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Empowering Small and Medium-sized Enterprises in Public Procurement

04 September 2024

Xinyue Xue

WP2 Procurement to achieve the SDGs



This project has received funding from the European Union's Horizon 2020 research and innovation programme under the Marie Skłodowska-Curie grant agreement No 956696.

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Xinyue Xue

PhD Candidate in Law (University of Birmingham); Marie Skłodowska-Curie Fellow (SAPIENS Network)

The target audience of this policy brief includes legislators, policymakers, procurement officials, and stakeholders involved in the design and implementation of public procurement rules. Specifically, it is aimed at those interested in enhancing the participation of small and medium-sized enterprises (SMEs) in public procurement. Additionally, the brief is relevant for contracting authorities, providing guidance on practices and techniques that can attract more bids from SMEs and increase competition.

Executive Summary

This policy brief provides a legal analysis of key measures aimed at enhancing SME participation in public procurement, including reserved contracts, the division of contracts into lots, and proportionate qualification requirements. It encourages policymakers and contracting authorities to adopt tailored strategies that lower barriers for SMEs, promote their long-term competitiveness, and preserve the integrity of the procurement process. Specifically, the brief recommends refining reserved contracts to reduce the risk of SME overreliance, optimising lot division to better align with SME needs, and adjusting qualification requirements to balance SME capacity with the need to mitigate risks of default or poor contract performance.

Introduction

SMEs are integral to national economies, driving economic growth, innovation, and employment. Despite their contributions, SMEs remain underrepresented in public procurement across many jurisdictions. For instance, within the European Union (EU), while SMEs account for 56% of economic value and 67% of employment, they secure only approximately 30% of public procurement contracts.¹ Similarly, in the US, small businesses receive around 27% of the total value of Federal procurement contracts despite their

¹ Manuel J García Rodríguez, 'European Public Procurement (2012–2022): Indicators and Maps of Competition and SME Participation for Cross-border Analysis Based on TED Data' (Tenders Electronic Daily, 3 November 2023) <https://ted.europa.eu/documents/d/ted/final_report-european-public-procurement-2012-2022-based-on-data-analysis-manuel-garcia> accessed 15 August 2024.



critical role in economic growth.² The underrepresentation of SMEs in public procurement is often attributed to several factors, including limited financial and human resources, the inability to undertake large contracts, and barriers within the procurement process itself. These barriers include, but are not limited to, large contract sizes, lack of access to tender information, disproportionate qualification requirements, and delayed payments. These issues necessitate the development of legal measures and policy frameworks that create a more inclusive environment for SMEs in public procurement.

Problem Statement

Countries adopt various instruments to enhance SME participation in public procurement, which can broadly be categorised into preferential and facilitative measures. Preferential measures give SMEs an advantage over larger firms, such as reserved contracts, price preferences during bid evaluation, and subcontracting-with-SMEs requirements. Facilitative measures, on the other hand, do not favour SMEs directly but aim to reduce barriers, such as by improving access to information, dividing contracts into smaller lots, and limiting disproportionate qualification requirements.

These measures are widely used, but their effectiveness remains debated, raising important questions about how different countries select them to achieve similar objectives. This research examines three key approaches—reserved contract,³ contract division into lots, and proportionate qualification requirements—to assess their impact on enhancing SME participation. It also analyses the trade-offs associated with each measure, including the costs imposed on the public procurement process, such as increased expenses for contracting authorities or reduced competition. This comprehensive analysis enables legislators and policymakers to choose strategies based on the extent to which they wish to actively support SMEs or simply level the playing field, while also understanding the broader implications for the procurement system.

Key Findings

- **Reserved Contracts:** While reserved contracts can provide short-term benefits to SMEs by providing them with business opportunities, they may also foster dependency, discouraging SMEs from expanding and competing with larger firms. This reliance undermines the long-term goal of promoting the competitiveness of SMEs. Despite deviating from the principle of full and open competition, findings suggest that competition within reserved contracts is not necessarily inferior to non-reserved contracts. This is attributed to the increased participation of small businesses and

² Small Business Administration, 'Small business procurement scoreboard overview' <<https://www.sba.gov/document/support-small-business-procurement-scorecard-overview>> accessed 15 December 2023.

³ The author has published a working paper on analysing reserved contracts. See Xinyue Xue, 'Empowering Small Businesses: The Impact of Reserved Contracts in U.S. Federal Procurement' (SAPIENS Working Paper Series, 15 July 2024) <<https://sapiensnetwork.eu/wp-content/uploads/2024/07/ESR-11-WP-final.pdf>> accessed 15 August 2024.



the reduced involvement of larger firms, which serves to intensify competition among smaller enterprises within the reserved contract framework.

- **The division into Lots:** Effective lot division can significantly impact SME involvement, but its success hinges on careful design. Key aspects of lot division design include whether the division is mandatory or voluntary, the justification required for not dividing contracts, limits on the number of lots that can be awarded to a single bidder, practices such as lot bundling and acceptance of alternative bids, and whether lots are reserved for SMEs. This research shows that without addressing these factors, lot division may fail to facilitate SME access and could increase administrative burdens for contracting authorities. For instance, while lot bundling and accepting alternative bids might improve cost efficiency for contracting authorities, these practices may favour larger firms and make it more challenging for SMEs to compete.
- **Proportionate Qualification Requirements:** Removing disproportionate qualification requirements is essential for reducing barriers to SME participation in public procurement. By limiting disproportionate criteria such as high annual turnover and successful past performance requirements, this measure can ease entry for SMEs without imposing additional administrative burdens on contracting authorities. However, while these adjustments facilitate access, they do not automatically improve SMEs' chances of winning contracts and may increase the risk of contract default or substandard performance.

Policy Implications

To enhance SME participation in public procurement, policymakers and contracting authorities may consider the following recommendations:

- **Reassess Reserved Contracts:** Evaluate the long-term impact of reserved contracts and seek ways to reduce SMEs' reliance on these measures gradually. Alternative approaches should be explored to encourage SMEs to expand and compete more effectively in the broader market.
- **Refine Lot Division Design:** Ensure that lot division designs are optimised to support SME participation. This includes implementing caps on the number of lots a single bidder can win and avoiding practices such as alternative bids that may disadvantage SMEs. Policymakers should balance the need for SME involvement with cost efficiency when making decisions.
- **Adjust Qualification Requirements:** Develop qualification criteria that effectively lower entry barriers for SMEs while also addressing potential risks of contract default or poor performance. Striking this balance is crucial for facilitating SME access without compromising the quality of procurement outcomes.

It is crucial to recognise that the effectiveness of these measures can differ depending on the jurisdiction and its specific objectives and principles. By adopting a balanced approach, legislators and policymakers can create a more inclusive and competitive public procurement environment that not only supports SME growth but also maintains the integrity and efficiency of the procurement process.

