience growth for at least 2 years after winning a contract, despite contract length of only 6 months to a year.
- Firms that barely win a contract participate in 30% more auctions over the next three months compared to those firms that barely lose.
- A year later, winners participate in 20% more auctions than losers over a 30 day window, leading to further contracts won.

While these results are not necessarily surprising, they serve as a sturdy example of economic (and psychological) gains experienced through winning a public contract. Therefore, boosting engagement with SMEs can help spur growth and employment gains in this context.

### 5.2.2 Uganda Case: Determinants of SME access to public procurement

In a study of factors influencing SMEs, owned by individuals aged 18-30, ability to access public procurement in Uganda, Obanda (2012) identified four primary interventions, these being Implementation, Training, Professionalism, and Information.<sup>161</sup> The study found that these interventions significantly explain SMEs access to public procurement contracts ( $R^2$  value of .789), with training and information being the most significant predictors.

When viewed more broadly at the systems level, the four interventions can be combined as Competence i.e. training and professionalism, and Information Systems i.e. information and implementation. When taking this approach, the interventions are an even better predictor of SMEs access to public procurement contracts ( $R^2$  value of 0.833). Amongst the now two variables, Competence proves to be the greater determinant (0.580) compared to that of Information Systems

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<sup>160</sup> For context, the authors note that this increase in growth moves a firm located at the median of the firm growth distribution to the 75th percentile of the distribution.

<sup>161</sup> The authors use these criteria due to their appearance in other studies and given the fact that there is little information as no similar study has been conducted so far in Uganda.



(0.409).<sup>162</sup> This suggests that a public investment in stakeholder competence both on the part of the government and the suppliers, would lead to slightly greater benefit in terms of helping more SMEs participate in procurement.

## 5.3 Procurement Reform Impacts

### 5.3.1 Philippines Case: Transparency and information access leads to reduced costs and processing times for government

In Naga City in the Philippines, an initiative to improve public sector transparency had a positive impact on SME performance.<sup>163</sup> It included the launching of an e-government website providing information on services, communication channels, and complaint mechanisms; a text message based communication method; improved internet access; and paper based tools for those without internet. The efforts have led to greater participation of service providers in the bidding process many of which are SMEs. For instance, 19 firms on average would bid for the supply of the city government's medicine and medical supply requirement, while the national government requires only 3 bidders.

Subsequently, by opening procurement to SMEs and allowing public scrutiny of notices and outcomes of bids posted on the website, this program significantly reduced costs of public projects (e.g. construction of a public school classroom was 36% cheaper and cost of asphalt overlays was 47% lower than those of other local governments).<sup>164</sup> The City Accountant's Office estimates that the increased transparency of the procurement system has saved the city government at least P10 million (USD200,000) a year.

### 5.3.2 Peru Case: Transparency, Training increases SME profit and hiring

In 2006 there were about 3 million firms in Peru, 99% of them were micro or small enterprises i.e. firms with less than 50 employees. Given their vast numbers, the Peruvian Congress approved in 2003 a law to promote micro and small firms, and designated PROMPYME (The Small and Micro Enterprise Promotion Commission) as the government entity in charge of executing the law. PROMPYME then implemented a Program of Public Sector Purchases from SMEs to promote participation in public procurement through improved access to information and web-based training. It served as a market development program, collecting and arranging public procurement data online enabling registered SMEs to quickly and easily access relevant procurement information on available tenders.

In a study by Lopez-Acevedo and Tan (2011), it was found that those participating in the PROMPYME program achieved 20% higher total and per worker profits and sales. Looking at the trends in mean profits per worker, from the beginning the program participants had higher profits per worker compared to non-participants, and this tends to widen over time. This suggests that while firms with higher levels of productivity were more likely to participate in the program, the program was successful in further improving these firms' performance.

### 5.3.3 Cabo Verde Case: Improved Legal and Regulatory Framework, E-procurement, Transparency, and Streamlined Processes increase SMEs engaged

In Cabo Verde, a World Bank supported project made public procurement more transparent and efficient by strengthening the legal and institutional framework, training staff, implementing an online

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<sup>162</sup> Obanda (2012)

<sup>163</sup> Robredo (2006)

<sup>164</sup> Robredo (2006)

procurement system and following ISO 9001 for quality controls and improved management system. These reforms supported the modernization of the national procurement system, addressing issues in the legal and institutional framework while working to promote competition, avoiding conflict of interest, and improving transparency.

The project began in 2012 with a goal to increase the number of SMEs that compete for contracts in the public procurement system. By the project's conclusion in January 2015, results achieved include:<sup>165</sup>

- A total of 444 SMEs competed for contracts, up from an estimated 15 prior to the reforms.
- The SMEs winning contracts raised their average one-year growth in sales revenue by 43% over a comparable group of Cabo Verdean SMEs.
- The benefits amongst the winning SMEs extended beyond just sales growth. Amongst SMEs winning contracts, 32% launched firm level new products, compared to 13% of non-beneficiaries; 57% undertook training for their employees, compared to 26% of non-beneficiaries; and 68% adopted new technology, compared to 27% of non-beneficiaries.

Furthermore, in terms of gender, 28% of the beneficiary firms were led by women, while according to the Enterprise Surveys of 2009, only 16.7% of Cabo Verdean firms had a female top manager, suggesting the reforms also played a role in leveling the playing field for women compared to men owned businesses.<sup>166</sup>

These findings make clear the relatively rapid and widespread business impact occurring from public procurement contracts reaching SMEs, further supporting the need to engage with them.

## 5.4 E-Procurement Policy Case Impacts

**In Chile,**<sup>167</sup> ChileCompra acts as an electronic information intermediary between the procuring entity and the supplier. It also includes an official electronic register of suppliers and a virtual platform for tenders. Through these efforts, the government increased savings from \$180 billion to \$280 billion from 2010 to 2012. Further, SMEs share of procurement contracts on ChileCompra grew from 23.8% in 2003 to 44% in the first half of 2013, showing some correlation to the ability of SMEs to participate in procurement and the e-procurement platform.<sup>168</sup>

**In Georgia,**<sup>169</sup> paper-based tenders have been fully eliminated as 100% electronic tenders were introduced in 2010. As a result, from 2010 to 2011 the number of tenders rose from 1,923 to 33,000, many of which will be opportunities for SMEs.

**In Greece,** the government experienced significant cost savings through use of e-procurement - estimated a 1% savings in supply costs and a 20% savings in the cost per tender, a time savings of 39.7% in open tenders as well as a 7.6% reduction in administrative cost, and a 88.9% and 72% savings on lead time order cost and opportunity cost of capital.<sup>170</sup> The benefits to government are unquestionable; however these savings are not necessarily applicable to the SMEs as well. Although based on the higher

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<sup>165</sup> The World Bank (2015)

<sup>166</sup> The World Bank (2015)

<sup>167</sup> SELA (2015)

<sup>168</sup> World Bank Group (2016b)

<sup>169</sup> World Bank Group (2016b)

<sup>170</sup> Eei et al. (2012)

participation rate of SMEs in Greece (winning 78% of contracts by value), it appears the e-procurement process has not hindered their ability to participate.

**In the UK**, the government launched the supply2.gov.uk website, effectively opening the public procurement market to SMEs. To assess the benefits experienced by SMEs, a quantitative survey of suppliers using the website showed moderate success. Of the survey respondents, 43% believed that the e-procurement site had saved them time in finding or bidding on contracts. A third of users considered that supply2.gov increased the number of contracts they are likely to bid for.<sup>171</sup>

**In Malaysia**, the benefits of e-procurement have been limited. In 2009, despite having been in place for 10 years, the use of e-procurement had still not been widely adopted by SMEs. External barriers of technology, infrastructure and legislation along with internal barriers such as resource constraints were found to be the leading reasons for its limited success.<sup>172</sup> The combination of limited internet access and the costs and time needed to learn to use the ICT tools prevented any significant savings on the part of the SME. Instead, the main benefits were better market positioning, better access to market information and advertising.<sup>173</sup>

## 5.5 SME-specific Assistance

### 5.5.1 U.S.A. Case: Faster payment times for SMEs effect on SME growth

In 2011, the US announced the *Quickpay* reform which indefinitely accelerated payments to a subset of small business contractors who worked for the federal government. The reform reduced the time to receive payment from 30 days to 15 days.<sup>174</sup> A recent study by Jean-Noel Barrot and Ramana Nanda study the impact of this reform and find significant benefits in the area of small business employment. On average, the accelerated payments lead to an almost 7% increase in annual payroll after four years with much of the increase coming from new hires.<sup>175</sup> The authors explain that this policy effectively increased firms' internal cash flow by reducing the working capital needed to sell to the government.

The authors go on to note that the positive benefits experienced by those firms who received accelerated payment came at the cost of those firms who did not receive accelerated payments in the form of crowding out employment growth.<sup>176</sup> The increase in labor demand also pushed wages up, which then made it harder for other firms to make new hires.

Nevertheless, the message remains clear that shortening the payment time just 15 days in the U.S. is substantial enough to create significant impacts. In countries where the payment time can take months, it is reasonable to suspect that the impacts of this delay are much more dramatic.

### 5.5.2 Sweden Case: Smaller lot sizes effect on SME participation

A study of the public procurement market in Sweden (Stake 2013) found that breaking up contracts can have various effects on SME participation and their probability to win, with both factors found to depend on the number of contracts in the procurement. The study found that when a procurement

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<sup>171</sup> Kaspar and Puddephatt (2012)

<sup>172</sup> Kaspar and Puddephatt (2012)

<sup>173</sup> Eei et al. (2012)

<sup>174</sup> McKenzie (2017)

<sup>175</sup> Barrot and Nanda, (2017)

<sup>176</sup> Barrot and Nanda, (2017)

contract of a given size is divided into many parts, in this case more than 10, it significantly increased participation by micro and small firms. However, this benefit largely disappeared when the same contract was divided into 2-4 parts. In this case, it was found to have a negative effect on participation from small, medium and large firms alike, but still managed to increase micro firms' probability of winning a part of the contract compared to large firms.<sup>177</sup>

Still of note, if a contract is too large, in many cases an MSME will not be able to participate, no matter how well the procurement process functions and any other public financial or technical assistance they may be provided.

#### 5.5.3 Brazil Case: Contract threshold, streamlined SME processes, subcontracting, tie breakers

In Brazil a series of SME oriented procurement laws have been implemented since 2006. These include giving micro and small enterprises sole access to contracts worth less than BLR80,000 (USD26,000) as well as simplifying public tender procedures, permitting subcontracting of micro and small enterprises within larger contracts and, in the event of a tie, giving preference to small enterprise.<sup>178</sup> Most recently, the Sustainable Public Procurement Program was launched in 2012 by which the federal government gives priority to small businesses specialized in environmentally, socially and economically responsible goods and services.

In less than two years, the share of the total value of contracts supplied by micro and small enterprises rose 115%, from BLR6.6 million (~USD2.1 million) in 2010 to BLR22.4 million (~USD7.2 million) in 2012.<sup>179</sup> However, it has been noted that the inclusion of small businesses has required large efforts in training and professionalizing the staff of procuring entities as well as improving information dissemination.

#### 5.5.4 U.S.A. Case: Set-asides increase SMEs engaged, but potentially increases cost, without efficiency gains

The United States provides the main evidence for an examination of setting aside contracts for small business and women owned businesses.<sup>180</sup> The Small Business Act of 1953 first established the goal that small businesses receive a "fair proportion of the total purchase" of the federal government.<sup>181</sup> There is now a government wide goal that at least 23% of all contracting spending go to small businesses, with 5% going to women-owned small businesses. The U.S. has been largely successful in achieving these two goals as shown in the U.S. Small Business Administration's Performance Scorecard below.

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<sup>177</sup> Stake (2013)

<sup>178</sup> ILO (2014)

<sup>179</sup> ILO (2014)

<sup>180</sup> Arrowsmith (2010)

<sup>181</sup> U.S. Small Business Administration (2014)

Prime Contracting Achievement:			89.16%
	2014 Achievement	2015 Goal	2015 Achievement
Small Business	24.99%	23.00%	25.75% (\$90.7 B)
Women Owned Small Business	4.68%	5.00%	5.05% (\$17.8 B)
Small Disadvantaged Business	9.46%	5.00%	10.06% (\$35.4 B)
Service Disabled Veteran Owned Small Business	3.68%	3.00%	3.93% (\$13.8 B)
HUBZone	1.82%	3.00%	1.82% (\$6.4 B)

Source: U.S. Small Business Administration<sup>182</sup>

Still, the U.S. notes that procurement rates often vary widely across industries with rates often low in industries with high levels of procurement, low small business participation rates and/or in areas where there are relatively small amounts of competition and procurement spending is concentrated in a few businesses.<sup>183</sup> As a result, increasing engagement with SMEs will require improved identification of opportunities for smaller lot sizes suitable for SMEs.<sup>184</sup>

However, the use of the single metric: the percentage of total contract value awarded to SMEs is continually debated for its effectiveness. In part because it can be skewed by increases and decreases in overall spending and does not necessarily correlate with the overall efficacy of the small business program.<sup>185</sup> Further, it is coupled with a qualitative concept of 'maximum practicable opportunity', which likely does not coincide with the quantitative goal of 23% and may help agencies justify underachieving on their quantitative goal.<sup>186</sup>

Benefits of a set-aside approach are often debated in the U.S., some studies having concluded that there is little evidence that set-asides produce efficiency gains and at best ambivalent evidence that they promote equity or fairness.<sup>187</sup> While, Denes (1997) argues that the U.S. approach is not more costly due to the competition effects pushing down the price (assuming there are enough suppliers to compete on the given contract).

Regardless of its efficiency, it has been found that the set-aside approach has increased the value of contracts being awarded to small businesses,<sup>188</sup> however, distortions in the market were also evidenced as firms attempted to stay within the SME definitions in order to maintain preferential treatment.<sup>189</sup>

<sup>182</sup> <https://www.sba.gov/contracting/finding-government-customers/see-agency-small-business-scorecards>

<sup>183</sup> U.S. Small Business Administration (2014)

<sup>184</sup> Ibid.

<sup>185</sup> International Trade Center (2014)

<sup>186</sup> U.S. Small Business Administration (2014)

<sup>187</sup> Linarelli (2000)

<sup>188</sup> Glover (2008)

<sup>189</sup> Loader (2013)

## 5.6 Impact Findings Summary

With the wide variety of studies discussed, the key takeaway is that engaging with SMEs through public procurement proves to be beneficial to the firm itself, and often beneficial to the government and the local economy although rigorous analysis of this is limited. Table 6 below summarizes the findings from the various studies.

**Table 6: Impact Findings Summary**

Study Type	Finding(s)
<b>Correlations between procurement system and SMEs</b>	<ul style="list-style-type: none"> <li>- Positive correlation between BPP score and existence of SME initiative</li> <li>- Positive correlation between time to pay suppliers and percentage of contract values going to SMEs</li> <li>- No correlation between SME participation rates and BPP scores</li> </ul>
<b>Non-preferential treatment</b>	<ul style="list-style-type: none"> <li>- In Brazil, winning at least one contract in a quarter increases firm growth 2.2 percentage points over the quarter. Firms experience growth for at least 2 years after winning contract. Firms that win a contract participate in 30% more auctions over next three months</li> <li>- In Uganda, SMEs benefit most from training and professionalization of procurement process however improved information systems were also significant</li> </ul>
<b>Procurement Reform</b>	<ul style="list-style-type: none"> <li>- Improved transparency and access to information saved Philippine city \$200,000 per year and increased participation of SMEs</li> <li>- In Peru, increased transparency and SME training programs led to 20% higher total and per worker profits for participating firms</li> <li>- Improved regulatory framework and new E-procurement system in Cabo Verde increased SME participation to 444 enterprises from an initial 15 as well as raised average one-year growth in sales revenue by 43% for those SMEs winning contracts</li> </ul>
<b>E-Procurement</b>	<ul style="list-style-type: none"> <li>- In Chile, SMEs increased share of contracts won by SMEs 20 percentage points in 10 years</li> <li>- In Georgia, bids submitted increased from 1,923 to 33,000 in one year</li> <li>- In Greece, the government estimates 20% cost savings per tender and 39.7% time savings on open tenders</li> <li>- In Malaysia, access to internet and training to use online tools limited benefits to SMEs</li> </ul>
<b>SME-Specific Assistance</b>	<ul style="list-style-type: none"> <li>- In the U.S. accelerated payment times (from 30 days to 15 days) led to a 7% increase in annual payrolls after 4 years</li> <li>- In Sweden, breaking up lot sizes impacted the size of firms engaged with smaller lot sizes resulting in more micro and small firm participation</li> <li>- In Brazil, after creating a contract threshold, simplifying processes and permitting subcontracting of micro and small enterprises, shares of contracts won increased by 115% in two years</li> <li>- In the U.S. the set aside goal of 23% for SMEs is achieved and increases SMEs engaged with while cost effectiveness is debated</li> </ul>

## 6. Country Case Studies

The following are three in-depth country cases (Republic of Korea, India, and Mexico) detailing the institutional framework and specific efforts made to give preference to SMEs through public procurement and the results achieved thus far. Table 7 provides a summary of the three countries studied in depth.

Of note, there is a potential difficulty in using developed countries as case studies due to the amount of institutional/regulatory/legal foundations already in place which procurement policy is built on. Simply taking a specific policy in place in the UK for example, does not mean it will achieve the same results in a developing country. Implementation in developing countries must consider the varying foundations their policies would be built upon.

**Table 7: Country Case Summaries**

	Republic of Korea	India	Mexico
SME Definition	Average sales over past three years with unique figure for each industry. Example: Manufacturing \$130 million	Investment ceiling categorizes micro, small and medium sized enterprises separately and divided by manufacturing or service enterprises.	Combined criteria of workforce size and annual sizes establish micro, small or medium size status and subdivided by commerce, industrial or service.
Institutions	<ul style="list-style-type: none"> <li>Centralized and Decentralized procurement process.</li> <li>Korean Small and Medium Business Administration supports SMEs.</li> <li>Public Procurement Services (PPS) central government agency in charge of procurement</li> </ul>	<ul style="list-style-type: none"> <li>Largely decentralized procurement process.</li> <li>National Small Industries Corporation coordinates efforts to support SMEs.</li> <li>Public Procurement Bill (2012) at central government level established set-aside goals.</li> </ul>	<ul style="list-style-type: none"> <li>Ministry of Public Administration handles nationwide public procurement.</li> <li>Ministry of Economy establishes policy goals regarding SMEs and facilitates information access for SMEs</li> </ul>
Instruments/ Policies	KONEPS E-Procurement platform, Prompt Payment Reform, Financial assistance, Advanced Payments, SME marketing support, Training services, Contract thresholds, Reserved Products, Multiple Award Schedule for SMEs	E-procurement, Prompt Payment Reform, SME Consortia Formation, Training and Technical Assistance, Reduction of Transaction Costs, Setting up Grievance Cell, Penalties for Payment Delay, Set-asides, Reserved Products, Bid Price Preferences	Streamlining processes, E-procurement, Transparency initiatives, Social Witness (anti-corruption), Prompt Payment Reform, SME online support, Training programs, Financial Assistance, Advanced payments, Public Procurement Fair (marketing), Reserved Contracts, Award Criteria
Gender-specific	Contracting goals for women-owned businesses, Contract thresholds	Reserved products, indirect support through previously disadvantaged populations support programs	Support for women owned enterprises but not specific to procurement
Impact	Share of PPS purchases from SMEs up to 73.9%, 75% of KONEPS contracts won by SMEs.	Expected \$260 billion in public spending directed to SMEs from public sector by 2020.	Six-fold increase in contracts awarded to SMEs since 2009, 67% of contracts (not subject to free trade agreements) won by SMEs, 80% of E-procurement contracts won by SMEs



## 6.1 Republic of Korea

### 6.1.1 General country profile and stats

**Government:** Unitary Presidential Constitutional Republic, founded 1948 following division of Korea after World War II.

**Population:** 50.8 million

**Urbanization:** 92% urbanized

**GDP per capita (PPP):** \$38,000

**GINI:** 30.2 – medium

**HDI:** 0.898 – 17<sup>th</sup> in world

**Unique Features:** Economy averaged an annual 10% growth for 30 years.

In 1960 was one of the poorest countries in the world with a GDP per capita of \$79 - Today most industrialized country in the OECD.

Freely trades with 75% of world's economy

Has world's fastest internet speeds, highest rates of smartphone ownership, and ranks first in e-Government.

The Republic of Korea provides an example of a comprehensive, integrated approach to promoting SME participation in public procurement through the use of a procurement platform along with a wide range of supporting mechanisms. Support for SMEs in Korea is a strong priority, given there are approximately 3.3 million SMEs in Korea, while there are only 2,900 large businesses. 1.8 million employees work for large businesses, while SMEs employ 13 million, or 87.6% of the workforce. An estimated 47.7% of the value added generated by the Korean economy is attributed to SMEs.<sup>190</sup>

### 6.1.2 SME Definition

In 2015, Korea revised its approach for defining SMEs, now using the average sales figures over the past three years and tailoring the cutoff to each industry. For example, the average sales for manufacturing industries is set at ₩150 billion (USD130 million), but is ₩80 billion (USD70 million) for the transportation industry. Korean authorities had found the previous SME definition which focused on number of employees or paid-in capital did not effectively capture the company's output and also enabled the "Peter Pan Syndrome" where a company will refuse to grow to allow it to still be considered an SME.<sup>191</sup>

### 6.1.3 History, Institutional framework and Trade Agreements

Over the last 15 years, increased recognition has been given to SMEs as a key element in achieving a more balanced development of the Korean economy, with public procurement singled out as an important avenue by which to pursue this goal.<sup>192</sup>

Procurement from SMEs is covered by the main procurement legislation<sup>193</sup> and the legal basis of support of SMEs comes from Article 4 of the 'Act on Facilitation of Purchase of Small and Medium Enterprise Manufactured Products and Support for Development of Their Markets', which requires public

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<sup>190</sup> OECD (2016)

<sup>191</sup> Korea WTO (2016)

<sup>192</sup> Jones (2011)

<sup>193</sup> Korea WTO (2016)

institutions to provide SMEs with increased opportunities to participate in the procurement process and to win contracts.<sup>194</sup>

### *Combination of Centralized and Decentralized procurement*

At the national level, medium to large scale procurement i.e. contracts over ~USD200,000, for central government agencies are handled by Public Procurement Service (PPS) while small scale procurements are handled by the individual government agency. Meanwhile, local governments and public enterprises are autonomous in their procurement process

### *Korean Small and Medium Business Administration (SMBA)*

Since its foundation in 1996, SMBA has supported Korea's SME sector. SMBA's primary mission is to support competitive and innovative SMEs to maximize the growth of Korea. SME Certification is conducted annually by the Small and Medium Business Administration according to the terms of Article 27 of the Small and Medium Business Framework Act.

### *Public Procurement Services (PPS)*

Public Procurement Services (PPS) is the central government procurement agency of Korea under the Ministry of Strategy and Finance.

- PPS's main functions are: supplying goods and services for government use; contracting and managing public works; stockpiling 15 types of essential raw and construction materials to secure price stability and supplies; coordinating and auditing government goods and real estate property management; and operating KONEPS – Korea's public e-procurement system.<sup>195</sup>
- PPS had a total procurement volume of 28.8 billion USD in 2014, amounting to about 30% of Korea's total public procurement.<sup>196</sup>
- The PPS handles procurement from SMEs and other socially disadvantaged sectors, such as regional companies and women-owned businesses.<sup>197</sup>

### *Trade Agreements*

Korea maintains free trade agreements with 75% of the world economy including China, the U.S. and the EU – the only G20 country to freely trade with all three of these economies.

Korea has been a party to the WTO Government Procurement Agreement (GPA) since 1997. When it implemented the revised GPA in January 2016, it expanded its procurement commitments by adding entities, including the Fair Trade Commission and several other central government entities, among others.<sup>198</sup>

## 6.1.4 Relevant instruments

An interesting aspect of the Korean procurement policy is the variety of incentives they provide. These include awards, access to financial services, advance payment of contract, among others. These are noted as separate policy instruments and yet the Korean case shows how they can be built into a single

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<sup>194</sup> OECD (2016)

<sup>195</sup> WTO (2016)

<sup>196</sup> OECD (2016)

<sup>197</sup> WTO (2016)

<sup>198</sup> WTO (2016)

strategy in order to enhance the effectiveness of the overarching policy, in this case preferential public procurement for SMEs.

### *E-Procurement*

The Korean Public Procurement Service Authority (PPS) has several initiatives to increase SME participation in government procurement, primarily within Korea's electronic procurement platform, Korea On-line E-Procurement System (KONEPS). KONEPS developed from e-Document interchange in 2000, to e-Bidding and e-payment in 2001, to KONEPS (single portal and e-contracting) in 2002, and now the inclusion of online shopping and mobile bidding.

### *Anti-Corruption – Anti-bid rigging*

The Korea Fair Trade Commission (KFTC) uses bid rigging indicator analysis system, to monitor the public procurement for any evidence of bid rigging. Since January 2009, all procuring entities have to provide the relevant information to the KFTC, allowing the KFTC to identify and investigate potential bid rigging cases.<sup>199</sup> Efforts like this better SMEs' chances of winning a contract they might otherwise have lost to a large firm through bid rigging.

### *SME-specific Assistance*

Korea, unlike the US and many other countries with preferential SME procurement policies, does not use either bid price preferences or set asides to encourage SME participation. Instead the preferential procurement consists of several elements built into the electronic procurement platform, all aimed at promoting and enabling SME participation and chance of success, along with certain products reserved for SMEs.

### *Financial Assistance*

The Korean government provides preferential financial assistance in several forms throughout the procurement cycle:

- Advance payments to SMEs, as much as 70% of the purchase price.<sup>200</sup>
- Fees for various bidding procedures are waived for SMEs.
- SME Network Loan Program
  - Under the Network Loan Scheme, SMEs can borrow from 15 commercial banks up to 80% of the contract sum without security (the security being provided by the Public Procurement Service). At the end of the contract, the loan is repaid directly by the Public Procurement Service.<sup>201</sup>
- SMEs are often entitled to instant payment upon presentation of an accepted invoice – and KONEPS facilitates this payment within four working hours.<sup>202</sup>

### *SME Marketing support*

An "SME Excellent Government Supply Products" award program to increase SME product visibility among all government suppliers, contractors and consultants.<sup>203</sup>

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<sup>199</sup> OECD (2011)

<sup>200</sup> ADB (2012)

<sup>201</sup> Jones (2011)

<sup>202</sup> WTO (2016)

<sup>203</sup> ADB (2012)

### *Training Services*

PPS conducts training for suppliers, usually consisting of a two day course covering public tenders generally and the use of the KONEPS system at a cost of USD 82.<sup>204</sup>

### *Multiple Award Schedule (MAS) for SMEs*

A Multiple Award Schedule (MAS) for SMEs is a simplified process for procurement of recurring, high volume purchases at more competitive pricing associated with volume buying through use of indefinite delivery contracts.<sup>205</sup> MAS works through contracts awarded to multiple suppliers, each offering goods of similar quality, performance and efficiency, thereby allowing more suppliers to participate in the public procurement process.<sup>206</sup>

### *Contract Thresholds*

Large businesses, are restricted from participation in tenders for goods below the WTO GPA threshold.<sup>207</sup> Additionally, within the construction sector, large construction companies are prohibited from forming consortiums, thereby allowing construction SMEs more opportunities to win contracts for parts of these projects.<sup>208</sup>

### *Reserved Products*

A range of products are also reserved to be exclusively provided by SMEs.<sup>209</sup> The Small and Medium Business Administration provides the list of set-aside products to be procured through competition among SMEs. The list includes 204 products that will be reserved for SMEs until 2018.<sup>210</sup> Under the GPA, Korea excludes these products, based on a variety of measures, including the 'Act Relating to Contracts to Which the State is a Party and it's Presidential Decree', which apply to central government entities.

Further, a new technology purchasing assurance program for public procurement of SME technology products encourages public institutions to buy SME technological products approved by the government.<sup>211</sup>

## 6.1.5 Impact achieved

Known results of the policies:

- For the KONEPS product catalogue, in 2008, over 2,000 SME products were listed.<sup>212</sup>
- SMEs participation: 99.5% of the total 191,000 registered bidders on KONEPS are SMEs (as of 2011). Also 97% of the suppliers on the Online Shopping Mall (site for commonly purchased products) are SMEs.
- KONEPS has saved an estimated USD 8 billion annually in administrative costs – mostly through reduced burden on suppliers.<sup>213</sup>

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<sup>204</sup> OECD (2016)

<sup>205</sup> ADB (2012)

<sup>206</sup> OECD (2016)

<sup>207</sup> OECD (2016)

<sup>208</sup> Jones (2011)

<sup>209</sup> Jones (2011)

<sup>210</sup> WTO (2016)

<sup>211</sup> Manchester Institute of Innovation Research (2012)

<sup>212</sup> ADB (2012)

<sup>213</sup> OECD (2016)

- Volumes contracted by KONEPS through use of MAS are reported to have approximated almost US \$9 billion, over 250,000 contracts, during 2008.
- As of December, 2014, 326, 409 items were contracted with MAS, which accounts for 88.5% of total goods registered on KONEPS, totally USD 53.9 million. The number of contractors increased over 80% since 2008, to reach more than 5,000. Further, SMEs account for 98.4% of MAS contractors.<sup>214</sup>
- Integrity perception index of PPS improved from 6.8 to 8.52 out of 10 since launch of KONEPS.<sup>215</sup>
- The share of contracts that go to SMEs through the country’s e-procurement portal rose from 55 percent in 2003, to 75 percent in 2010.<sup>216</sup>
- Between 2011 and 2015, the share of PPS’s purchases from SMEs rose from 66.3% to 73.9% of total procurement of goods and services and construction works of the PPS.<sup>217</sup>
- SMEs increased share of contracts won by competition, acquiring over 50% of contracts in 2013 compared to the 30% share in 2009.<sup>218</sup>

**Table 8: SME Contract performance by competition (USD billions)**

Categories	2009	2010	2011	2012	2013	2014
Competition Contracting	11.4	11.3	12.0	13.4	14.7	11.8
Competition among SMEs	3.5	4.3	5.7	6.9	7.7	6.3
Percentage	30.5%	38.2%	47.8%	51.5%	52.1%	53.7%

Source: OECD (2016)

### 6.1.6 Gender component

Korea is making multiple efforts to engage specifically with women-owned businesses in addition to its previous SME oriented initiatives.

- Article 4 of the Act on Support for Female-owned Businesses instructs, “the head of a public entity shall promote the purchase of goods manufactured and supplied by women-owned small and medium businesses.”
- Article 7 of the Enforcement Decree of Act on Support for Female-owned Businesses sets target goals for procurement from women-owned business at 5% or more of total purchasing value of goods and services, and 3% or more of total purchasing value of construction works.<sup>219</sup>
- For goods tenders, women-owned businesses and businesses with high employment of women are given additional points in the contract fulfilment capability test, boosting the business’ perceived ability to successfully implement the contract.<sup>220</sup>

<sup>214</sup> OECD (2016)

<sup>215</sup> OECD (2015)

<sup>216</sup> Public Procurement Service (2012)

<sup>217</sup> WTO (2016)

<sup>218</sup> OECD (2016)

<sup>219</sup> OECD (2016)

<sup>220</sup> OECD (2016)

- In cases where the contract value is below KRW 20 million (USD17,000) and no supplier is recommended by the end-user entity, PPS directly awards the contract to a woman-owned business recommended by the Review Committee for Recommendations for Small Direct Contracts, which is composed of four women’s associations.<sup>221</sup>

### 6.1.7 Country Takeaways

- Korea is an open, technologically advanced and largely urbanized economy allowing for widespread ICT access for SMEs.
- There is a wide range of instruments used to both level the playing field and give SME-specific assistance that have been developed and launched over the previous decade.
- Korea has seen steady growth of SMEs engaged and contracts awarded to SMEs with upwards of 75% of contracts from the Public Procurement Service going to SMEs and over 50% of contracts from open competition, however preferential treatment is limited due to extensive free trade agreements.
- Unique preferences are provided for women owned businesses.
- Korea’s efforts have also lead to increased competition with more contractors participating and improved perception of government procurement integrity.

## 6.2 India

### 6.2.1 General country profile and stats

**Population:** 1.2 billion - 2<sup>nd</sup> most populous country in the world

**Urbanization:** 31%

**Government:** Federal Parliamentary Constitutional Republic, world’s largest democracy. Achieved independence in 1947.

**GDP per capita (PPP):** \$6,600

**GINI:** 35.1 – medium

**HDI:** 0.609 – 130<sup>th</sup>

**Unique Features:** Market based economic reforms launched and followed since 1991.

Current WTO member and a GPA observer although not a party.

Considered a newly industrialized country

India provides an example of a large, developing economy with a decentralized procurement system that has developed several initiatives in the past 5 years designed to support MSMEs. These initiatives were launched due to the recognition that MSMEs play a crucial role in the socio-economic development of India. The sector includes about 26 million MSMEs,<sup>222</sup> accounts for 12-13% of the country’s GDP, 45% of its manufacturing output and 40% of exports.<sup>223</sup>

### 6.2.2 SME Definition

In India, the government has developed a classification for enterprise size based on sector and invested capital as shown in Table 9 below.

<sup>221</sup> OECD (2016)

<sup>222</sup> Small Enterprise India (2011)

<sup>223</sup> Varhad Group (2013)

**Table 9: MSME Definition**

Classification	Investment Ceiling	
	Manufacturing Enterprises	Service Enterprises
<b>Micro</b>	Up to INR2.5m (USD50,000)	Up to INR1m (USD20,000)
<b>Small</b>	Above INR2.5m up to INR50m (USD50,000 – USD1,000,000)	Above INR1m up to INR20m (USD20,000 – USD400,000)
<b>Medium</b>	Above INR50m up to INR100m (USD1,000,000 – USD2,000,000)	Above INR20m up to INR50m (USD400,000 – USD1,000,000)

### 6.2.3 History, Institutional framework and Trade Agreements

There is no central agency responsible for regulating public procurement at a national level in India and no common legislation governing procurement at different levels of government.<sup>224</sup> The Ministry of Finance in the Central government is responsible for issuing basic guidelines on procurement policies and regulations. Central agencies, like the Central Vigilance Commission supplement this effort by laying down vigilance benchmarks in the procurement system. However, individual ministries can develop their own rules and regulations while implementing their procurement policies.<sup>225</sup> If individual ministries do not have the required expertise to procure goods, procurement may be carried out through the Directorate General of Supplies and Disposal (DGS&D), the central purchase organization, with the approval of the competent authority.<sup>226</sup>

The following measures and practices exist in India to promote integrity in public procurement:<sup>227</sup>

- 1) Codes of conduct for procurement personnel contain conflict of interest regulations.
- 2) There are penal sanctions for corruption in public procurement and companies are removed from the list of registered suppliers.
- 3) Bidders who believe there have been unfair procurement practices can seek judicial review of the decision or can resort to public interest litigation.
- 4) The Right to Information Act of 2005 gives citizens access to procurement decisions in a given time frame.
- 5) Internal and external audits are carried out of agencies that procure goods and services. The external audit information is available to the public.
- 6) Records are kept of all procurement decisions, but there is no set period for retention of these records by various agencies.

There are two primary developments at the national level that benefit SMEs:

- 1) National Small Industries Corporation (NSIC) coordinates efforts for SMEs including preferential public procurement efforts.
  - NSIC registers MSEs under the single point registration scheme. Registration is granted for a fixed period depending on the nature of the goods, and may be renewed upon application.<sup>228</sup>
- 2) The Public Procurement Bill passed in 2012

<sup>224</sup> WTO (2015)

<sup>225</sup> Varhad Group (2013)

<sup>226</sup> WTO (2015)

<sup>227</sup> Kirton (2013)

<sup>228</sup> WTO (2015)



- The policy aims to make it mandatory for all public sector organizations to source a minimum 20% of their total respective procurement from MSMEs from April 2015 onwards.<sup>229</sup>
- Prior to the new policy, in 2009, only 5% of the Central Government and Public Sector Units procurement came from SMEs.<sup>230</sup>

### *Trade Agreements*

India is an observer to the WTO Agreement on Government Procurement.<sup>231</sup>

## 6.2.4 Relevant instruments

In addition to the Public Procurement Bill in 2012, India has recently launched several other initiatives, both as general procurement reforms as well as SME-specific initiatives.

### *E-procurement*

Increasingly, government tenders are displayed on a central website – the Government e-Marketplace. Selection criteria must be stipulated in the bidding document and the winner should provide 'value for money'.<sup>232</sup> All ministries/departments of the central government must use e-procurement to publish all tender enquiries (from 1 January 2012).<sup>233</sup>

The Government e-Marketplace (GeM) includes a complete procurement system for purchase of common use goods and services by government buyers, including payment to suppliers. The system enables online registration of suppliers and government buyers using self-certification and authentication.<sup>234</sup>

### *Prompt Payment*

The Department of Expenditure of the Ministry of Finance, Government of India has issued a directive to all paying authorities to make payments on GeM procurement within a maximum of ten (10) days. It is the responsibility of the buyer/procurement manager to ensure that acceptance or rejection of goods is done within ten (10) days of receipt, else the goods will be deemed accepted.<sup>235</sup>

### *Consortia formation*

India allows suppliers to form a consortium to bid for a contract. This enables groups of SMEs to band together to win larger contracts they would otherwise not be capable of winning on their own. Under the criteria for a consortium to submit a bid, members that qualify (e.g. minimum net worth of 25% of estimated capital cost of project, or at least 15% for project over \$200 million) must have at least 26% share of consortium's equity. Qualifications and experience of other consortium members with small equity holdings are not considered in the selection process.<sup>236</sup>

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<sup>229</sup> Varhad Group (2013)

<sup>230</sup> Varhad Group (2013)

<sup>231</sup> WTO (2015)

<sup>232</sup> Kirton (2013)

<sup>233</sup> WTO (2015)

<sup>234</sup> SME Street (2016)

<sup>235</sup> SME Street (2016)

<sup>236</sup> Garcia (2009)

### *SME-specific assistance*

India includes a wide range of SME-specific initiatives in their public procurement processes. Notably however, the splitting of purchases into contracts of smaller value is explicitly forbidden.<sup>237</sup>

### *Training and Technical Assistance from NSIC*

NSIC provides a range of services to SMEs to better enable their participation in public procurement. Namely:

- Infrastructure and expertise
- Training to entrepreneurs and workers
- Testing and quality control facilities for SME products
- Marketing assistance

### *Reduction in transaction costs*

To reduce transaction cost of doing business, Micro and Small Enterprises are provided tender sets free of cost, exempting Micro and Small Enterprises from payment of earnest money and security deposit.<sup>238</sup> They are also exempt from paying bid guarantees while submitting their offers and performance guarantee when the contract is awarded.

### *Setting up of Grievance Cell*

A Grievance Cell is set up in the Ministry of Micro, Small and Medium Enterprises for redressing grievances of MSMEs in Government procurement, including imposition of unreasonable conditions in tenders floated by Government Departments or agencies that put MSMEs at a disadvantage.<sup>239</sup>

### *Penalties for Payment Delay*

In India, the parliament approved an Act that seeks to compensate SMEs against delay in payment. Under the act, the purchaser is liable to pay interest to the SME at a rate of 5% higher than the prevailing bank rate, if payment is delayed beyond 90 days.<sup>240</sup>

### *Set-asides*

The government set an annual goal of procuring a minimum of 20% of goods and services from micro entities and SMEs in India.<sup>241</sup> The order also earmarked a sub-target 4% procurement of goods and services, out of the 20% from MSEs owned by Scheduled Caste or Scheduled Tribe entrepreneurs.<sup>242</sup>

### *Reserved Products*

Reservations exist for MSEs and for certain products. MSEs receive purchase and price preferences in procurement by central Government ministries/departments and CPSEs. Under the purchase-preference system, 358 items have been reserved for exclusive procurement from MSEs and 20 items for exclusive manufacturing in the micro- and small sectors.<sup>243</sup>

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<sup>237</sup> WTO (2015)

<sup>238</sup> WTO (2015)

<sup>239</sup> Ministry of MSMEs (2012)

<sup>240</sup> Linarelli (2000); Varhad Group (2013)

<sup>241</sup> ADB (2012).

<sup>242</sup> WTO (2015)

<sup>243</sup> WTO (2015)

### *Bid Price Preferences*

Also in India, the purchase-preference system offers price preferences of up to 15% to MSEs over the quotations provided by large-scale industries. They are however provided on a tender by tender basis as the procurement official has discretion to award a preference when they believe it necessary. It is not the intention of the policy that SMEs should be able to charge higher rates in public purchasing or that the purchaser should pay premiums regardless of the needs of the SMEs participating in the procurement in question.<sup>244</sup>

### 6.2.5 Impact achieved

A review committee has been set up to monitor the policy's implementation and effectiveness. The mandatory set aside did not come into effect until April 2015. However, SMEs are expected to gain \$260 billion (INR 17 trillion) of additional opportunity between 2014 and 2020 from the public sector, with the implementation of the Public Procurement Bill.<sup>245</sup>

### 6.2.6 Gender component

In India, 90% of women are employed in the informal sector where 70% of the women are involved in the agriculture sector.<sup>246</sup> The central government has reserved all items of hand-spun and hand-woven textiles for exclusive purchase from women in khadi and village industries commission (KVIC). Government has also reserved all items of handloom textiles including Barrack Blankets for exclusive purchase from KVIC or notified handloom units through the Association of Corporations and Apex Societies of Handlooms and Women's Development Organization.<sup>247</sup>

India also has various initiatives in place to support previously disadvantaged populations. It is recognized that there are some complementary features between these policies and the MSE preferential procurement policy. For example, among registered MSEs, 10.73% are owned by Scheduled Castes/Scheduled Tribes<sup>248</sup> entrepreneurs, 38.7% by Other Backward Classes<sup>249</sup> and 13% by Women entrepreneurs - all of which are previously disadvantaged groups the government would like to support.<sup>250</sup>

### 6.2.7 Country Takeaways

- India has a largely de-centralized procurement coupled with a massive MSME population (26 million estimated) making a centralized policy agenda perhaps more difficult but still recognized as needed.
- MSME procurement legislation was passed 2012, so changes are still relatively recent.
- Procurement reforms including e-procurement platform have been implemented along with multiple SME-targeted instruments. All have been implemented in past decade.

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<sup>244</sup> Linarelli (2000); Varhad Group (2013)

<sup>245</sup> Varhad Group (2013)

<sup>246</sup> Kirton (2013)

<sup>247</sup> Kirton (2013)

<sup>248</sup> traditionally disadvantaged populations

<sup>249</sup> socially and educationally disadvantaged castes

<sup>250</sup> Government of India (2011).

- Impacts to date are largely unclear but there is \$260 billion expected from public sector directed to MSMEs between 2014-2020 and more SMEs to be included through Set-aside goals.
- India is working to incorporate more women but struggles given the often informal nature of their work. As a result, it is recognized that efforts towards formalization may be a required first step to supporting women owned enterprises.

## 6.3 Mexico

### 6.3.1 General country profile

**Government:** Federal Presidential Constitutional Republic

**Population:** 119,000,000

**GDP per capita (PPP):** \$18,800

**GINI:** 48.2

**HDI:** 0.756

**Unique features:** 11<sup>th</sup> largest economy in the world by PPP.

WTO member but not a party or observer to GPA.

Series of procurement reforms launched following 2008 financial crisis.

Mexico provides an example of a recently reformed procurement system that has included several elements designed to incorporate SMEs. The targeted inclusion of SMEs in government purchasing has the potential to help address the issue of economic dualism, bringing technical development, skilled jobs, and overall productivity increases to the often excluded SME sector.<sup>251</sup>

### 6.3.2 SME Definition

**Table 10: MSME criteria**

Size	Sector	Workforce size	Annual sales (millions of pesos/millions USD)	Maximum combined limit*
<b>Micro</b>	All	Maximum 10	Up to \$4 / Up to \$0.2	4.6
<b>Small</b>	Commerce	11-30	\$4.01 to \$100 / \$0.2 to \$5	93
	Industrial and Services	11-50	\$4.01 to \$100 / \$0.2 to \$5	95
<b>Medium</b>	Commerce	31-100	\$100.01 to \$250 / \$5 to \$12.5	235
	Services	51-100	\$100.01 to \$250 / \$5 to \$12.5	235
	Industrial	51-250	\$100.01 to \$250 / \$5 to \$12.5	250

\* Maximum combined limit = (Workforce size x 10%) + (Annual sales x 90%)

Source: Agreement for the establishment of the stratification of Micro, Small and Medium sized businesses. June 2009

SMEs represent more than 99% of Mexico's formal companies and provide between 49.7% (industry) and 86.1% (services) of formal jobs.<sup>252,253</sup>

<sup>251</sup> Silva and Scott (2014)

<sup>252</sup> OECD (2013)

### 6.3.3 History, Institutional framework and Trade Agreements

Mexico has undergone transformational reforms in its federal public procurement system, re-orienting it around principles of delivery for results and focus on outcomes, and away from overarching processes and compliance procedures. Previously, the Mexican procurement system was noted for its inefficiency, lack of transparency, corruption, lack of governmental capacity and an outdated e-procurement system. Starting in 2009 a series of reforms were implemented to reduce costs as well as launch a new e-procurement system.<sup>254</sup>

#### *Institutional framework*

In Mexico, the agency in charge of public procurement nationwide is the Ministry of Public Administration (SFP). The national public procurement system law is the Public Sector Acquisition, Leasing and Services Act passed in 2000 and amended in 2009.<sup>255</sup> Government procurement processes and the contracts themselves are governed by the Constitution (Article 134), the Law on Public Sector Procurement, Leases and Services (LAASSP), the Law on Public Works and Related Services (LOPSRM), the Law on Public-Private Associations, the Mexican Petroleum Law, and their corresponding regulations.

Beginning in 2008 with the financial crisis, Mexico instituted a series of policy initiatives aimed at reforming the procurement system and increasing the participation of SMEs in public procurement. This includes a formal effort to include MSMEs by invitations to bid for federal contracts and development of a law that pushes all federal level agencies must work to procure at least 35% of all goods, services and public works (not subject to free trade agreements) from SMEs.<sup>256</sup>

#### **Law for the development of the competitiveness of micro, small and medium sized enterprises** (Ley para el desarrollo de la competitividad de la micro, pequeña y mediana empresa)<sup>257</sup>

*“The planning and execution of policies and actions to promote the competitiveness of SMEs must ...encourage the agencies of the federal public administration and its delegations in the Federal States and the Federal District to procure gradually goods, services and public works to SMEs until reaching a minimum of 35% of all goods, services and public worked procured”*

Also in January 2009, the Inter-Ministerial Commission on Procurement from SMEs was created to recommend and propose measures to all Federal agencies and departments in order to increase SME participation.<sup>258</sup> The commission works to facilitate coordination between the various players, in particular the Ministry of Public Administration (SFP), the Ministry of Finance (SHCP), the Ministry of Economy (SE) and the National Development Bank (NAFIN). The commission focuses on three axis, 1) strengthening of institutions, 2) development of tools, 3) normative changes.<sup>259</sup>

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<sup>253</sup> In contrast to the above size criteria, the National Institute for Entrepreneurs (INADEM) is implementing a definition for ‘high impact entrepreneurs’ – this being a start up enterprise that alters the environment in which they work. This definition is meant to better direct resources to where economic impacts will be maximized.

<sup>254</sup> <http://www.worldbank.org/en/results/2013/04/03/mexico-moves-to-results-based-procurement-system>

<sup>255</sup> SELA (2015)

<sup>256</sup> OECD (2013); WTO (2013); Del Olmo, Personal Interview, Feb 28, 2017

<sup>257</sup> OECD (2013)

<sup>258</sup> WTO (2013); Del Olmo, Personal Interview, Feb 28, 2017

<sup>259</sup> Del Olmo, Personal Interview, Feb 28, 2017

The results of these efforts thus far has led to procurement reforms, SME specific tools as well as the creation of the Compras de Gobierno unit in the Ministry of Economy that sets policy goals for the other federal agencies including goals for the percentage of procurement spending that should go toward SMEs. The various ministries then often use bidding by invitation to engage SMEs, in some cases based on previous experiences, in order to reach their respective goal. This is as opposed to a public tender which is open to all competitors.

### *Trade Agreements*

Mexico has not signed the WTO Agreement on Government Procurement and does not participate as an observer in the WTO Committee on Government Procurement.<sup>260</sup> Government procurement provisions are also included in Mexico's trade agreements with European Free Trade Association, Central America, Chile, Costa Rica, Colombia, Canada, the United States, Israel, Japan and the European Union.<sup>261</sup>

The use of trade agreements alters the contracts available for SME preferential procurement, with the aforementioned 35% goal applicable only to contracts not subject to free trade agreements.

### *SME specific Obstacles*

In addition to the obstacles that faced the procurement system as whole there are several that still exist and have been identified as particularly cumbersome to SMEs. These include:<sup>262</sup>

- Corruption
- Transparency
- Complicated and numerous procedures
- Lack of preparation/experience of SMEs
- Obtaining guarantees
- Obtaining financing
- Timely payment uncertainty
- Resistance to risk

CONCAMIN notes the need to standardize procedures to better enable SME participation. The Ministry of Economy unit of Compras de Gobierno reiterates these obstacles, pointing out that in surveys with SMEs access to financing and corruption continue to be leading issues for their participation in public procurement and overall engagement with the government. Additionally, the National Institute for Entrepreneurs (INADEM) noted in its survey of over 28,000 enterprises that obstacles varied based on size of firm. Notably the top problem experienced by micro enterprises was a lack of credit, while for small and medium enterprises the top problem was the high taxes they have to pay.<sup>263</sup>

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<sup>260</sup> WTO (2013)

<sup>261</sup> WTO (2013)

<sup>262</sup> Martin, Email Correspondence, Mar 3, 2017

<sup>263</sup> Martin, Email Correspondence, Mar 3, 2017; Gonzalez, Personal Interview, Mar 3, 2017; Del Olmo, Personal Interview, Feb 28, 2017

## 6.3.4 Relevant instruments

### *Streamlining Processes*

With the procurement reforms in 2009, several steps were taken regarding how procurement is conducted in general as well as how it enables SME participation.<sup>264</sup>

- Eliminated 586 procurement regulations and rationalized application of excessive and complex laws
- Improved clarity to the sanctions regime and dispute resolution frameworks
- Applied framework agreements, consolidated purchases and reverse auctions
- Established the procurement intelligence unit, a strong skills development and certification program
- Access to tenders free of charge for SMEs

### *E-procurement and Transparency*

Compranet is the name of the federal government e-procurement system. Since the reform of Mexican procurement law in 2009, it is now required that Mexican federal public administrations use Compranet. This website publishes information such as annual procurement programs, tender procedures (solicitation documents, minutes of the clarification meetings and of the opening of tenders), contract awards history and formal complaints as well as electronic submission of bids.<sup>265</sup> This also includes posting information about the suppliers including their products, services, business history, etc.<sup>266</sup> Compranet has significantly helped SMEs access information about opportunities.

### *Social Witnesses*

In Mexico, since 2009, social witnesses<sup>267</sup> are required to participate in all stages of public tendering procedures above certain thresholds as a way to promote public scrutiny. While this instrument may be of less relevance to SME contracts, it still helps strengthen the institutions and increase trust. In 2014, these thresholds were MXN 336 million (approx. USD 25 million) for goods and services and MXN 672 million (USD 50 million) for public works.<sup>268</sup>

### *Prompt Payment Reform*

As a part of the 2009 reforms, the maximum time for making a payment to suppliers was reduced to 20 days from the previous 45 days.<sup>269</sup> Issues with implementation of this reform have still occurred, as the process to validate payment compliance can be arduous for SMEs.<sup>270</sup> Further, public purchases are sometimes not aligned with budget availability creating lags in payment times.

### *SME online support portal*

An online portal specifically for SMEs was created in 2010, called 'Compras de Gobierno' housed within the Ministry of Economy. The portal provides a variety of information regarding the procurement

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<sup>264</sup> <http://www.worldbank.org/en/results/2013/04/03/mexico-moves-to-results-based-procurement-system>

<sup>265</sup> OECD (2015)

<sup>266</sup> Silva and Scott (2014)

<sup>267</sup> Social witnesses are NGOs and individuals selected by the ministry of public administration (SFP) through public tendering.

<sup>268</sup> OECD (2015)

<sup>269</sup> Del Olmo, Personal Interview, Feb 28, 2017

<sup>270</sup> Martin, Email Correspondence, Mar 3, 2017



process and access to various resources. It also provides an MSME calculator to help firms determine if they are eligible for preferential treatment, based on the criteria included in Table 9 shown above.

### *Government training*

The professionalization of public procurement has been developed in Mexico. The Government Contracting Standards Unit trains government officials in order to update and develop their knowledge of the regulations having to do with public procurement financed with federal funds or with loans from international financial bodies.<sup>271</sup>

### *Training for SMEs*

SMEs receive training on areas such as business management, exports, and the use of Compranet 5.0. In 2010, the Ministry of Economy awarded 4,500 scholarships to be trained on Compranet 5.0.<sup>272</sup> CONCAMIN believes that these trainings could be expanded for SMEs, and in particular, creating a series of online training courses to maximize firms trained.

### *Financing options*

NAFIN provides financing support through an online platform (Cadenas Productivas) to facilitate factoring services for SME suppliers. This factoring allows suppliers (90% SMEs) to use their accounts receivables from large creditworthy buyers to receive working capital at a small discount.<sup>273</sup> The suppliers are able to rapidly receiving this working capital, often the same day it's sought, allowing it to overcome potential liquidity issues and maximize the available capital it can use on other productive, revenue producing contracts. This can also help reduce the risk of long payment terms on contracts and maximize growth potential for the suppliers.

NAFIN also administers the National Credit Guarantee Program to increase commercial banks' net credit lending to SMEs, lowering interest rates on loans. While this program is viewed favorably by many market players, some such as CONCAMIN have said it is not exploited to the extent it could be.<sup>274</sup>

### *Advanced payments*

Special flexibilities for SMES in order to receive higher advanced payments from public entities for goods which have a production process of more than 60 days.<sup>275</sup>

### *Public procurement fair*

The government annually organized a public procurement fair, Expo Compras del Gobierno, for suppliers to provide guidance and training for SMEs on becoming government suppliers, contributing to development of their business.

The expo includes the participation of the 17 federal secretariats and 94 decentralized institutions, as well as the largest government purchasers such as Petroleos Mexicanos (PEMEX) and the Mexican Social Security Institute (IMSS).<sup>276</sup> The Expo promoted 65,000 enterprises from 2009-2013.

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<sup>271</sup> SELA (2015)

<sup>272</sup> OECD (2013)

<sup>273</sup> Martinez, Personal interview, Mar 3, 2017

<sup>274</sup> Martin, Email Correspondence, Mar 3, 2017

<sup>275</sup> OECD (2013)

<sup>276</sup> SELA (2015)

### *Contracts reserved for SMEs*

At least 50% in value of the contracts issued under the exception to public tender for low value must be awarded to SMEs.<sup>277</sup> Additionally, other public tenders may be exclusively reserved for SMEs, however it serves more a provision to allow such actions rather than dictating when and how contracts will be reserved.

### *Award Criteria*

Award criteria can be used in two situations. The first being the more common, essentially a tie breaker scenario giving preference to national SMEs in case of a tie with a larger firm.<sup>278</sup> Additionally, award criteria may be given to SMEs that produce goods with technological innovation. This instance is more up for interpretation.<sup>279</sup>

## 6.3.5 Impact achieved

Results from SME-targeted assistance:

- Six-fold increase in contracts awarded to MSMEs since 2009, moving from 17,660 million pesos in 2009 to 110,017 million pesos in 2016. The 2016 figure surpassed the goal for that year by 5% however, the goal set by the government has plateaued since 2014 in recognition they have limited room to expand SME participation under current systems.
- NAFIN extended over \$136 million in factoring financing in 2016 with over 90% going to SMEs and an estimated 30% of factoring opportunities coming from government entities contracting with SMEs.<sup>280</sup>
- Purchases from SMEs are dominated by public works projects, generally accounting for 80-90% of contracts by value.<sup>281</sup>

According to the data the target of 35% of procurement from SMEs, for those contracts not subject to FTAs was achieved.<sup>282</sup> In fact, in 2015, the federal government reached figures of 67% of contracts not subject to free trade agreements going to SMEs and a total spending of Mex\$105,401 million.<sup>283</sup> However, not all entities achieved their individual goal. Out of all procurement, SMEs were able secure about 16% of contract value in Mexico as of 2014.<sup>284</sup> The limited change in contracts awarded to SMEs since then suggests a similar present figure.

From 2013 – 2016, government purchases from SMEs has plateaued, while still achieving their annual 35% goal. The Unit of Compras de Gobierno notes they have reached a point where they are looking for additional ways to benefit SMEs without being unnecessarily cost prohibitive. This includes looking at including an SME subcontracting requirement for larger companies that win contracts.

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<sup>277</sup> OECD (2013)

<sup>278</sup> OECD (2013)

<sup>279</sup> Silva and Scott (2014)

<sup>280</sup> Silva and Scott (2014); Martinez, Personal interview, Mar 3, 2017

<sup>281</sup> Del Olmo, Personal Interview, Feb 28, 2017

<sup>282</sup> WTO (2013)

<sup>283</sup> Del Olmo, Personal Interview, Feb 28, 2017

<sup>284</sup> <http://www.elfinanciero.com.mx/economia/licitaciones-y-compras-del-gobierno-escasas-en-pymes.html>

Results from Procurement Reform (SME specific):<sup>285</sup>

- Compranet, launched in 2010, now has over 177,000 SMEs registered. 9 out of 10 businesses that register on Compranet are SMEs. 46% of those who bid on a contract in their first year, and 26% win a contract in their first year.
- The value of Compranet for SMEs is further shown in that 80% of contracts reported on Compranet are awarded to MSMEs.

Results from Procurement Reforms (non-SME specific):<sup>286</sup>

- Costs saving strategies and e-procurement systems have generated significant results and savings of US\$1 billion in three years (Dec. 2009 – Dec. 2012, based on audited expenditures).
- Increased the number of governmental entities with a certified procurement department, organized to support performance budgeting in the future, from none in 2010 to 322 in January 2013.

Potential Negative Effects:

- The process of bidding by invitation often used by Ministries, while effective in increasing the contracts awarded to SMEs also has the potential negative effect of reducing competition, leading to higher costs for government and risk of corruption. CONCAMIN believes a more open competition would be better along the lines of the Colombian system.<sup>287</sup>
- In a survey of SMEs participating in NAFIN's financing programs, the SMEs claimed their major limiting factor is still having enough money and access to money. Further they also claim that corruption limits them.<sup>288</sup>
- On the government side, Ministries have acknowledged that increased administrative costs of managing smaller contracts rather than awarding a single contract to a large company.

### 6.3.6 Gender component

There are no women specific procurement preferences; in part because the government says they are not yet able to gather sufficient data to determine women owned enterprise eligibility.<sup>289</sup> Other women specific support mechanisms do exist through INADEM and NAFIN, just not specifically relating to public procurement access. INADEM includes award criteria when determining projects they will support – women owned enterprises receive additional points over their male counterparts. NAFIN also has developed a women specific credit opportunity (Mujer PYME) for women that have started a small or medium sized company.

### 6.3.7 Country Takeaways

- The public procurement reforms in Mexico, including several MSME preferential policies were all implemented following the financial crisis and within a 2 year time span.
- Multiple federal agencies are coordinating the SME procurement instruments including Ministry of Economy, Entrepreneurship Institute, and the National Development Bank although all under the guidance of the Compras de Gobierno unit within the Ministry of Economy.

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<sup>285</sup> Del Olmo, Personal Interview, Feb 28, 2017

<sup>286</sup> Silva and Scott (2014)

<sup>287</sup> Martin, Email Correspondence, Mar 3, 2017

<sup>288</sup> Del Olmo, Personal Interview, Feb 28, 2017

<sup>289</sup> Del Olmo, Personal Interview, Feb 28, 2017

- Since implementing the reforms, Mexico has seen a six-fold increase in contracts awarded to MSMEs since 2009 although this has begun to plateau in the past couple years.
- Data collection on participating SMEs is limited although it is noted as being an area of great interest for government entities as well as other market players (e.g. CONCAMIN).
- Struggles with corruption and access to finance continue to major obstacles to SME participation.

## 7. Lessons Learnt

Based on the experiences in the country cases and the evidence of impact of various procurement initiatives, several primary lessons learnt can be outlined that can help other governments avoid potential pitfalls, pursue opportunities, and better understand existing efforts.

1. 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.
2. Public procurement can be used to address socio-economic policy agendas, with varying results being achieved. In some cases, aspects of corruption or informality pose greater obstacles. Balancing agendas and strengthening institutions must be considered and in some cases prioritized.
3. Procurement reforms are best by efficiency standards, but direct SME-targeted assistance is best for maximizing 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 based on Benchmarking Public Procurement surveys. They have all been found to be beneficial to SMEs as well with varying cost effectiveness for the government.
7. The gender component of public procurement is often ignored or forgotten, but worthy of addressing.

### 7.1 Need better data collection

In many cases, the preferential procurement programs resemble the clients they are meant to support: having limited resources, outdated technology and a lack of managerial capabilities.<sup>290</sup> As a result, these programs have a lack of data collected to effectively monitor and evaluate their performance. Baseline data is often lacking including such information as the number of beneficiaries of a program. Building data collection processes into the implementation of a new policy will support the government's ability to learn about their efforts and maximize the benefits. This need is especially pronounced in cases of SME-targeted assistance where there is risk of increased costs being born by the government.<sup>291</sup> Using such tools as annual economic surveys and open contracting principles<sup>292</sup> that include information on the size of the firm, its growth and its participation in tenders could prove beneficial.

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<sup>290</sup> Lopez-Acevedo and Tan (2011)

<sup>291</sup> Nicholas and Fruhmann (2014); Lopez-Acevedo and Tan (2011)

<sup>292</sup> <https://www.open-contracting.org/what-is-open-contracting/global-principles/>

## 7.2 Difficulty in managing wide ranging procurement goals

Public procurement is a multi-objective policy tool addressing both economic and social agendas. However, many governments continue to struggle to find the balance between these often competing goals, such as improving efficiency while improving SME access to procurement contracts.<sup>293</sup> Still, some tools discussed such as e-procurement and professionalization of the procurement process have shown promising results in terms of achieving the dual objectives.

## 7.3 Procurement reforms best by efficiency standards

Procurement reforms are often noted for their general efficiency and benefits provided to the procuring entity, but they also tend to help level the playing field supporting the engagement with SMEs. However, in many economies, SMEs are so far behind in their ability to compete that SME targeted assistance may be needed to help support their development and in fact, these forms of assistance have proven effective in their ability to engage SMEs.

## 7.4 Winning procurement contracts supports growth and employment

While it may not be surprising that accessing an additional source of demand, in this case the government, can prove beneficial to a company's growth, it was rigorously proven in a study involving SMEs in Brazil. This will serve an important reference point for policymakers around the world debating the effect of supporting SMEs through public procurement.

## 7.5 Best Practices of Developed Countries not always best for Developing Countries

Several countries in Africa including Uganda, Tanzania, Kenya, among others, have struggled under a centralized procurement system largely inherited from the colonial models. The demands of a developing economy have led to some of these economies moving towards a decentralized practice subject to centralized regulation as an alternative.<sup>294</sup> This serves as but one example where the models implemented in one country are not necessarily suitable elsewhere. A deep look at the local context must be taken in order to implement the most effective practices.

## 7.6 Occurrence of SME incentives

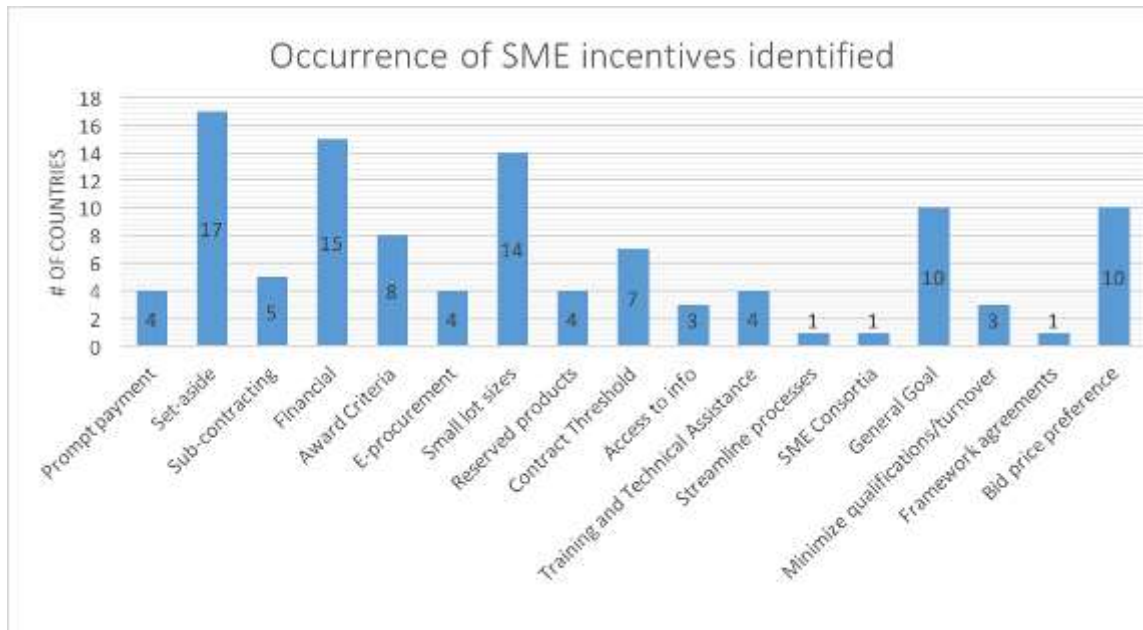
Of those countries in the World Bank's Benchmarking Public Procurement survey that identified the existence of an SME incentive, the incentives cover a wide variety of tools, however tending to be focused on Set-asides, Financial assistance, smaller lot sizes, and Bid-price preferences (See Figure 13). The other common incentive identified, General Goal (an indicator used for the purpose of this report), was less a specific incentive as it was an expression of the government's desire to support SMEs through procurement.

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<sup>293</sup> Uyerra and Flanagan (2009); Kattel and Lember (2010)

<sup>294</sup> Agaba and Shipman (2007)

**Figure 13: Occurrence of SME incentives**



Source: Adapted from World Bank (2016b)

### 7.7 Still much to be done to improve gender component

There continues to be a need for more proactive policies to include women owned businesses in public procurement. As described by Kirton (2013) “adding a gender dimension to public procurement and trade issues represents a commitment to achieving gender equality where it matters most - in policies governing the flow of economic resources.” This includes targeted efforts at capacity building for women in areas of education, training and business development skills which often limit their ability to engage with the government and its bidding requirements.<sup>295</sup>

## 8. Good Practices for Engaging SMEs

Lastly a few Good Practices are identified, taking into account the just discussed lessons learnt, and combining these lessons with the initial policy considerations described in Part 3. These good practices will better enable the efficient and effective inclusion of SMEs in public procurement, maximizing their benefits, and in many cases, also improve the functioning of the government itself.

1. Coherent, comprehensive, coordinated legal and regulatory framework
2. Centralized, E-procurement portals
3. Minimizing ‘size’ discrimination i.e. those aspects of the procurement process that inherently favor a larger company
4. Evaluate 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
6. Understand the sectors SMEs tend to work in and capabilities they have/need to determine if preferential treatment will be beneficial

<sup>295</sup> Kirton (2013)

## 9. Future Research Needs

### 9.1 Need more studies

In general, there is a need for more studies. This ties into the aforementioned lesson learnt, that governments have to improve their data collection relating to preferential procurement policies. Without this improved data collection, the studies simply will not happen. For example, more data on the size of procurement markets and SME's/women's participation in these markets could serve as first step.

#### 9.1.1 Preferential SME treatment studies

There are often times assumptions of increased cost, reduced transparency, from pursuing socio-economic goals in public procurement such as preference to SMEs and women owned enterprises.<sup>296</sup> Similarly, it is often assumed that increased engagement of SMEs is necessarily better for society. However, there is a persistent lack of studies attempted in this area, making concrete claims about efficacy and positive impacts more difficult.

This will require more experimental and quasi-experimental studies of the costs-benefits of SME preference as well as require more time to better understand the results of policies, particularly given that many of the existing preferential procurement policies are relatively new.

#### 9.1.2 Non-preferential SME Treatment studies

In addition to understanding the SME-specific policy impacts, there is also a greater need for understanding how the procurement process in general relates to SME participation. For example, studying the correlations between the Benchmarking Public Procurement data and SME costs-benefits. Further, there are many countries that have relatively high SME engagement with little to no SME-specific preferences being given. Understanding how these high rates are achieved could impact the types of policies worth implementing.

#### 9.1.3 Women specific

There is very little study of women specific preferential procurement policies and the corresponding impacts of such policies. This will require a combination of both improved data collection both before and after preferential policies are implemented, as well as the corresponding studies of this data.

### 9.2 Need to understand diversity within SMEs

In focusing on the SME as a singular economic sector, studies have often overlooked the disparities in capabilities and behaviors within the SME sector. By overlooking potential differences, it creates an impression of uniformity.<sup>297</sup> As Flynn et al. (2015) point out, "continued reliance on SMEs as the unit of analysis means that significant differences within the SME population will remain hidden." Targeted assistance that benefits a small business may be of little benefit to a medium sized business and what benefits a micro enterprise may in fact work against medium sized enterprises. It is unlikely that a single policy remedy for SMEs will have the desired effects across the entire sector.

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<sup>296</sup> Erridge (2005)

<sup>297</sup> Flynn et al. (2015)



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