



BIAC THE VOICE OF
BUSINESS AT THE OECD

OECD FORUM ON INNOVATION PROCUREMENT

The Case for More Inclusive Innovation Procurement

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BIAC speaks for business at the OECD. Established in 1962, we stand for policies that enable businesses of all sizes to contribute to growth, economic development, and prosperity. Through BIAC, national business and employers federations and their members provide expertise to the OECD and governments for competitive economies, better business, and better lives.

Entrepreneurship is one of the biggest sources of productivity, employment, and inclusiveness. Not only large companies but also Small and Medium Sized Enterprises and start-ups operate as entrepreneurs in our economies by taking risks, innovating, and creating new businesses and jobs to serve new markets. BIAC welcomes the SME focus of the OECD Forum on Innovation Procurement as we believe that well-designed and targeted public procurement policies can play a key role to leverage private-sector growth and in particular enable SMEs in a more inclusive manner.

Innovation is another important leverage for new growth. SMEs and start-ups drive innovation, create jobs, and boost local – and global – economies. BIAC therefore encourages continued OECD efforts to benchmark opportunities for public procurement, together with the costs of regulation and administrative requirements, access to finance, access to raw materials, aspects of tax policy and labor market regulation. These issues are particularly challenging for SMEs, which have been particularly held back by reduced access to finance and red tape in recent years¹.

SMEs' Leading Role in the World's Economy

SMEs, by number, dominate the world business stage and are vital engines for the much needed growth across the OECD. Precise, up-to-date data is difficult to obtain, absent a comparable **framework for analysis**: the OECD for instance defines Small and Medium-sized Enterprises (SMEs) as “non-subsiary, independent firms which employ fewer than a given number of employees”, but this number varies across countries: the most frequent upper limit designating an SME is 250 employees but, some countries set the limit at 200 employees, while the United States considers SMEs to include firms with fewer than 500 employees. Nevertheless, estimates suggest that more than 95% of enterprises across the world are SMEs, accounting for approximately 60% of private sector employment. In OECD countries, they account for 99% of all firms and 40-80% of total value added for the business economy². In the European Union, SMEs account for 99.8% of all enterprises in the non-financial business sector³.

It is estimated that SMEs contribute to 52% of the **gross value added** (GVA) globally. This contribution seems to vary widely between countries and regions. Nevertheless, although they play key roles in high-income countries (51% of GDP), SMEs are also important to low-income countries (16%, but up to 33% for particular countries), making significant contributions to both GDP and employment (up to 45%)⁴.

Overall, **SMEs are creating more jobs** than large enterprises. Between 2002 and 2010, on average, 85% of total employment growth was attributable to SMEs, also in emerging markets with 4/5 jobs created by SMEs⁵. In the European Union, SMEs accounted for 71.4% of the increase in employment in 2014.

¹ Also see *BIAC Statement to the OECD Ministerial Council Meeting (MCM) 2014* (biac.org)

² OECD *Entrepreneurship at a Glance 2016*

³ *European Commission's Annual Report on European SMEs 2014 / 2015*

⁴ Dalberg (2011), *Report on Support to SMEs in Developing Countries Through Financial Intermediaries, SME Briefing Paper* (Geneva: European Investment Bank)

⁵ de Kok, J., Vroonhof, P., Verhoeven, W., Timmermans, N., Kwaak, T., Snijders, J. Westhof, F. (2011), *'Do SMEs Create More and Better Jobs?'* (EIM Business and Policy Research).

Hurdles to SME Performance in Public Procurement Processes

Public procurement is of **tremendous economic significance for business** at large: estimates made by the European Commission put the total value of expenditure by general government and utilities on public works, goods and services in 2016 at 14% of the EU's Gross Domestic Product. This is a decrease compared to the 19% representing 2.406 billion euros in 2014, but it follows a steady growth over the previous decade. A large part of this purchasing is subject to public procurement rules, either national or EU regimes, accounting for about 425 billion euros in 2011 (3,4% of GDP).

Nevertheless, there is a significant growth potential to be leveraged by a **more strategic involvement of SMEs** in public procurement processes. Regional analysis is somewhat impeded by the lack of consistent follow-up, compilation and reporting of procurement data, which would be key to address strategic policy objectives and in particular the involvement of SMEs. Still, estimates show that SMEs have won 56% of domestic public contracts above the EU-thresholds between 2009 and 2011, and 54% of cross-border contracts. In terms of value, SMEs' share is somewhat lower in cross-border procurement: 22% only vs. 29% in domestic procurement⁶.

A number of **structural hurdles** impede the further engagement of SMEs in public procurement processes⁷, some of them impacting more specifically innovation SMEs.

1. Large contract volumes and broad capabilities required and temporary closing of the market through framework agreements
2. Disproportionate technical and financial qualifications levels
3. Over-emphasis on price and costly industry standards and certifications
4. Insufficient access to information and about opportunities, lack of knowledge about procedures, unclear requirements, limited tendering skills and intelligence
5. Little dialogue with procurers and feedback
6. Lack of time to prepare bids
7. Excessive administration burden
8. Late payments, risks of non-payments
9. Excessive track record requirements
10. Insufficient focus on Public Procurement for Innovation (PPI) and Pre-Commercial Procurement (PCP)
11. Problem with being the first on the market with a new product

⁶ PwC, ICF GHK and Ecorys (the Consortium) (2014), *SMEs' access to public procurement markets and aggregation of demand in the EU*

⁷ Also see PwC, ICF GHK and Ecorys (the Consortium) (2014), *SMEs' access to public procurement markets and aggregation of demand in the EU*

Opportunities to Tackle the Exclusionary Effects of Public Procurement Processes

1. Large contract volumes and broad capabilities required and temporary closing of the market through framework agreements

- Obstacles related to the size of contracts can in some cases be overcome by breaking down tenders into lots and restricting bidders from competing for all lots, and by limiting the duration and the renewal of framework agreements – with due consideration for the cost impact and the overall complexity of the public offer.

2. Disproportionate technical and financial qualifications levels

- Disproportionate technical or financial requirements can be avoided, in particular by defining clear and proportionate rules on technical qualifications levels, but also by limiting financial qualification levels and reducing the amount of financial guarantees. Joint bids are also an alternative.

3. Over-emphasis on price and costly industry standards and certifications

- Emphasis must be put on quality and flexibility. Contracting authority can be enabled to take account of criteria that reflect qualitative, technical and sustainable aspects of the tender submission as well as price when reaching an award decision – with due consideration for the overall administrative burden. Performance or functional requirements, as well as a full life-cycle costing, can also be beneficial: many procurers demand the cheapest price and do not go for total lifecycle costs due to a variety of reasons, ranging from short-sighted budget constraints to the lack of know-how to calculate total lifecycle costs.

4. Insufficient access to information and opportunities, lack of knowledge about procedures, unclear requirements, limited tendering skills and intelligence

- Overall, the quality and transparency of the information provided by procurers regarding public procurement opportunities and tender documentation can be improved. Contract notices, tender documentation, guidelines and other support material for tenderers must be accessible easily and for free. Further support should be provided via helpdesks or training opportunities for tenderers.

5. Little dialogue with procurers and feedback

- A better dialogue between procurers and tenders could be supported by online Q&As on the tender procedure or even more importantly through opportunities for a face-to-face exchange of information with the procurer on the tender's requirement and specifications. Post-award briefings are furthermore necessary to the smooth delivery of services.

6. Lack of time to prepare bids

- Providing sufficient time to complete bids is absolutely key for SMEs to participate in tenders. Reasonable deadlines should be foreseen to submit tenders.

7. Excessive administration burden

- Access to public tenders can involve heavy regulatory and policy burden which heavily affect and discourage SMEs due to high compliance costs. Policy intervention is needed to develop public procurement rules that stifle competition and that facilitate SME's access⁸. More specifically, BIAC's recommendation to the OECD is to facilitate SMEs access to public procurement by establishing "one-stop shops" and e-government solutions for SMEs to file all administrative paperwork across agencies, and by maintaining a stable regulatory environment, through Regulatory Impact Assessments and fixed dates for the implementation of new regulations.

8. Late payments, risks of non-payments

- In its 2015 *Progress Report to the G20 on SME Financing*⁹, the OECD assessed that "Government to Business (G2B) transactions could be encouraged to enhance the cash flow of small business suppliers". SMEs are particularly vulnerable to late payments or non-payment and governments and policy-makers should ensure that norms are designed, implemented and enforced to discourage late payments in commercial transactions, including for cross-border trade. Liquidity problems can be partly overcome through reasonable payment deadlines and sanctions for late payments or by allowing advance and interim payments.

9. Excessive track records

- The Public sector is, by definition, risk averse and therefore often closely looks whether there are long track records. SMEs and particularly new companies do not have these track records and are therefore often not accepted in tenders. Track records should only apply in a limited number of situations.

10. Public Procurement of Innovative Solutions (PPI) and Pre-Commercial Procurement (PCP)

- Demand-side innovation policies are seen as major instrument to boost innovation. Yet these tools are rarely used in many countries.

11. First on the market

- Being the first on a market is not always an advantage: in many instances, innovative solutions will not be considered by procurers because of the requirement to compare similar offers before going for the optimal solution. This requirement is limiting innovation.

⁸ See *BIAC Policy Priorities for SMEs to Drive Growth* (2015)

⁹ *G20/OECD Progress Report on the Development of Effective Approaches to Support the Implementation of the G20/OECD High-Level Principles on SME Financing* (September 2015)

SME's Ambivalent Attitude to Innovation

Research shows that SMEs are usually leaner and more flexible than large firms, which allows them to react more quickly to **radical technological innovations**. Very often, SMEs in general and start-up firms in particular are an important channel for the commercialization of such radical innovations. Moreover, many SMEs occupy market niches that are not profitable for large firms and they can better adapt new products to individual customer needs¹⁰.

However, according to OECD analysis, the **innovation potential** of many businesses, and in particular of SMEs, is locked. For instance, the adoption of ICTs that enable digitalized industrial production is still low¹¹. Furthermore, innovation and research and development (R&D) activities are traditionally less frequent in SMEs than in larger firms. Lastly, national data reveal a significant decline of SMEs' investment and innovation activities since the crisis. During the past years, SMEs reduced or postponed investment and innovation expenditure¹².

Attention to **innovation-enhancing policies** has grown across many countries, often targeted to SMEs. Incentives such as R&D tax credits, regulations and standards are also being used to encourage pre-commercial R&D activities, such as feasibility studies and prototyping. But the effectiveness of technology diffusion institutions depends in part on firms' absorptive capabilities and in parts on access to investment. To date, more than 50% of SMEs lack access to finance and suffer from excessive red tape, which eventually hinders their access to innovation and to innovation procurement.

In 2015, BIAC and the B20 Turkey recommended to **raise SME access to finance and skills** through an integrated approach. A predictable and enabling policy environment is necessary to allow and support different actors to undertake voluntary approaches that ensure seamless financing to SMEs in GVCs. This calls for an integrated approach along GVCs that combines diverse forms of suitable, fit-for-purpose finance. Taking steps to improve access to finance for SMEs, increase investments in research, infrastructure, expanding trade, reforming tax systems, reforming immigration systems, and other steps are critical to help raise productivity growth. In our more globalized economy, incentives for innovation and investment are global, and our policy choices affect one another encouraging groups like the OECD to push together towards better outcomes.¹³

¹⁰ Dr Jennifer Abel-Koch (KfW), Gino del Bufalo (CDP), Miguel Fernandez (ICO), Juliane Gerstenberger (KfW), Dr Vivien Lo (KfW), Blanca Navarro (ICO), Baptiste Thornary (BPI), *SME Investment and Innovation: France, Germany, Italy and Spain* (2015)

¹¹ *Enabling the next Production Revolution – The Future of Manufacturing and Services – an Interim Report* (OECD)

¹² Dr Jennifer Abel-Koch (KfW), Gino del Bufalo (CDP), Miguel Fernandez (ICO), Juliane Gerstenberger (KfW), Dr Vivien Lo (KfW), Blanca Navarro (ICO), Baptiste Thornary (BPI), *SME Investment and Innovation: France, Germany, Italy and Spain* (2015)

¹³ See BIAC, B20 China, *Financing Growth ; SMEs in Global Value Chains - The case for a coordinated G20 policy approach* (2016)



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