

**SMALL AND MEDIUM-SIZED ENTERPRISES POLICIES IN PUBLIC  
PROCUREMENT: TIME FOR A RETHINK?<sup>1</sup>**

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**ABSTRACT.** This paper will consider the rationale and effectiveness of SME-support policies in the award of public procurement (PP) contracts. One group of economic justifications for SME policies derives from the notion that awarding PP contracts to SMEs (and micro-enterprises) encourages innovation, entrepreneurship and so contributes to job creation, economic growth and can support local and regional developments to the benefit of wider society. The link between SMEs, innovation and economic growth has often been assumed in PP policy-making. While some studies show higher growth rates in small than larger firms, others indicate, to the contrary, that many micro and small enterprises, and particularly informal businesses, are not actively seeking to grow. This paper will assess how effective SME policies may be, and questions the extent to which they are properly evaluated.

**INTRODUCTION**

Günter Verheugen, Member of the European Commission, Responsible for Enterprise and Industry, said in 2006, “Micro, small and medium-sized enterprises (SMEs) are the engine of the European

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economy. They are an essential source of jobs, create entrepreneurial spirit and innovation in the EU and are thus crucial for fostering competitiveness and employment ....” (EC/Enterprise and Industry, 2006, frontispiece). Looking beyond the EU, SMEs “constitute the vast majority of business establishments, are usually responsible for the majority of jobs created and account for one third to two thirds of the turnover of the private sector” (OECD/UNIDO, 2004). As a result, governments of countries at all levels of economic development pursue policies to support SMEs (Storey, 1999).

This paper will consider the economic rationale behind such SME policies, how they may be pursued through public procurement, and whether and how their effectiveness can be evaluated. It will conclude with some considerations for policy-makers in public procurement. It will not analyse social and political justifications for SME policies per se, though it is acknowledged that righting historical disadvantage and supporting minorities in public procurement can have consequential economic benefits.

The two main economic policy considerations revolve around (a) improving SME participation in the public procurement market, with a view to enhancing competition and hence value for money, and (b) awarding more procurement contracts to SMEs, with a view to encouraging entrepreneurship and innovation, and thereby job creation, economic growth and development to the benefit of wider society. While this paper draws heavily on authoritative works on SME policies, it is not intended to provide a comprehensive survey of the economic literature on the subject. Rather, it seeks to highlight some of the published findings on the scope and impact of SME policies, and to urge policy-makers to seek and consider empirical evidence and move to policy, rather than the other way around.

#### **STATISTICS ON SMES AND THE PUBLIC PROCUREMENT MARKET**

The volume of statistics on SMEs in many systems amply demonstrates that SMEs overall constitute the overwhelming majority of all enterprises (to report on them in detail exceeds the scope of this paper, but an example is found in EC, 2003). For example, in the EU, 99.8% of enterprises in the non-financial sector are stated to be SMEs (representing 67% of the total non-financial employment), and 92% of the total business sector is estimated to be micro-enterprises, with fewer than 10 employees (de Kok et al., 2011). SMEs comprise

over 99% of the UK's 3.8m businesses, and provide 56% of its private-sector employment and 52% of total UK turnover (Small Business Service (SBS), 2004, cited in Zheng, Walker, & Harland, 2006). In South Korea, the statistics show that SMEs comprise 99% of businesses and 88% of private-sector employment (Government of Korea, 2011); in South Africa, 55% of private sector employment, and 22% of GDP (Kauffmann, 2005, and cited in Kim, 2011). In the US, SMEs constitute 99.7% of all businesses, generate 46% of private, non-farm GDP, and smaller SMEs employ 34.9% of all private sector workers (US Census Bureau, 2007).

There are varying definitions of SMEs: OECD/UNIDO (2004) note that SMEs are defined in the literature most commonly by reference to employment, due to the simplicity of the measure and the ease of collection of data (the OECD and US generally use a measure of under 500 employees, the EU 250). Many systems use a broader definition in practice, e.g. in the EU, where SMEs are those with fewer than 250 employees, provided that their turnover and assets are below certain limits (EU, 2008), although EUROSTAT statistics are presented by reference to employee numbers only (EU, 2014). A similar approach is employed in the standards used by the US Small Business Association (SBA) to classify SMEs (though the SBA is not concerned with public procurement). Hence the figures in the preceding paragraph are not directly comparable, even before accounting for the different level of development in the countries and regions concerned, though a general conclusion that most businesses are "SMEs" can be drawn.

It is also clear that SMEs' share of the public procurement market is below their proportion of total enterprises: in the EU, for example, SMEs secured 35%-35% of contracts by value in 2006 and 2007, and 42% in 2008 (EU, 2009); and between 53% and 78% of contracts by volume (EU 2008). This is not a recent trend: Bovis (1998) argued that market access is also limited for SMEs. The situation is similar elsewhere: the US SBA estimates that 21.89% of contracts were awarded to SMEs in 2009 (SBC, 2010), whereas in Canada since 2006-2007, over 43% of the total value of contracts on average was awarded to SMEs (Government of Canada, 2014).

Within the overall numbers and using a more flexible approach to what is an SME, the EU (in a report on SME access to public procurement) notes that SMEs' access to public procurement varies

from one Member State to another, but that overall they are awarded 18% lower contracts than their overall economic share calculated by turnover (EU, 2009). Behind these aggregated data, however, the position varies as between micro, small and medium-sized enterprises: “medium-sized enterprises do not seem to be unduly under-represented in public procurement,” but “the relative significance of micro and small enterprises lags considerably behind their actual role in the real economy”. The percentage lags are 2% (medium-sized, i.e., with up to 249 employees), 5% (small, i.e., with 10-49 employees) and 11% (micro, i.e., with up to 9 employees) (EU, 2009; European Commission, 2013).

#### **ECONOMIC (AND OTHER) JUSTIFICATIONS FOR SME POLICIES**

These overall conclusions of under-performance are taken as evidence of market failure that justifies intervention. Estimates of the value of the total public procurement market vary, but according to the OECD “governments in OECD member countries spend on average 12% of their GDP on public procurement (excluding procurement by state-owned utilities)” (OECD, 2011). Variations are considered to reflect the different size of the state, its role in the economy and the existence of high-value infrastructure and similar projects, and range from 15% of GDP (the Netherlands, the Czech Republic and Iceland) to under 7% (Mexico, Chile and Switzerland) (ibid, 2008 figures). The figures consequently appear to justify intervention on a significant scale: Storey (2006, also cited in Freeman, 2013) estimates that the annual total financial support for SMEs in the UK is equivalent to £7.9 billion per annum -more than is spent on the police force or universities.

A separate area of rationale for SME support policies arises from cited economic benefits of SMEs over enterprises in general, such as that SMEs add value and promote innovation (Carter et al., 1999, Erridge et al., 1998, and Hoffman et al., 1998, as cited in Zheng, Walker, & Harland, 2006); that SMEs are more adaptable and responsive to the needs of purchasers (Zheng, Walker, & Harland, 2006) and support the creation of new supply markets, and respond to supply market dominance and fragmentation (Caldwell et al., 2004); that there are benefits to local economies from local sourcing (Walter, 2005, NERA, 2005 (and cited in Zheng, Walker, & Harland,

2006). At the micro-economic level, SME support can contribute to individual business sustainability (Zheng, Walker, & Harland, 2006).

The economic rationale is linked closely to social motivations (McQuade & Johnson, 2003, Ram et al., 2002, cited in Zheng, Walker, & Harland, 2006), including public relations and reputational value for enterprises contracting with local SMEs, and minority-support policies that lie at the heart of the US SBA and South African Black Economic Empowerment policies. Perhaps as a consequence, the policy goals behind SME policies are frequently stated in very broad and political terms (as the quotations in the introductory paragraph to this paper indicate).

Indeed, a recent report into SME access to public procurement in the EU concludes a statistical overview saying that “it is important to highlight that SMEs’ share of the value contracted for contract below €300,000 in fact slightly exceeds the corresponding figures for real economy. However, this is more than offset by the huge disadvantage they (micro and small enterprises primarily) have in accessing larger contracts. Whilst one would not expect the largest contracts to be won by SMEs, they could eventually win more lower-value contracts to have their ‘fair share’ of public procurement overall” (EU, 2009). Gibbs (2000), in a paper entitled “SME policies, academic research, and the growth of ignorance, mythical concepts, myths, assumptions, rituals and confusion,” highlights that along with the substantial growth in SME research and publications there has been a parallel growth of ignorance, and that “mythical concepts” and “myths” are used as a basis for key areas of policy development.

#### **DATA ON SME POLICIES**

This lack of clear policy goals is, unsurprisingly, reflected in the data available on SME policies themselves. This situation was already identified over a decade ago; when considering whether bank lending to SMEs was insufficient, the UK’s Bank of England sought to “bring facts into debates typified by anecdote, assertion and assumption” (Bank of England, 2004, cited in Freeman, 2013). Freeman adds that “a close examination of the academic, regulatory and commercial literature regarding SMEs and their role in the economy remains riddled with poor thinking and muddled conclusions, problems compounded by a plethora of issues relating to the availability and quality of relevant data.” Zheng, Walker, and Harland (2006),

Karjalainen and Kemppainen (2008) and Dalberg (2011) have all noted the relatively limited extent of empirical data.

Zheng, Walker, and Harland, citing the SBS and other sources from the UK, note that many policies are presented in descriptive terms rather than by reference to measurable objectives or goals. A later example can be found from the European Commission, which says that SMEs policies are mainly concentrated in five priority areas, covering: “the promotion of entrepreneurship and skills; the improvement of SMEs' access to markets; cutting red tape; the improvement of SMEs' growth potential, and strengthening dialogue and consultation with SME stakeholders” (EU, 2014).

While these objectives may be desirable policy objectives, achievements are effectively immeasurable without targets or benchmarks. The literature reveals few targets, though notable exceptions are found in the US, which has a policy goal of 23% awards by value to SMEs (SBA, 2010), and the UK (25% by 2015, UK Government, 2014).

A first issue, therefore, is to identify what we can learn about the use of SME policies that may be of use to policy-makers. Much literature on SMEs participation in public procurement has tended to review SMEs as a group. That is, the data are aggregated data, rather than broken down by market sector, SME type or size, nature of the public purchaser, or refer to differing business goals, owners' backgrounds, levels of available technologies, skills and experiences, and regions in which SMEs operate. In addition, there is a significant focus on the social aspects of SME purchasing (from minorities, etc, which are key elements of policies in the US and South Africa) (Zheng, Walker, & Harland, 2006). Research at this aggregate level gives little insight into what may motivate individual procuring entities and buyers to purchase from SMEs (Curran, 2000), and what factors influence their individual decisions (Zheng, Walker, & Harland, 2006); decisions of procuring entities may be influenced by variable characteristics, such as spend portfolios, priorities, cultures and stakeholder requirements (Caldwell et al., 2004).

However, as Storey (2008) notes, the situation is gradually improving. For example, a recent EU Report provides a comprehensive set of data at the regional level; it contains an analysis of SME under-performance in public procurement contracts, which is broken down by country, type of government awarding body,

contract size and whether the contract was for goods, services or construction, and by procurement method. The overall trend reflects the unsurprising proposition that the larger, more complex contracts are rarely won by micro and small enterprises (EU, 2009). Nonetheless, although the report starts with a chapter breaking down SMEs by industry sector, the analysis of under-performance in procurement is not broken down this way; in addition, the surveys of suppliers and procuring entities do not appear to have enquired into the different award proportions per sector, though they do identify a limited number of obstacles that have differing impact on micro, small and medium-sized enterprises (and many of these obstacles are reported by all sizes of enterprise). In addition, the EU notes that data for different periods are not fully comparable (EU, 2009), a finding repeated in many other studies.

Indeed, in 2000, Curran had already reported on data difficulties and obstacles to the quantitative evaluation of policies: he cited quantitative methodologies that do not adequately account for net positive outcomes (“additionality”), as deadweight (i.e. outcomes that would have occurred without the policies concerned) and displacement (firms outside the policy cease to trade, have lower sales or employment, or have higher costs). A lack of matched control samples as a result of the heterogeneity of SMEs was indicated by Storey (1999); difficulties of selection bias and low or biased response rates are evident. These factors also mean that deadweight is the most difficult element to evaluate – precisely the factor that policy evaluation should address if it is to be meaningful. Although qualitative alternatives have been employed to seek to improve this situation, they are essentially add-ons to quantitative research. Curran’s overall conclusion that “there will always be a high level of uncertainty in estimating outcomes and impacts of [SME] policies” would not seem to have changed significantly. Indeed, a general policy of deregulation may have perverse consequences in that some SMEs now slip below the reporting obligations that allow statistical evidence to be gathered (Freeman, 2013).

#### **NEED FOR SME POLICIES: MARKET FAILURES AND SME SUPPORT**

The World Bank and IFC consider that the theoretical justification for SME support lies in “market and institutional failures that bias the size distribution of firms, rather than on any inherent economic

benefits provide by small firms” (WB/IFC, 2000). Adapting Storey’s 2008 analysis of forms of market failure relevant to SME policies to the public procurement context, there are several types of failure that may justify market intervention. However, while market failure has long been noted as a necessary precondition for government intervention, it is not a sufficient one: intervention is justified only where the results will improve welfare (Storey, 2008). This issue will be considered below, after a description of the failures themselves and common policies applied to mitigate them.

The first group of market failures arise, adapting Storey (1999), as SME owners do not realise the benefits of participating in the public procurement market, and do not fully appreciate the benefits to their business of taking steps such as workforce or management training and promotion activities, which would allow them better access to this market. This is indicative of inadequate information (EU, 2009; ADB, 2012; Smith et al., 2001). The EU has also recognized that poor information about procurement opportunities can close markets to SMEs, and that inadequate information on procurement regulations and requirements are a major impediment to SME participation in procurement (Mishory, 2013). Similar findings are reported in Karjalainen and Kempainen (2008, citing Fee, Erridge, & Hennigan, and ECEI, 2014). Indeed, Fee, Erridge, and Hennigan (2004) argue that inadequate access to information is the most significant barrier to SMEs’ performance generally. The EU, however, has found more recently that information about procurement opportunities is less of an issue than information on tenders themselves (ambiguous requirements, late information, and a lack of debriefing, for example... (EU, 2009). Lack of information about the procurement process itself, such as the mandatory legal requirements and associated procedures that all participants must follow, also presents obstacles to SMEs (EU, 2009).

A further limiting factor is the costs of participating in public procurement, which are noted as being 10-50% higher than for comparable projects in the private sector (Fee, Erridge, & Hennigan, 2002, cited in Karjalainen & Kempainen, 2008, Smith et al., 2001, UK Government consultation, 2013). These costs disproportionately affect SMEs, in part because many are fixed (ECEI, 2014; ADB, 2012). Indeed, a 2010 study found that the costs of regulation per employee are 36% higher for small than medium-sized and large



firms in the USA (ADB, 2012). The costs themselves are derived from the disbursements required in the procurement process (including tender securities and performance bonds, inspection fees, registration and document fees) and the time and resources involved in complying with rigorous and protracted procedural requirements, such as registration, production of detailed tender information (e.g. regarding minutiae of prices) and large volumes of documents (ADB, 2012; Karjalainen & Kempainen, 2008; Fee, Erridge, & Hennigan, 2002).

SMEs are also noted as suffering from tender preparation periods that are too short (ECEI, 2014) to provide sufficient time to bid (EU, 2009). Bovis (1998) also cited the lack of language skills in technical areas of tendering as a further obstacle to SMEs (in Karjalainen & Kempainen, 2008), a finding also evident in the 2009 EU Report – SMEs do not have tender-writing specialists, and are less experienced in the task. This report also highlighted an over-emphasis on price in evaluation, disproportionate qualification and other criteria. Although interaction with the procuring entity was noted to have improved over recent years, SMEs as a group considered further reforms in this area would be among the most pressing (EU, 2009).

After the selection process is complete, a winning supplier can expect to be confronted with complex contract management procedures and dispute resolution processes (ADB, 2012), and the costs and cash-flow implications of funding the projects concerned until payment - the payment period in the public sector is significantly longer than in the private sector (ADB, 2012, Intrum Justicia, 2013).

Other issues relate to the manner in which the procuring entities manage contracts and SME participation. Here, an observed tendency is towards larger contract sizes and contract aggregation through framework agreements and similar tools (EU, 2014). For example, the value threshold above which the statistics indicate that SMEs underperform is in the range of €300,000 to €1m (EU, 2009). While noting that the median size varies among member States, a recent report states that the median contract size above thresholds should be accessible for SMEs, but that this median has increased recently from about €330,000 to €928,000 (EU, 2009). Even by 2003, the US equivalent of framework agreements accounted for nearly 30% of federal public procurement; the value of one type of framework agreement alone rose from \$4bn in 1992 to \$32.5bn in

2004 (Gordon et al). The literature on economy and efficiency in procurement routinely notes an increasing use of framework agreements, purchasing consortia and centralised purchasing agencies to aggregate purchases and enhance value for money. Bundling is also claimed to be administratively efficient (Clark & Moutray, 2004; ADB, 2012), though more recent studies are indicating that there are trade-offs in terms of meeting the needs of certain procurers, and where framework agreements used as the purchasing tool are sub-optimally set up and used (Nicholas, 2011). The pressures of financial austerity and shrinking procurement budgets is, for example, part of the reason for an ever-greater use of framework agreements in this context. SME surveys report a significant impact through bundling (EU, 2009; ADB, 2012), and aggregation has been considered to be “bad news for SMEs” (Smith et al., 2001). The “bad news” arises in two ways: bundling or aggregation at the geographical level or through grouping types of purchases excludes SMEs that do not cover all necessary areas or ranges (Bovis, 1998; EU, 2009), and through larger orders that exclude SMEs who do not have the requisite capacity or capital (Morand, 2003; EU, 2009; Zheng, Walker, & Harland, 2006).

SMEs surveyed also highlight risk aversion on the part of procurement officials as a significant barrier to participation (EU, 2009). Zheng, Walker, and Harland cite studies pointing to issues with professionalism in procuring entities, trust between SMEs and procuring entities, and a lack of technical expertise in applying socio-economic objectives because of a lack of understanding of their implications and impact on purchases themselves (citing Ruth et al., 2002; Dollinger et al., 1991; Drabkin & Thai, 2003). These issues increase the apparent risks of contracting with SMEs. Procurement officials also have fiduciary duties as regards public moneys (ECEI, 2014), which may translate into stringent financial and experience requirements that disfavour SMEs (ADB, 2012). This may also be a paradoxical result of measures to enhance transparency and accountability, as individual procurement officials seek to avoid censure for sub-optimal outcomes. At the institutional level, some compliance requirements on suppliers may have little to do with performance risk in a public procurement contract, but are designed to avoid political risk (contracting with “undesirable” suppliers with convictions for tax evasion, for example). In terms of the demand side, where innovation could be encouraged, procurement officials

are cited to be reluctant to retreating from the tried-and-tested, “safe” solutions, specifications and suppliers (Georghiou, Edler, Uyarra, & Yeow, 2013), leading to a perception that the “nobody ever got fired for choosing IBM” rationale remains a real barrier (Smith et al., 2001).

#### TYPES OF INTERVENTIONS TO SUPPORT SMEs

Storey (2008) sets out an analytical basis for distinguishing the types of intervention that may mitigate these obstacles and those that may be used to pursue overall goals. A key distinction in policy can be observed: measures may seek to lower barriers or to offer support. Many governments pursue a mixture of both measures, whose goal should arguably be to encourage participation (and hence the potential for competition in the public procurement market concerned) (UNCITRAL, 2012).

To start with the “barrier” side, measures in the public procurement sphere may seek to reduce unnecessary regulations and/or to mitigate their impact. Extrapolating from the World Bank’s *Doing Business Surveys* (citing the 2006 study), Storey (2008) categorises two policy options: first, policy-makers can seek to lower the impediments to business creation or small-firm expansion (broadly speaking, the approach of the USA, Canada and perhaps New Zealand). Secondly, policies can seek to provide direct assistance to compensate for the burdens or impediments (broadly speaking, the situation in the EU, which has relatively high impediments to starting a business in particular). Storey also notes that the situation in developing countries is often characterised by both high impediments and low direct assistance, an interesting finding given the many statements about the importance of the SME sector in those countries. Drawing on Lundstrom and Stevenson (2005), Storey concludes that there is considerable diversity in approaches to reduction of administrative burdens.

The legal framework for public procurement will include provisions on eligibility and qualification, descriptions of contract terms and specifications, and evaluation criteria, each of which have the potential to fall disproportionately on SMEs. In recognition of this general proposition, the 2014 EU Directives on public procurement introduce new measures to counter the burdens involved: first, self-declarations in matters of qualification are being introduced, with the

declared aim of primarily benefitting SMEs. Secondly, the evidence of financial capacity of the supplier that can be required is to be limited as a general rule: for example, that for turnover requirements may not exceed a maximum of twice the estimated value of the contract (EU, 2014).

Other programmes seek to eliminate unnecessary qualification requirements: for example, the UNCITRAL Model Law on Public Procurement (which includes procedurally simpler methods for smaller-value procurement) provides for tender securities, but the Guide to Enactment that accompanies Model Law discourages imposing tender securities routinely, on the basis that the formalities and expenses concerned may discourage the participation of suppliers. It adds, “the procuring entity should consider all the implications of requiring tender securities (positive and negative), on a case-by-case basis, prior to deciding whether or not to require them”, and suggests that guidance and regulations should provide examples to assist whether a tender security could be excessive safeguard and where it would be justified, by reference to contract value, performance risk and so on (UNCITRAL, 2012). Other policies may encourage international standards, testing and other requirements to be applied in a more user-friendly way, and to use functional, output-based rather than technical, input-based specifications, and less price-dominated evaluation criteria (EU, 2009); all these measures have been cited as pro-SMEs because their benefits will accrue proportionately more to SMEs. At a more practical level, rules designed to ensure objectivity, clarity and transparency in specifications can be supported by tools to improve and standardise documents and terminology. The EU requires the use of its common procurement vocabulary (CPV, adopted by Regulation (EC) No. 213/2008), to standardise specifications and other elements of descriptions of what is to be procured. The UN operates a similar scheme – the United Nations Standard Products and Services Code (“UNSPSC”). These tools are designed to establish “a shared and common understanding of a product domain” (Leukel & Maniatopoulos, 2005), and so address the information asymmetry of SMEs. Other measures include addressing possible SME weaknesses in terms of technical and financial capacity, by allowing joint bidders to fulfil requirements, improving dialogue between procuring entities and suppliers, engaging in post-submission qualification, and so on (EU, 2009). However, many procuring entities indicate that their time

and resources, and a lack of concrete SME policies, do not allow for the full benefit of these types of scheme to be realised (EU, 2009). A further constraint may be risk aversion, considered further below.

A wide range of economy-wide administrative requirements may be incorporated into the public procurement sphere by reference. These include the need for licences, and compliance with health and safety, employment, environmental and other requirements. Requirements such as outmoded or unnecessary regulations; technical requirements that limit entry unnecessarily or serve as disguised tools for excluding competing suppliers (i.e. regulations that are non-discriminatory on the surface but are subtly discriminatory in their substantive requirements) and poorly designed regulations that are desirable in principle but unnecessarily intrusive, have long been recognised as detrimental to participation in markets and hence competition (WTO, 1998, in Anderson, Kovacic, & Müller, 2011). The European Commission has established a high level expert group to consider reductions of specific disproportionate regulatory burdens on business (thereby covering SMEs as well). However the EU approach only focuses on so called “regulatory burdens” - costs imposed by reporting and monitoring obligations under EU legislation. As of today no EU-wide model for measuring compliance costs has been established (EC, 2007). The 2009 EU Report noted that SMEs frequently do not comply with necessary requirements, some of which are technical or relate to health and safety, and some relate to sustainability, equality and diversity policies (EU, 2009). To this can be added the displacement time spent in complying with rules (time spent with tax officials, for example the World Bank, [2014]).

A related area of concern involves integrity measures in the procurement system that can have the unintended effects of limiting market participation. For example, expansive civil and criminal strictures against fraud in public procurement markets may create asymmetries between public and private contracting (Anderson, Kovacic, & Müller, 2011).

Other measures designed to reduce information asymmetry include the improvement of transparency in public procurement. UNCITRAL discusses the need to implement transparency requirements in a way that allows meaningful access in the prevailing circumstances; this may be particularly relevant in the context of developing countries as well as micro-enterprises in all systems,

which may have lower technical resources than other SMEs (UNCITRAL Guide, 2012). The European Commission has been seeking to increase “access to information on procurement opportunities” and the “transparency of public procurement requirements,” in its three revisions to the Public Procurement Directives over the last 15 years (EU, 2014).

Many commentators have noted that improving regulations does not generally involve significant social cost (e.g., World Bank, 2014). However, as the legal framework is generally permissive rather than prescriptive, permitting less onerous requirements alone will not achieve the desired policy objective: meaningful guidance along the lines suggested by UNCITRAL and other measures to reduce risk aversion will be necessary for successful implementation. In addition, it is important not to equate better regulation with less regulation: the World Bank’s Doing Business indicators are predicated on the notion that economic activity requires “good rules and regulations that are efficient, accessible to all who need to use them and simple to implement” (World Bank, 2014). Hence some indicators give a higher score for more regulation (e.g. transparency measures) and others for simplified regulations (such as a one-stop shop for business start-up formalities) (ibid).

Measures aimed at better regulation are unlikely to be recorded within the approximately £8bn assessed to be the annual cost of SME policies in the UK (Freeman). While no studies have been found directly addressing the costs of improving regulation, there will be costs in terms of designing and bringing in new regulations, but it is at least arguable that the benefits of better regulation will have a positive contribution to overall welfare. However, and as Storey has argued, the concept of market failure (here, regulation discriminating against SMEs in fact) does not guide the appropriate scale or envisaged length of intervention (Storey, 1999). A relevant consideration here is the cost of “regulation churn”, that is the costs of introducing and complying with new regulations, which should be evaluated when new policies are proposed; once the desired policy goal is achieved, the policies should cease. Freeman cites a Bank of England finding regarding lending to SMEs, though recent news items indicate that the issue continues to attract much political attention. The more obvious costs include the expenses directly incurred in changing systems and monitoring; indirect (opportunity) costs may

arise where resources are diverted from, say, putting together good offers to the public sector to learning the new regulations will be harder to identify and measure.

Moving to the support side, Piga (cited in ADB) records that SMEs consider the unbundling of large contracts as critical to increasing their access to public procurement. While in theory the use of procurement procedures that allow for partial offers coupled with appropriate selection of lot sizes might theoretically enhance SME opportunities (UNCITRAL Guide, 2012), there is little evidence of this in practice. However, the 2014 EU Public Procurement Directives encourage contracts whose value exceeds €500,000 to be split into smaller lots, to be more SME-friendly, and require procuring entities to explain why they opt out of structuring a contract into lots in this way (EC, 2014). Interestingly, the EU Final Report did not identify the use of smaller lots as one of the more helpful tools that could be introduced (EU, 2009). UNCITRAL, too, has provisions in many procurement methods (including framework agreements) that allow suppliers to compete for part only of a procurement contract, and permits the use of multi-supplier framework agreements, both of which techniques can facilitate SME access (UNCITRAL, 2011, UNCITRAL, 2012; EU, 2009). The Korean online purchasing system (KONEPS) includes a Multiple Award Scheme for SMEs, with simplified processes for purchases of high-volume, repeated products (ADB, 2012).

Nonetheless, the general trend towards aggregation may mean that procuring entities are unlikely to take advantage of any available power to allow for partial offers or unbundle contracts. In addition, key procurement officials and oversight entities need to focus on the highest-value contracts and those at greatest risk and not those in which SMEs may be interested; indeed, the extent of business with SMEs may not even be measured (Smith et al., 2001), so SME exclusion is unlikely to be acted upon. No macro-economic empirical studies into the long-term effects of aggregation on SMEs and competition generally in public procurement were identified, though some commentators consider the opportunity costs of excluding suppliers from the market, and the potential for oligopolies or even monopolies to arise if the market concentrates as a result of aggregated purchasing by dominant purchasers (Graells, 2011, Albano, 2010). UNCITRAL encourages public procurement agencies

to coordinate with competition agencies and share data on relevant trends (UNCITRAL, 2012).

Technical assistance and outreach to SMEs can address the second of the “information gaps” above. Within the EU, there are several schemes at the national level: France has a programme entitled “Practical guide for SMEs” and an association called “PactePME”; the UK has training courses offered through “Supply London”, local council website, face-to-face meetings, and tender resource packs for example (EU, 2009). Part of the USA’s Small Business Administration programme is to sponsor and participate in conferences and training designed to enhance SME participation in public procurement (ADB, 2012); in South Korea, the “SME Excellent Government Supply Products” award programme is designed to increase SME product visibility, and to include SME products in the KONEPS database (ADB, 2012). Other measures with similar aims include enhanced information distribution networks, the use of e-procurement systems and e-catalogues, targeted training and outreach. While many studies cite the rise in e-procurement tools and techniques as benefitting SMEs through enhanced transparency and efficiency (EU, 2009, for example), others indicate a lesser effect particularly on micro-enterprises and those in developing countries (an example given is South Africa (Zheng, Walker, & Harland, 2006)). Zheng, Walker, and Harland also cite earlier studies identifying limited use of the e-marketplace by SMEs beyond email and Internet for information-gathering and communications; a recent EU report also indicates some limits to the observed benefits of e-technologies, though with an indication that the position is improving and the drive towards full e-procurement should continue (EU, 2009).

Programmes to mitigate the impact of lengthy delay in payment under public procurement contracts on SMEs include direct financing measures. For example, in South Korea, the Public Procurement Service Authority (PPS) provides advance payments for goods contracts, and an SME network loan programme (ADB, 2012). In addition, the KONEPS system is designed to pay accepted invoices in four hours (Public Procurement Service, 2014).

A further set of interventions seeks to go beyond barrier removal and support measures. These range from subcontracting programmes to price-preferences and set-asides. These measures are directly aimed at SMEs, and to that extent are restrictions on



competition. An initial consideration, therefore, is whether they are legally permitted. Many public procurement systems are regulated on the basis that the system should afford equality of treatment to all enterprises, so that “size cannot be a criterion in comparisons of tenders” (Karjalainen & Kemppainen, 2008) or, indeed, in any part of the design of and selection in the procurement procedure. Examples at the international level include the EU Procurement Directives, which set out an express principle of equal treatment (in the 15th recital to the 2004 Directives, for example); and one of the WTO GPA’s two “cornerstone principles” is non-discrimination. The World Bank Procurement Guidelines set out a general consideration that the Bank will give all eligible bidders from developed and developing countries the same information and equal opportunity to compete in Bank-financed procurement (January 2011 version). Although these “international” procurement texts are aimed at preventing discrimination at overseas suppliers and apply over certain thresholds, to limited sectors of the economy and to limited groups of nationals, the extent to which affected governments can apply price preferences or similar measures to support national SMEs is limited. A different approach is found in UNCITRAL, which is a template for national procurement systems rather than an international agreement or regulation of a donor programme. UNCITRAL’s Model Law includes the objective of “fair, equal and equitable treatment”, but permits the use of price preferences and set-asides, subject to compliance with international constraints and rigorous legal justification and transparency safeguards (UNCITRAL, 2011; 2012).

Where such direct assistance programmes are permitted, the advantages cited are that they support SMEs directly through creating and sustaining demand, and provide quick and visible benefits to SMEs. Some systems – such as in the US and South Africa, which base their SME policies on targeted assistance for economic and social reasons – set targets for awards to SMEs using a flexible combination of price preferences and set-asides, (and in the case of the US), require procuring entities to justify deviations from the policies concerned (ADB, 2012). This process has high administrative costs, arising from the use of classes and sub-classes of programmes, for which there are strict eligibility requirements, and the extent of justification for deviations. In the EU, where such policies at the national level would not be permitted, quasi-quotas including “community benefit clauses” to require the employment

of local trainees, unemployed persons or other community building benefit can be applied in limited circumstances (EU, 2009).

### MONITORING AND EVALUATING SME POLICIES

Storey (2008) identified a series of steps to assess SME policies, under a “COTE” framework, which involves policy clarity and coherence (“C”), specified objectives (“O”), measurable targets (“T”), and evaluation (“E”). However, he indicates that the “massively diverse” SMEs policies are not evaluated in practice at least partly for political reasons: partly because the “C”, “O” and “T” elements are lacking; also because governments do not want SME policies to be evaluated (Storey, 2008; Nightingale & Coad, 2011). Some issues relating to “O” and “T” have been canvassed above; some thoughts on “C” and “E” follow.

As regards “C”, clarity and coherence, The UK Audit Commission referred to SMEs policies as “a patchwork quilt of complexity and idiosyncrasy” (Audit Commission, 1989; echoed by Storey (1994). SME policies should be simple and consistent, but in practice there is a bewildering array of them, at all levels of government, the effect of which is to impose rigorous qualification standards (and hence exclude many SMEs) (Storey, 2008) More generally, SME policies are said to have been implemented piecemeal and poorly (Storey, 1998), a finding subsequently echoed by Georghiou et al. (2013).

At a more detailed level, some of the literature surveyed distinguishes between new SMEs and established SMEs when assessing the impact that administrative requirements may impose on new firms as compared with established ones. The effects of reducing more stringent financial and experience requirements – such as reducing the number of years’ of required annual returns, tax compliance and previous contracts – may support financially less robust new SMEs proportionately more than established SMEs, as will reducing the costs of supplying tender securities. On the other hand, measures reducing the disproportionate tendering procedures and costs will benefit established as well as new SMEs. Policy-makers should be encouraged to decide whether they wish to target either or both groups; nothing in the literature surveyed indicates that policy-makers are heading down this path.

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, SMEs policies are merely pro-growth policies clothed in politically encouraging language (Freeman, 2013). Back in 2000, Curran identified some of the issues that inadequately targeted SME policies may raise, arising from a key finding: the low level of take-up of SME policies – many outreach initiatives rarely exceeding a 10% take-up, and often much less. The issues indicate insufficient targeting, in three key respects: first, there was a perception that the support provider did not understand the business at issue. This perception was not clearly rooted in the nature and quality of the programmes, which were often carefully designed with appropriate professional input. Curran suggested that the obstinacy of the SME-owner and fear of losing personal autonomy may have been a partial cause; the SME owner's strong commitment to autonomy may also explain documented lack of growth ambitions. A second aspect was the "top-down" nature of the contents of outreach and training policies, much of which were distilled from large management practice and standard academic works. A third aspect stemmed from administrative convenience: governments favoured (and continue to favour) standardised approaches that are easy to cost, administer and monitor. In this regard, Curran suggests that even where the case for national measures is difficult to justify, local, better-targeted programmes may be more productive. Gibbs (2000) discusses the definitive work of Bennett and McCoshan (1993) supporting bottom-up development and local ownership as indicators of success in SME programmes, but notes an absence of such an approach at the time. The outreach programmes in EU countries described above may be indications that this lesson is finally taking hold.

More generally, SME policies in public procurement are not pursued in isolation. "Socio-economic policies" as summarised in the UNCITRAL Guide to Enactment include SME policies, community participation in procurement, strategically placed contracts, sustainable development environmental policies, and it is noted that they "may be aimed at a specific sector or general development, environmental improvements, enhancement of the position of disadvantaged groups and economic factors" (Guide, 2012), echoing a point also made by Erridge (2004). Zheng, Walker, and Harland

note that there is limited knowledge of how to apply such policies systematically in purchasing decisions (citing Maignan et al., 2002), and that there will inevitably be tensions among the policy objectives including as between regulatory, commercial and socio-economic goals (as in Erridge, 2004).

A pertinent example can be seen in the context of contract aggregation as described above. Since value for money in procurement – often considered the primary goal of procurement systems – may indicate aggregation, and SME policies may indicate disaggregation, a review of the implementation and interaction of the policies at a detailed level is warranted. In a “Study to identify options to ensure that the Government’s ICT and SME policies are mutually reinforcing” (Government of Australia, 2013), the detailed consideration showed that the policies themselves were suitably aligned, but that there were problems in their implementation, such as a failure to take advantage of the ability to cap liability under ICT contracts that would facilitate SME participation. This example may be instructive, and policy-makers may also need to consider risk aversion particularly where efficiency and individual performance are included as goals of the public procurement systems concerned.

As regards “E”, evaluation, the literature on SME policies in procurement indicate that surveys of suppliers and procuring entities are noted as generally effective at identifying market failures and the obstacles to SMEs, as the above analysis makes clear. However, in the context of public procurement and incentives to innovation, the policy solutions are considered not to address these barriers adequately (Georghiou et al., 2013), a finding that would be of significant concern if relevant to all SME policies. Hence more enquiries of stakeholders on the impact of SME policies are also indicated.

The long shopping-list of possible policies to support SMEs set out above have been well ventilated in the literature, but there appears to be little evidence on the economic efficacy or otherwise of them (at both the aggregate and detailed levels), beyond small increases in some measures of contract awards to SMEs (EU, 2009, for example). Indeed, Smith and Hobbs (2001) asserted that only a limited number of SMEs were able and willing to sell to the public sector in the UK; a Small Business Service (SBS) survey in 2006 found only 7% of UK SMEs were interesting in collaborating with the public sector (in

Karjalainen et al.); an earlier survey by the same grouping in 2004 had placed the figures at 14% (Zheng, Walker, & Harland, 2006). Whether this decrease is simply a data anomaly or the beginning of a trend and, if so, why, would merit examination.

Better regulation or de-regulation may reduce the administrative burden on SMEs, such as through relaxation of reporting requirements, reducing compliance with the regulatory requirements implied into public procurement procedures noted above, and other deregulation measures (EC, 2007). However, even deregulation can involve unintended costs. An ad hoc example from Austria may illustrate the problem: when postal services were deregulated, installing new post boxes was required. The costs of so doing were completely unknown at the time, though a model to assess them has now been designed. As direct intervention policies have the potential for even more costs than deregulation and other support measures, they should perhaps receive primary attention, and the administrative costs should not be ignored.

An initial mitigating step would be to enhance the collection of relevant data. As noted above, a primary objective in the procurement context is to enhance participation in procurement opportunities. From this perspective, data on awards are only a proxy for identifying participation. Although the SBS survey in 2006 highlighted pre-qualification and tendering processes as the most significant disincentives to participation, all empirical studies identified for this paper since that point continue to focus on award of public procurement contracts as the key determinant of whether or not the regulatory simplification measures noted above are working. (It appears that this is to some extent a forced measure, because of the limited data that are available.) A recent EU report recommends, for example, that an SME-marker (identifying whether a supplier is a micro, small or medium-sized enterprise) should be included in EU contract notices (EU, 2009), so as to improve the information base. It is suggested that this information should be collected from all participants downloading or otherwise requesting tender documents. That information could be analysed against the nature and number of suppliers in the relevant market, by reference to the typology applied in competition policy to determine markets.

Assessing the level of contract awards nonetheless may be a key indicator of broader SME policies pursued using public procurement

as a vehicle, a strategic use of public procurement that has become more accepted, reflecting an increasing awareness of the wider impact of public procurement decisions on “supply markets, local economies and society” (Zheng, Walker, & Harland, citing Walker, 2005). The World Bank has found, however, that while a large SME sector is characteristic of successful economies, the data do not indicate that SMEs have a causal impact on growth (World Bank, 2004). Indeed, the link between SMEs and GDP growth may be a truism: given the high numbers of SMEs in economies at all levels of development, any per capita GDP growth must be to some extent attributable to SMEs.

An example of the difficulties found in identifying causation is the use of SME policies to encourage job creation and/or economic growth through developing an “enterprise culture” and innovation. Here, too, there are some Gibbsian myths and policy confusions (initially identified in Curran, 2000), conflating SMEs, innovation and enterprise. Wong, Ho and Autio (2005) (among many others) note that SMEs create a substantial number, and perhaps the majority, of new jobs, citing studies in USA, Sweden and Canada, which may simply reflect the proportion of SMEs in the economy. (It should be noted that Wong, Ho and Autio (2005) do not consider SMEs *per se*: their focus is on SMEs as a vehicle for entrepreneurship). Statements on the issue are often made at the political level, without empirical justification and in some cases relying on sources that may have an interest in promoting SMEs (Curran, 2000). In ADB, 2012, for example, it is asserted that “according to the SME Finance Forum [no reference given], [SMEs] are crucial for growth and job creation, accounting for nearly 86% of employment opportunities in developing countries.” ADB continue that it is now well-established that SMEs play an important role in job creation and are positively associated with GDP per capita growth, citing Beck et al. (2004).

Wong, Ho and Autio recall the well-established links between technological innovation and economic growth, but note that the recent focus on this link (rather than the earlier Schumpeterian tradition of the “entrepreneur as innovator”) does not provide any direct test of the creation of new firms and innovation. They draw on a suggestion in the literature surveyed that entrepreneurship contributes to economic growth by “introducing innovations, creating change, creating competition and enhancing rivalry.” They also

consider that the notion of entrepreneurship includes both new entrants to the market-place and “innovative and imitative entries” into new markets from established firms. They conclude that it is fast-growing new firms – and not new firms in general – that account for most of the job creation in SMEs in advanced countries. As they note, “truly significant contributions are made by the fast-growing ‘gazelle’ firms (Birch et al., 1997)”, rather than new firms in general.

Freeman also comments on the misleading extent of apparent entrepreneurial activity in SMEs (Freeman, 2013), drawing on Nightingale and Coad’s summary of data flaws (Nightingale & Coad, 2011). They note that conventional datasets often miss whole areas of SME activity and over-represent successful SMEs (only those that survive long enough to be included); unrepresentative samples and skewed statistics (most entrepreneurs perform poorly, but the stellar performance of a few bring up the average to a point where the ‘average’ is meaningless); regressions to the mean may lead to misleading analysis (citing the example of a high growth SME that grows large as a result; should it subsequently shrink, it will be classified as a fast-shrinking large firm). In addition, and as noted earlier in this paper, data are often not comparable and “conceptual slides”, such as between net and gross figures, and definitions vary so significantly that there is no consensus on policy goals, what to measure and findings. Nightingale and Coad (2011) remind us that “while most (but not all) new firms are small, most small firms are old”; and of Storey’s 1994 finding; “firms with less than 20 workers [are] responsible for 54% of gross job gains, which sounds remarkable until [we note] that they were also responsible for 54% of gross job losses.”

In other words, not all new-business entrepreneurs create employment; new businesses may be started by what would be otherwise unemployed individuals, and thereby guarantee the owners’ employment but do not generate growth. (These latter entrepreneurs – termed “refugees” – are more likely to be found in “lower-income nations with less-developed social security systems”, in times of a decline in the business cycle, according to data from the OECD 1974-1994 cited by Wong, Ho and Autio). Storey (2008) and Freeman (2013) make a similar point about SMEs displacing earlier businesses.

Nightingale and Coad in their paper “Muppets and Gazelles” therefore suggest that the single category “entrepreneurial firms” be broken up along a continuum from the large number of economically marginal, undersized, poor performance enterprises (“muppets”) to the small number of high performance “gazelles” that drive most positive impact on the economy. This, they say, would allow a more realistic evaluation of the impact of entrepreneurs by avoiding a composition fallacy that assigns the benefits of entrepreneurship to the average firm (Nightingale and Coad, 2011). A recent OECD publication on ‘Innovative SMEs and Entrepreneurship for Job Creation and Growth’ provides data and suggestions towards this end (OECD, 2010). Suggestions in some recent literature that SME policies should be harnessed to drive innovation, drawing on findings that demand and new requirements drive innovations rather than in-firm innovations (Edler & Georghiou, 2007; Georghiou et al., 2013), should perhaps be analysed through this prism.

More generally, there appears to be a dearth of data on the costs of preference policies and set-asides; these may be among the most difficult to measure, especially the “deadweight” and “displacement” elements noted by Curran (2000), along with the long-term costs of restrictions in the market that such policies may involve (higher prices, lower quality, innovation). Curran postulates that SMEs receive more subsidies and benefits than they merit: by analogy with “zombie firms” that recent bank lending may be keeping alive under policies designed to address recent recessions, there may be an argument that SME policies are maintaining “zombie SMEs”. Curran also states that it seems to be universally accepted that more small enterprise is beneficial for the economy, but academics are demonstrating scepticism (Curran, 1993; Storey, 1994, 1998; Gibb, 1998, all as cited in Curran, 2000).

## CONCLUSIONS

It can be concluded that the time for a wholesale review of SME policies is ripe. Whether this will take place is, however, questionable. Indeed, it has been asserted that SMEs policies are “an intensely political issue” (Freeman, 2013), and a convenient proxy for pro-growth policies, and vote-winners to boot (Storey, 1998), indicating that the political goals will dominate the economic motivations. Further, many commentators allude to the fact that pro-SME policies



have become an unchallengeable leitmotif (Freeman, 2013); the “value of entrepreneurs has become such a part of the cultural zeitgeist that to ask for evidence, or even question the robustness of that evidence has become the height of political correctness” (Nightingale & Coad, 2011). Nightingale and Coad’s paper opens with a citation: “*He who makes 'the desert bloom' is often a very colourful person; a study of him in consequence is likely to turn into a romantic product ... Cold-blooded appraisals of the role of the entrepreneur in economic development are rare: glorification is usual (G. H. Evans (1949).*” It is to be hoped that a cold-blooded appraisal will be undertaken for SME policies in public procurement as well as generally: public procurement systems are required to be transparent, objective, to demonstrate integrity and to provide value for money. There is no reason that SME policies applied in public procurement should be exempted from these requirements.

#### NOTES

1. The opinions in this paper are personal, and not and are not to be viewed as representing official views of the United Nations or the Government of Austria.

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