



The involvement of small- and medium-sized enterprises in public procurement: Impact of resource perceptions, electronic systems and enterprise size

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ABSTRACT

The importance of small- and medium-sized enterprises (SMEs) as employers and suppliers is high, and there are studies that evaluate the benefits of having SMEs as suppliers. The challenges of SMEs as buyers have been explored, but there is little research on the obstacles that SMEs encounter as suppliers. This article focuses on the implications of perceived resources, electronic systems and enterprise size. It uses survey data to analyze what type of resources and characteristics in particular influence the involvement of SMEs in public procurement. The results of hypothesis testing show that perceived lack of resources especially in legal expertise and administration is associated with low SME involvement. By analyzing suppliers to municipalities and state organizations separately, it is found that lack of electronic systems in order processing and invoicing is related with low involvement of SMEs in state procurement. In short, this article contributes to the current knowledge on SMEs and public procurement by demonstrating the influence of resource perceptions and electronic systems on SME involvement and by pointing out the differences between the two levels of public sector actors (municipalities and state organizations).

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1. Introduction

This article examines why it may be difficult for small- and medium-sized companies (SMEs) to become suppliers in public procurement, a domain that has not been extensively studied before (Zheng et al., 2006; Clark and Moutray, 2004; Fee et al., 2002; Peet et al., 2002). In the European Union (EU), it is relevant to what extent SMEs should be preferred or assisted in public procurement access. This is particularly due to the legislation that defines the principles for tendering processes and supplier selection in all public organizations. In the EU, companies of all sizes are assumed to have equal opportunities to participate in public procurement because EU public procurement law has defined the principles for tendering procedures: transparency, equal treatment, genuine competition and non-discrimination. Because of these principles company size cannot be a criterion in comparisons of tenders, but it can play a role in terms of the capacity of an SME to supply to public sector organizations. Even though public sector buyers cannot favour SMEs over larger

enterprises according to the EU principles or otherwise support them, it should not be overlooked that public organizations in general may be in favour of encouraging smaller suppliers because of the potential positive impact on local economies. This is why it is important to identify possible obstacles hindering SME involvement in public procurement. Involvement refers to SMEs' participation in tendering competitions, through which they have a chance of supplying public sector organizations.

1.1. Benefits of SME involvement in public procurement

Rationally the value for money spent in purchases should be as high as possible. Both Thai (2004) and Erridge (2004) have, however, argued that public procurement can also be used for economic, social and other purposes such as supporting local and domestic firms, assisting minority and woman-owned businesses or environmental protection. The involvement of small businesses in public procurement can serve these purposes. For example, by contracting with small businesses the government gains increased innovativeness, encourages entrepreneurship and contributes to job creation and economic development (Reed et al., 2004). Small businesses also tend to have higher growth rates than large firms (Denes, 1997). Thus, by buying from SMEs the public sector can positively influence local economies, regional regeneration and

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local sourcing (Walker, 2006 in Zheng et al., 2006). These external benefits accrue to the economy and society (NERA Economic Consulting, 2005), but SMEs have some features that present high potential for public sector buyers as well. They are considered as a locus for innovation (Hoffman et al., 1998), and they produce over 10 times more patents per employee than their larger counterparts (Clark and Moutray, 2004). SMEs are also seen as a source of flexible personalized services (Zheng et al., 2006). In addition, small businesses are expected to be able to respond quickly to changing market demands, are organizationally flexible and have more efficient internal communications than large firms (Reed et al., 2004). These are the types of benefits that accrue to procurers both in the short and the long run.

1.2. Scope of the study

Prior research has investigated SMEs as buyers (e.g. Agndal, 2006; Morrissey and Pittaway, 2004; Mudambi et al., 2004; Rooks and Snijders, 2001). However, current knowledge on involving small businesses in public procurement is limited. Caldwell et al. (2005) argue that there is little empirical evidence on the role of public procurement in promoting competitive markets. According to Zheng et al. (2006) there is some evidence on the level of SME involvement at the aggregate level but knowledge on a disaggregated level, such as what types of SMEs act as suppliers to public organizations and in which public sectors, is limited. Differences between SMEs' actual involvement and their opportunities for involvement between municipal- and state-level procurement have also not been researched. Hence, there is a need to investigate what characteristics (i.e. capabilities, resources and perceptions) of SMEs influence both their actual involvement in public procurement and their perceptions of their possible involvement.

This article seeks to provide insights on those issues. This is done by identifying characteristics of SMEs affecting their involvement in public procurement and by examining whether the perceptions of SMEs on their own capabilities affect their involvement in public procurement. Furthermore, the article analyzes the factors explaining SME involvement separately in state and municipal procurement, which differ in certain aspects (e.g. level of centralization, demand and automation), although prior research has treated them as a uniform group. The research problem is centred on investigating how the resources, perceptions and characteristics of SMEs affect their access into public sector procurement. Particular attention is paid to the effects of whether the SMEs are in possession of electronic order processing and invoicing systems and to the difference between SMEs of two different sizes.

When referring to SMEs in this article, we adhere to the EU definition that the category of micro-, small- and medium-sized enterprises is made up of enterprises that employ fewer than 250 persons and have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro (European Commission, 2005). In terms of this study, however, the potentially limited resources of SMEs referred to in many previous studies (e.g. Lee et al., 1999; Nooteboom, 1993; Grando and Belvedere, 2006) are more important than the criteria used in the official SME definitions, as these limitations make it difficult for SMEs to be involved in public procurement. SMEs perceive public procurement processes as too burdensome. According to Lee et al. (1999), lack of resources is very often cited as one of the major obstacles faced by SMEs. Nooteboom (1993) suggests that SMEs' disadvantages most often lie in material resources, including high costs due to diseconomies of small scale, limited scope, experience and learning. In the hypotheses, a

further division is made between micro firms of less than 10 employees and other SMEs, to investigate whether there are differences among SMEs of various sizes.

The remaining part of this article is organized as follows. First, relevant prior research on obstacles of SME involvement in public procurement is discussed and hypotheses are presented. Second, research design including the choice of methodology and collection of empirical data are described. Then, results of the survey conducted among Finnish SMEs are reported. Discussion of the main findings as well as their implications for management practices and future research will conclude the article.

2. Literature review

This section defines hypotheses based on prior literature and introduces a conceptual model that is expected to explain SME involvement in public procurement. Hypotheses are related firstly to SMEs' perceptions of their resources and their electronic systems as explanatory factors for involvement in public procurement, and secondly, to the impact of enterprise size on SMEs' perceptions of resources available to support involvement in public procurement.

2.1. SMEs as public sector suppliers

Small and medium businesses have a crucial role in employment and the whole economy of the EU. They account for over 99 percent of the total number of enterprises in the area and provide jobs for over 100 million people, which is over 2/3 of total private employment (European Commission, 2004). Despite the apparent importance of SMEs, Bovis (1998) has argued that market access in public procurement is limited for SMEs and disproportionately low in relation to their number throughout the EU. Intriguingly, only a limited number of SMEs are able and willing to sell to the public sector (Smith and Hobbs, 2001). For example, in the UK only 7 percent of SMEs was interested in collaborating with the public sector (SBS Survey, 2006). One reason for the low interest in being involved in public procurement could be that bidding for government contracts is typically 10–50 percent more costly than bidding for comparable projects in the private sector (Fee et al., 2002). The buying process of public organizations is different from private sector because the principles for tendering processes and supplier selection are regulated by law. For example, within the EU both union-wide directives and national legislation govern the buying process of state and municipal organizations. All purchases above set thresholds need to be publicly announced using formal channels such as TED (Tenders Electronic Daily) database and must be subjected to competitive tendering. The threshold values depend on the type of contract and public agency (Heijboer and Telgen, 2002).

Previous literature has presented obstacles for the low level of SME involvement in public procurement in three categories: the bidding process, contract sizes and inadequate information sharing. First, the bidding process regulated by procurement legislation is rigorous and resource consuming by nature, and even insignificant deviations from the requirements may lead to the rejection of bids. According to the SBS Survey (2006), the most commonly cited barrier for selling more to the public sector was the effort involved in bidding or supplier pre-qualification. Fee et al. (2002) also pointed out other problems such as burdensome documentation, the time and cost involved in preparing offers, and specification of standards. Similar problems were noted already in 1991 by MacManus. Furthermore, SMEs may lack the language skills needed particularly in technical areas (Bovis, 1998).

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