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Review of Government Procurement SME Policies

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Final Report

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Abstract

This report analyzes Jordanian data and resources to identify the definition of small and medium size enterprises (SMEs), and then explores different means for involving SMEs in the public procurement process.

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Executive Summary

This report analyzes Jordanian data and resources to identify the definition of small and medium size enterprises (SMEs), and explores different means for involving SMEs in the public procurement process. This is mainly targeted to verify the relevance of SMEs in public procurement and, therefore, to recommend how to include any language, if necessary, in the Public Procurement Regulation for Jordan currently being reviewed by the Public Procurement Committee. This regulation is being drafted as part of the Government's efforts to accede to the Government Procurement Agreement of the World Trade Organization.

The report reviews different definitions of SMEs applied by agencies of the European Union, United States and United Nations, and attempts to relate these definitions to public procurement. The conclusion made is that SMEs need not be defined in a standalone definition; rather, it is more importantly to describe the role of SMEs in public procurement.

The report explores different options for including SMEs in the public procurement process, and concludes that there are basically two options: a government policy or a legal stipulation. The government policy may or may not be included in law and is easily implemented and changed, while a legal stipulation is more stable yet less flexible. The Government of Jordan needs to examine all options to decide on its preferred approach regarding SME participation in its procurement. Further work is needed to itemize elements of such participation and their implications.

The conclusions reached in this report are as follows:

- ☑ As important as devising a definition for SMEs, it may not be a fundamental element for including these types of businesses into public procurement. Rather, it is more important to recognize the means for assisting SMEs to embark upon this field rather than attempting to categorize enterprises eligible for such, which may lead to the exclusion of SMEs in one way or another.
- ☑ Consequently, there is a need to identify the optimum solution for assisting SMEs to enter the government procurement market fervently. This solution will depend on the government's willingness and recognition of the importance of this step, and will need to be structured within the appropriate regulatory setup that is most indicative of the intended outcomes.
- ☑ International best practice in this area indicates that many countries opt for legislative intervention. Hence, similar experience in such drafting may be imitated for the short-medium term, and until government policy regarding such subject is clear for it to be rolled-out among all governmental institutions and applied in diverse innovative initiatives that are not necessarily built on law.

Lastly, the recommendations based on the analysis made in this report are the following:

- ☑ Obtain a clear government policy direction on how to include SMEs in public procurement; the desired achievements; and preferably any public/budget//institutional constraints that the government foresees in this respect. This will identify whether the government may be willing to establish a fund for development or ease up administrative requirements or by e-procurement as explained above, or assist SMEs in ways other than amending the laws.

- ☑ In all cases, suggest to include in the new Government Procurement Regulation some specific articles as those emulated in international best practices to specifically articulate the needed legal interventions. These articles must be crafted in a way that will strike a balance between the need for clear precise articles that attain the objectives needed while maintaining an adequate level of flexibility and leverage to adopt administrative ideas and initiatives that are do not necessarily stick to rigid legal wordings.

Research undertaken in this report is based on web material that has been referenced where applicable.

1. Background

The objective of this report is to assist the Government Procurement Committee to develop an effective means of supporting SMEs to be authorized and described in the draft Government Procurement Regulation.

During the course of negotiations to join the World Trade Organization (WTO) the Government of Jordan (GOJ) committed to initiate negotiations to accede to the Government Procurement Agreement (GPA) by presenting an entity offer. In 2001, the GOJ established a National GPA Committee to prepare and negotiate Jordan's accession to that Agreement. A working group comprising representatives from the General Supplies Department, Government Tenders Directorate of the Ministry of Public Works and Housing, and the Foreign Trade Policy Department of the Ministry of Industry and Trade have been tasked with formulating the Government's entity offer.

In support of the offer formulation process the USAID-funded AMIR Program funded three separate activities. In June 2001, it funded the creation of a database of the procurement undertaken by every government entity during 1999-2000. In October 2001, a team of consultants used the data to analyze procurement patterns. A National GPA Committee was established to draft an initial offer by Jordan to GPA member countries. The offer sets out the entities, goods and services, and value thresholds for which Jordan will allow international competition under the GPA. In September 2002, the USAID-funded AMIR Program sponsored a procurement lawyer to review the first version of a draft entity offer. Jordan submitted the offer in February 2003 and is now discussing and revising the offer with GPA members. Accession to the Agreement occurs once interested members have made bilateral agreements with Jordan and a final offer is accepted by all members. This process is expected to be completed by March 2005.

At the same time Jordan is negotiating accession to the GPA, it established a further committee, the National Steering Committee on Legislation, to prepare new procurement legislation that complies with the requirements of the GPA. Article XXIV.5 of the GPA requires that acceding Parties to the GPA have compliant legislation in place upon entry into force of the GPA. The USAID-funded AMIR Program is supporting the drafting of a new Procurement Regulation. A draft regulation has been completed. A policy issue has arisen that the Committee has not been able to resolve: What are the appropriate methods to support small and medium sized enterprises (SMEs) through government procurement?

In writing this report, the following specific tasks were undertaken in order to reach the conclusions explained in this report:

1. Describe the typical characteristics of SMEs relevant to government procurement practices in countries with similar economic and social conditions to Jordan.
2. Develop a definition of SMEs appropriate to Jordanian government procurement circumstances.
3. Describe government procurement policies that improve communication between the government and SMEs, improve SME understanding of procedures and reduce SME documentation requirements.
4. Describe pre-qualification and bidding consortia design issues that are appropriate to SME limitations.
5. Describe alternative government procurement policies that provide preferential

treatment for SMEs. Include discussion of the costs and benefits of setting procurement quotas for SMEs, and discuss the value and range of supplies and works when quotas are appropriate.

6. For each alternate policy described in task 5, above, discuss the national economic costs and benefits of providing preferential treatment to SMEs.
7. Recommend a set of government procurement policies that improve the ability of Jordanian SMEs to compete for and undertake contracts to supply goods and services to the Government of Jordan.

2. Definitions of Small and Medium Enterprises (SMEs)

2.1 SMEs in General

Research suggests that there is no single definition of a small enterprise, mainly because of the wide diversity of businesses. Demographic and economic variation between and within countries make it difficult to reach a single definition that would encompass all intended purposes. However, there are some unifying definitions used in certain regions, whereby the same thresholds and criteria are applied when defining SMEs relevant to each region.

SMEs in the European Union (EU) must share the same characteristics in order to be identified as such by the European Commission, who applies its SME definition across EU programmes and proposals. The Commission recommendation on the definition of SMEs is issued following the logic of a single market without internal frontiers, which entails that the treatment of enterprises should be based on a set of common rules.[1]

Under this recommendation, to be classified as an SME in Europe, an enterprise has to satisfy the criteria for the number of employees and one of the two financial criteria, i.e. either the turnover total or the balance sheet total. In addition, it must be independent, which means less than 25 percent owned by one enterprise (or jointly by several enterprises) falling outside the definition of an SME, whichever may apply. Furthermore, small enterprises are defined as enterprises which have fewer than 50 employees, and have either, an annual turnover not exceeding € 7 million, or an annual balance sheet in total not exceeding € 5 million.

Table 1: Thresholds of SMEs in the European Union

	Medium	Small	Micro
Max. number of employees	Max 250	Max. 50	Max. 10
Max. turnover (million ECU)	40	7	-
Max. balance-sheet total (million ECU)	27	5	-

Note: Micro-enterprises refer to enterprises having fewer than 10 employees.
Source: EU website.

The US Government is currently working with the following definitions:

1- Micro enterprise: up to 10 employees, total assets of up to $100,000 and total annual sales of up to $100,000;
2- Small enterprise: up to 50 employees, total assets of up to $3 million and total sales of up to $3 million;
3- Medium enterprise: up to 300 employees, total assets of up to $15 million, and total annual sales of up to $15 million.

Conversely, identifying a common definition of SMEs in developing countries is more challenging, as economies tend to vary considerably in their socio-economic and political factors. However, attempts have been made to identify SMEs in developing countries. The United Nations Commission on Trade and Development reports:

[1] 96/280/EC: Commission Recommendation of 3 April 1996 concerning the definition of small and medium-sized enterprises, *Official Journal L 107 , 30/04/1996 P. 0004 – 0009.* Whilst the European Commission encourages the Member States to apply this definition for their programmes, the Member States are not obliged to comply with it, as it permits them to use lower threshold figures, if desired.

" SMEs are widely defined in terms of their characteristics, which include the size of capital investment, the number of employees, the turnover, the management style, the location, and the market share. Country context plays a major role in determining the nature of these characteristics, especially, the size of investment in capital accumulation and the number of employees. For developing countries, small-scale generally means enterprises with less than 50 workers and medium-size enterprises would usually mean those that have 50–99 workers. In Uganda, a small-scale enterprise is an enterprise or a firm employing less than five but with a maximum of 50 employees, with the value of assets, excluding land, building and working capital of less than Ugshs. 50 million (USD 30,000), and an annual income turnover of between Ugshs. 10–50 million (USD 6,000–30,000). A medium-size enterprise is considered a firm, which employs between 50–100 workers. Other characteristics have not been fully developed.[2]"

Ultimately, SMEs in developing countries must be subjected to different criteria than those applied in the developed countries, in order to ensure they will not be prejudiced in scope. The economic gap between developed and developing countries inevitably disallows the use of same thresholds, where we see that small enterprises of the United States are of a size that proportionally matches that of enterprises ranked as "large" or even more inexistent size-wise in modest economies such as Jordan.

In Jordan specifically, the new Chambers of Commerce Law defines a small commercial enterprise as being any company or sole proprietorship whose primary objective is commerce, works in a specific commercial sector, and the registered capital of which does not exceed five thousand dinars.[3] Typically, registered capital merely constitutes only one objective criterion to identify small businesses.

2.2. SMEs in Public Procurement

Both the European Commission and US definitions of SMEs are applied to public procurement. However, devising a definition for SMEs in developing countries may be more difficult than describing their role in the public procurement processes. As SMEs are generally identified as the smaller businesses in a certain economy, exploring their opportunities to participate in public procurement should depend on the type of services and work subject to procurement, and hence the type of businesses generally participating in such.

However, devising a definition for SMEs in developing countries may be more difficult than describing their role in the public procurement processes. As SMEs are generally identified as the smaller businesses in a certain economy, exploring their opportunities to participate in public procurement should depend on the type of services/works subject to procurement, and hence the type of businesses generally participating in such.

SME participation in government procurement stems from the fact that all businesses, large and small, should have equal opportunity to tender for government work. The deciding factor between which firm gets the job should not be the size of the company, but how capable that company is at carrying out the task.

[2] 'Improving the Competitiveness of SMEs in Developing Countiries, The Role of Finance To Enhance Enterprise Development,' UNCTAD/ITE/TEB/Misc.3.
[3] Chambers of Industry Interim Law No. (70) of 2003.

3. Assisting SMEs to Engage in Public Procurement

3.1 Reluctance of SMEs to Participate in Government Procurement

Participating in government procurement by SMEs is often looked at as a challenge, mainly since larger companies are able to overcome problems of access to information regarding public procurements and learn of new business opportunities with the government via their advanced and sizeable research and marketing departments. Alternatively, SMEs often lack these resources due to their size. Larger businesses are also often well placed to deal with government because they are better acquainted with its procedures and personnel than SMEs.

3.2 Benefits of SME Participation in Government Procurement

The creation of simpler procedures that allow SMEs to participate in public procurement is very important, as improving access for SMEs to the market for government suppliers would improve those parties impacted by the procurement cycle. For example, many SMEs can be more innovative than larger businesses because they do not have to adhere to rigid rules and procedures, but are instead at liberty to try out new ways of delivering goods and services. Their ability to experiment allows many SMEs to operate more flexibly and so offer a potentially more responsive level of service in comparison to that provided by larger companies.

It is very important to note that allowing SMEs to participate in government procurement can be equally beneficial to the procuring entity, leading to a well-balanced supply chain that will avail all parties to this chain. For example, the following is a non-exhaustive list of the benefit derived by facilitating the participation of SMEs in public procurement:

- ☑ SMEs may offer better value for money than larger suppliers by bringing greater and more diversified competition to the marketplace;
- ☑ SMEs have smaller administrative overheads and management costs than larger firms which allows them to set lower prices for their bids, which in turn allows to bring down the prices for awarding the bids;
- ☑ SMEs have shorter administrative hierarchy, so they can respond quickly to changing requirements. SMEs may also be highly focused on particular markets making them particularly responsive to changes in those markets;
- ☑ SMEs may be more willing to custom tailor a product or service to meet government needs more than what large firms are willing to as they sell established products.

3.3. Ways to Facilitate SME Access to Government Procurement

3.3.1 Government Policy

The government is an essential stakeholder and an obvious catalyst to encouraging SMEs to engage in public procurement. Indeed, without a clear governmental policy to facilitate the regulatory procedures associated with public procurement, SMEs will always lag behind in this area. The government policy in assisting SMEs need not be incorporated in law, but it may very well make use of exiting laws to operate. The following are ideas on how the government can assist SMEs -by means of policy decrees and formulation- to enter public procurement sector.

- **Development Fund**

The government may assist SMEs by allocating a percentage of procurement to be completed by SMEs participating in a development fund. The fund will guarantee a more systemic and coordinated effort to involve SMEs in public procurement, whereby an eligibility criteria based on basic thresholds can be used to determine the SMEs allowed to participate in the process.

The King Abdullah II Fund for Development stands as an ideal model to assist SMEs to participate in government procurement. This Fund is established pursuant to the King Abdullah the Second Fund for Development Interim Law No. (81) of 2001, and aims to participate in establishing entrepreneurial projects for citizens that would assist in achieving integrated development in the different areas of the kingdom. The Fund also aims to support efforts and programs that are directed towards increasing productivity and to improve living standards of citizens.

In order to achieve its objectives, the Fund is intended to establish production and development projects and extend advice and technical consultancy to such projects. As well, the Fund may conclude investment contracts with third parties or participate with citizens wishing to benefit from the Fund's projects.

Hence, the Fund may be an ideal platform that supports SMEs to participate in government procurement projects. This can be done if the Fund creates a program supported by the government and which mandates that all government departments complete a minimum share of, for example, five percent of their procurement activities through the Fund. This will greatly increase the scope of projects and opportunities available to SMEs and will ensure a sizeable section of Government projects are allotted to companies registered with the Fund.

- **E-Procurement**

One fundamental advantage of using electronic means for procurement is the fact that SMEs can use the Internet in the same way as larger businesses. This can significantly promote SMEs involvement and interactive participation in government procurement, while minimizing the burdens of administrative and resource-based requirements usually associated with the paper and physical handling of procurement procedures such as providing copies and paper submissions and the like.

E-methods need not be intimidating for SMEs; on the contrary, a strategy for e-procurement --if implemented in a systemized and well-thought manner-- will result in better submissions for the bids at much lower costs and better values, inevitably leading to professional bids that are concise and clear. This former statement however implies an important note; which is the need to have a clear and well-structured strategy for e-procurement. Given currently implemented e-businesses worldwide, there is a danger that e-procurement procedures, if not complemented by ongoing and effective awareness raising and capacity building programs for smaller bidders who are eager to enter into the market, may exclude them from the public procurement scheme, and therefore limit competition.

- **Government Procurement Cards**

The United Kingdom is currently implementing the Government Procurement Cards (GPC) scheme to its public procurements. Jordan may want to consider this scheme and review the feasibility, efficiency and workability to Jordanian public procurements.

The GPC is a Visa charge card, issued by the main banks, which eliminates the need to send out purchase orders or deal in paper-based systems. Orders are placed directly with suppliers who can accept Visa cards, either by personal visit, phone, fax, e-mail or, possibly, over the Internet. The supplier keys the transaction into a terminal, including the card holder's unique identification number. Once accepted, approval to release the goods or service is given and a delivery is made. The GPC has been introduced across central government and is used to buy low-value goods and services directly from suppliers. The advantage to suppliers when public-sector organizations use GPC is that it removes a lot of the paperwork and speeds up the payment process. Accounts are credited within two to four days.[4]

- **Easing Administrative Requirements**

Other means for the government to facilitate the public market for SMEs include the following; however, we must note that proposing these means should not be taken to mean immediate adoption thereof. Rather, these are ideas to be considered and examined closely to verify their worthiness in the context of legal, cultural, and socio-economic factors in Jordan:

- ☑ Divide tenders into smaller lots whenever appropriate;
- ☑ Include opportunities for cooperation between larger and smaller bidders in the invitations to tender by promoting for example the use of incentives when sub-contracting to SMEs;
- ☑ Encourage bidders of small size to ask questions and create easily accessible means to do so;
- ☑ Focus on the outputs required, not on how they are to be delivered (the 'what' rather than the 'how') and avoid over-specifying the requirements;
- ☑ Specify standards where they are necessary, rather than including a standard list as routine;
- ☑ Give small bidders guidelines on drawing up their proposals.

3.3.2 Introducing Legal Articles into Procurement legislation

Legal amendments are a very important tool to attain the objectives envisaged by this consultancy. Having the different options for the participation of SMEs in public procurement stipulated clearly in the relevant legislation allows for effective implementation of policy directions behind the legal wordings but without the flexibility usually associated with unwritten policies. This is very useful in the sense that SMEs will not be subjected to different schemes but will be operating under a stable and consistent mechanism that is based on law.

On the other hand, legal intervention may be risky and therefore it needs to be examined in scrutiny to ensure the adoption of a well-structured setup for facilitating SMEs participation in public procurement. As legal tools in Jordan are not easily changed, the proposed law needs to allow for the necessary flexibility that encourages innovation and does not impede advancement.

The legal additions to the law can either be in general outline for means of government support to SMEs in procurements thereby, or they can include specific language to describe the mechanisms of support, whereby the core principles described in this paper under chapter IV-c must be incorporated therein. Either approach will need to be reviewed to decide what

[4] http://www.ogc.gov.uk

is best for the Jordanian context. Following are examples of some articles relating to this topic.

- Japan's Small and Medium Enterprise Basic Law No. 154, July 20, 1963:[5]

> ***Guarantee of opportunity for procurement of receiving orders from State, etc.***
> ***Article 20***
> *The State shall take the necessary enforcement policy to increase opportunity for receiving orders by SMEs with respect to the procurement of commodities, services, etc. by the State, etc., in order to increasing demand on commodities, services, etc. to be supplied by SMEs.*

- Small and Medium Enterprise Development Statute for Taiwan and its revisions and amendments.[6]

> ***Chapter Five: Public Purchasing and Public Construction***
> ***Article 37***
> *Where government at any level or a state-owned enterprise undertakes publicly-announced procurement or public construction, they shall assist SMEs to obtain the business opportunities created by this.*
>
> ***Article 38***
> *Where government at any level or a state-owned enterprise undertakes publicly-announced procurement, public construction or commissioning of R&D work, they shall, depending on actual needs, establish a system for qualification and registration of SMEs wishing to serve as suppliers or to bid for a tender.*

[5] Found at http://www.actetsme.org/japa/smepolicies/law.html#ch6
[6] First promulgated by presidential order on February 4, 1991. Law found on http://www.moeasmea.gov.tw/eng

4. Conclusions and Recommendations

The conclusions reached in this study are as follows:

- ☑ Devising a definition for SMEs and adding it to the government procurement legislation is an important step towards including this vital sector to procurement transactions, but as important as it is, it may not be a fundamental element for including SMEs into public procurement. It is more important to recognize the means for assisting SMEs to embark upon this field rather than attempting to categorize enterprises eligible for such, which may lead to the exclusion of SMEs in one way or another.
- ☑ Consequently, there is a need to identify the optimum solution for assisting SMEs to enter the government procurement market fervently. This solution will depend on the government's willingness and recognition of the importance of this step, and will need to be structured within the appropriate regulatory setup that is most indicative of the intended outcomes.
- ☑ International best practice in this area indicates that many countries opt for legislative intervention. Hence, similar experience in such drafting may be imitated for the short-medium term, and until government policy regarding such subject is clear for it to be rolled-out among all governmental institutions and applied in diverse innovative initiatives that are not necessarily built on law.

Following are some recommendations based on the analysis made in this report:

- ☑ Obtain a clear government policy direction on how to include SMEs in public procurement; the desired achievements; and preferably any public/budget//institutional constraints that the government foresees in this respect. This will identify whether the government may be willing to establish a fund for development or ease up administrative requirements or by e-procurement as explained above, or assist SMEs in ways other than amending the laws.

- ☑ At all cases, suggest to include in the new Government Procurement Regulation some specific articles as those emulated in international best practices to specifically articulate the needed legal interventions. These articles must be crafted in a way that will strike a balance between the need for clear precise articles that attain the objectives needed while maintaining an adequate level of flexibility and leverage to adopt administrative ideas and initiatives that are do not necessarily stick to rigid legal wordings.