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THE PARTICIPATION OF SMES IN STATE PROCUREMENT

Georgia in Focus

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Table of Contents

Introduction	2
Georgia in brief: the status-quo of public procurement.....	2
BSO interviews and SME public procurement needs	5
Integrating SMEs into public procurement.....	7
Key takeaways and recommendations	14
References	15

Introduction

Public procurement is regarded as a strategic governance tool for the endorsement of sustainable growth. OECD Public Governance Reviews (2018), for instance, highlight that public procurement accounts for 12% of GDP and 29% of total government expenditure in OECD countries.

To warrant the benefits of globalization and open markets, small and medium-sized enterprises (SMEs) often serve as significant agents for social integration, contributing to more than 60% of total employment and 40% of national income (GDP) in emerging economies (The World Bank Group). The public sector is a significant market for SMEs, accordingly, developing more SME-friendly public procurement practices, removing obstacles, and involving more SMEs in the process would maximize SME potential in creating more jobs, innovation, and growth. Higher competition is a further notable result motivated by increased SME involvement in public procurement.

In 2018, 32,597 tenders were announced and there were over 38 thousand registered suppliers in Georgian public procurement, and while this may appear noteworthy, the SME share is still vague as the agency does not record such data. Public procurement remains a substantial part of the Georgian economy, amounting to 10% of the country's GDP and 39% of the state budget in 2016 (World Bank). As one of the most significant governmental responsibilities, in essence, public procurement provides necessary services, goods, or work to society, thus it can act as a stimulus for development. Therefore, constant data-gathering, analysis, and monitoring of public procurement processes are vital for the country.

The aim of this policy paper is to emphasize the need of SME involvement in the Georgian public procurement process and to discuss certain international approaches used to reach various goals. The paper offers an overview of the Georgian public procurement system and subsequently focuses on SME involvement in this process, and finally proposes recommendations based on international practices.

Georgia in brief: the status-quo of public procurement

Since 2010, significant reforms have been executed within the Georgian public procurement system; most notably, in 2009, the current public procurement legislation was approved, considerably improving the legislative framework. Georgia, with the support of its international partners,¹ has implemented a more efficient approach of e-procurement, which is considered one of the most transparent in Europe and Central Asia. The political will of the Government of Georgia (GoG) was a core determinant of this marked success. Annulling paperwork, remote participation by bidders, increased competition and transparency, and reduced risk of collusion, alongside numerous other advantages, were the immediate

¹ The UK Government, the World Bank.

benefits of e-procurement for the country. In order to handle disputes in procurement, dispute settlement procedures were also established. Aside from e-procurement consolidated tenders,² simplified procurements (direct procurements),³ and contests are the other main forms of public procurement used in Georgia. The public procurement system continues to be developed further based on international experiences and programs twinned with Austria and Slovakia.

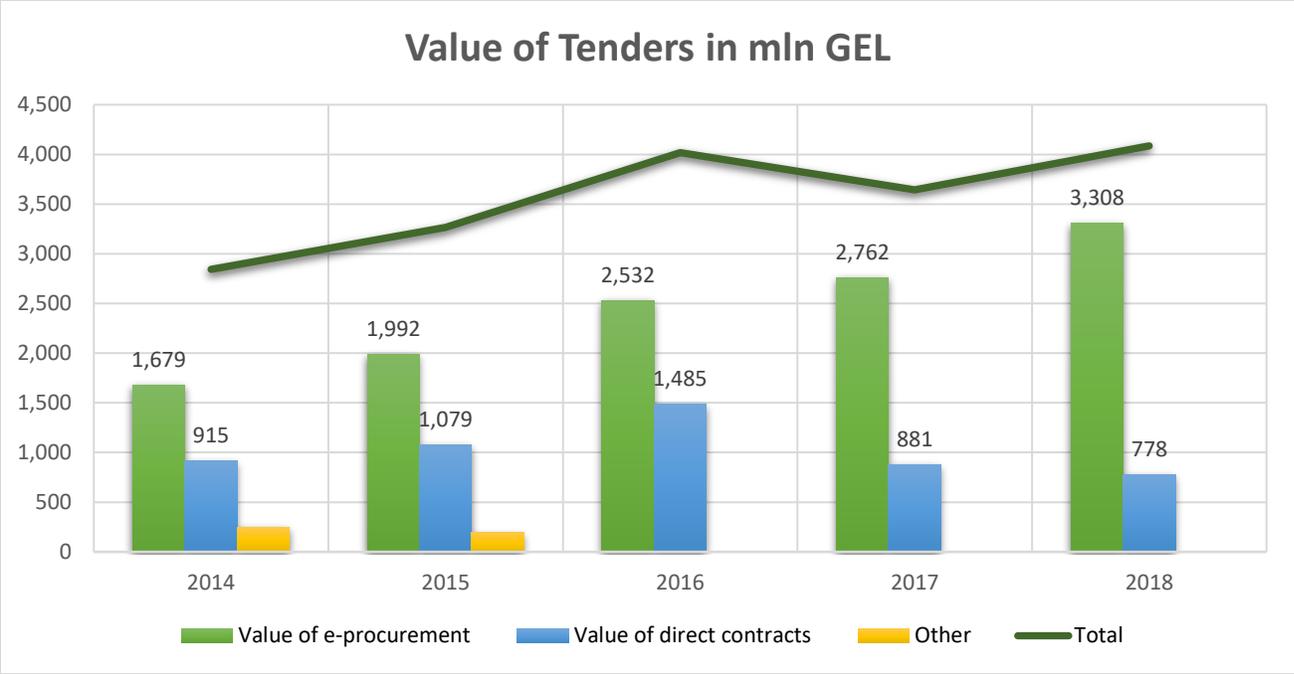
Several indicators are available to highlight the performance of the Georgian public procurement system. Certain signs of progress can also be readily seen, for example, the value of contracts is increasing over time (see figure 1). Significantly, starting from 2014, more variety was included in the forms of public procurement (contests, consolidated tenders, Geo tenders, etc.), while thereafter these forms were aggregated into larger groups (e-procurement and direct contracts).

The number of registered companies in the public procurement system and the tenders announced also display an increasing tendency over time (see figure 2). Remarkably, the number of registered companies is growing faster than that of tenders. In 2018, more than 3,300 new companies were registered, and the total number of registered suppliers reached 38,248. It is also noteworthy that, aside from local Georgian businesses, there is fairly significant interest from non-resident companies for public procurement tenders. The number of foreign suppliers reached 1,700 in 2018, with 61 contracts signed by foreign companies, for a total contract value of more than 122 million GEL. This accounted for approximately 4% of the total volume of tenders procured in Georgia. The majority of tenders in 2018, up to 40%, were of low value (in the 10,000 GEL or less group, within seven monetary value groups). The final statuses of contracts is also interesting, the contracts awarded coincided with 73% of the total tenders announced, while 3% were terminated, 18% never occurred, and 6% were completed, though with negative results.

Figure 1: The value of Georgian public procurement tenders

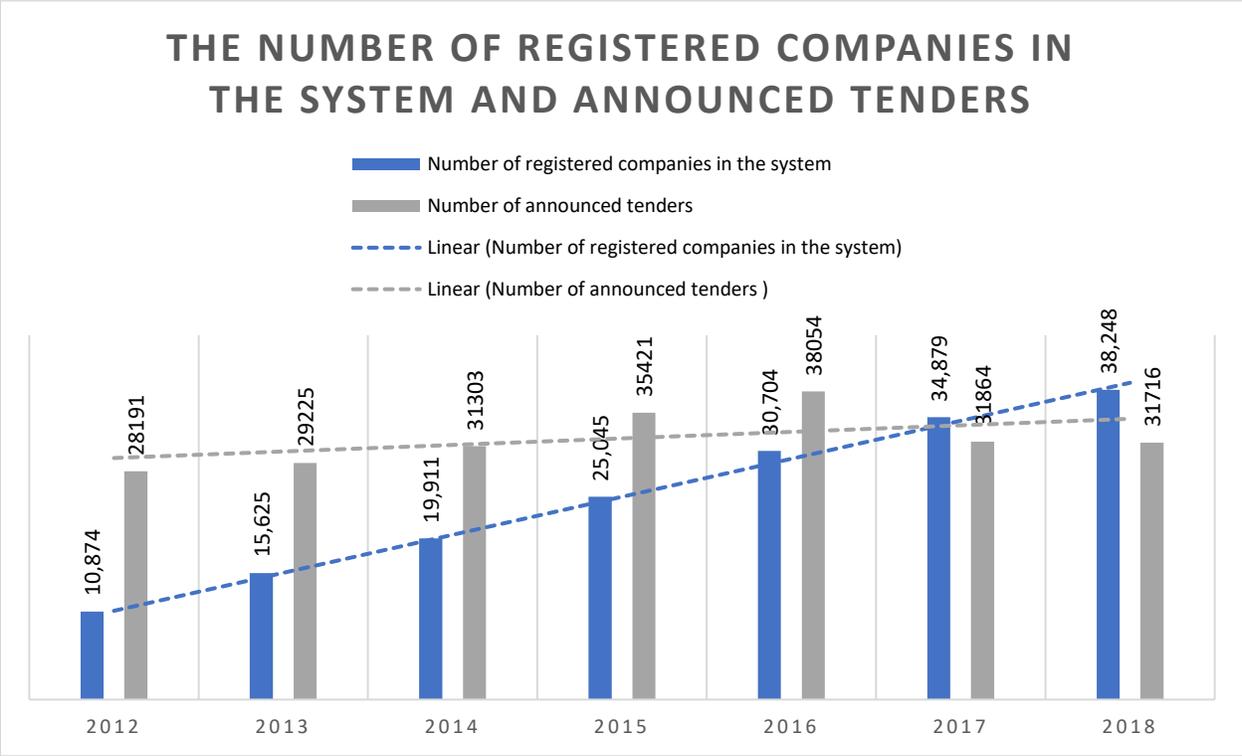
² A procedure conducted by an authorized agency, stipulated under the present law, set by the Government of Georgia for the procurement of a homogeneous object of procurement, during which the best tender proposal is identified.

³ The method of state procurement for homogeneous objects with a value up to 200,000 GEL.



Source: State Procurement Agency (SPA) statistics

Figure 2: The number of registered companies in the public procurement system and announced tenders



Source: SPA statistics

BSO interviews and SME public procurement needs

The previously mentioned statistics appear to offer the big picture, however, the core question of “how many SMEs participate in the process and how many are awarded contracts?” remains unanswered. The Georgian public procurement agency does not record this data, consequently the numbers simply cannot be attained. Moreover, from another perspective, SMEs claim that in most cases there are no opportunities to participate in public procurement and thus serve as suppliers.

In order to discern the bottlenecks that Georgian SMEs face in attempting to access the public procurement process, ISET-PI conducted interviews with five BSOs in the agricultural sector, and hosted a public-private dialogue (PPD) for BSOs and policymakers. The BSO representatives were asked about their member SMEs and their experiences with public procurement processes. They were also questioned as to whether they had ever tried to participate, whether they had encountered any obstacles, and finally if they had any recommendations.

The main impediments BSO representatives highlighted are the SMEs’ volume of production and the organization of logistics. They claimed that no single SME has the capability to supply products on their own while also providing logistical services.

The problem of subcontracting was also emphasized, even though large companies act as “prime contractors” and often buy products from SMEs, the benefits are not distributed proportionally. In most cases, small businesses sell their products at a very low price, while large companies supply these products at a relatively high price. As subcontracting is not formalized in Georgia and the public procurement agency does not monitor the process, only larger companies benefit from the mark-up.

A lack of knowledge about the public procurement process is one of the core problems that the interviewees identified; small businesses fear that they will not be paid by the government and they do not have enough understanding of the process. Additionally, they avoid submitting financial guarantees. In many instances, they simply lack comprehensive knowledge about the regulations, quality control, and production processes. The BSO representatives are all wholly convinced that SMEs’ involvement in the public procurement process, over time, would help resolve these problems and that SMEs would thus be given further opportunities to develop resources and gather more specific knowledge.

The Georgian public procurement agency (PPA) hosts meeting for all stakeholders regarding procedures related to public procurement, however, Public-Private Dialogue revealed that most BSOs and SMEs were unaware of this information. Furthermore, nine training centers are open and available for start-ups and SMEs in Georgia, yet business representatives remain uninformed about their activities.

The recommendations from SME representatives are as follows:

- More attention should be paid to tender division regionally. This will guarantee more involvement of SMEs, as the obstacles regarding logistics and volume will be partially overcome;
- Subcontracting is a major problem. SMEs should be registered as official subcontractors in the process if the prime contractor is a large firm;
- Financial literacy and regulatory knowledge should be offered to SMEs, specifically relating to the public procurement process.

To better understand the needs of companies in the process of public procurement, a survey conducted by G4G (Governing for Growth in Georgia) in 2016 is worth consideration. The survey is representative of the whole country and envelopes 958 companies, of which 80% were Limited Liability companies (LTDs). This study aimed at identifying the causes hindering Georgian companies from participating in public procurement. The results revealed four key factors necessary for companies to participate in the process:

Human resources: Companies that do not participate in government procurement tend to have fewer employees, and rarely have sales staff who could potentially concentrate on the procurement process. However, even with such employees (or a single employee), their computer literacy levels and even access to the internet are limited compared with companies who participate in public procurement. Accordingly, in order to enable companies to participate more actively in public procurement, it is advisable for companies to have an employee who is accountable for sales and is well-informed of the public procurement system.

Awareness: The survey highlighted that the majority of companies that have never participated in public procurement have no information about the procurement process or details of the relevant available seminars. The more publicity the public procurement system gains, the more widespread the relevant seminars and training will be disseminated, which would consequently increase participation in the public procurement system.

Trust: Those companies that have never participated in the state procurement system find it difficult to offer an opinion as to whether they trust the public procurement system. Increasing companies' confidence in the procurement system is vitally important for greater active involvement in the process.

Turnover required by procuring entities: The turnover required by public procurement organizations tends to be a bottleneck factor for companies starting to participate in the process. The amount of turnover simply represents a barrier preventing involvement. Therefore, in order to increase participation in state tenders, it is advisable that the current requirements are reviewed and modified according to the existing conditions in Georgia.

Integrating SMEs into public procurement

Despite the benefits of having SMEs in the public procurement market, they are still underrepresented in the process. According to PwC, ICF, and OECD (2014), the share of public procurement contracts for SMEs, relative to their value added or share of turnover in the market, is low in non-OECD as well as OECD countries. This therefore may serve as reasoning for governmental intervention (Nicholas & Fruhmann, 2014). Based on surveys carried out by EBRD (2017) and OECD (2017), the administrative burdens related to the paperwork required for applications, difficulties competing with large firms, slow payment cycles, insufficient access to information, excessive bureaucracy, unclear tender requirements, and a lack of feedback from public surveys, represent some of the complications SMEs face in the public procurement process.⁴ Liao, Orser, and Riding (2017) offer a discussion concerning SMEs' challenges within each stage of public procurement (Table 1).

Table 1: SME challenges of public procurement

Stage of Procurement Process	Challenges
Access to information	<ol style="list-style-type: none"> 1. Finding opportunities on tendering platforms online 2. Lack of understanding of the procurement process 3. Expectations that the government favor larger suppliers
Pre-qualification	<ol style="list-style-type: none"> 1. Excessive paperwork 2. Difficulty getting bid lists for local contracts 3. The time invested does not guarantee an invitation to tender
Tendering	<ol style="list-style-type: none"> 1. Contracts are awarded considering the lowest price, not the best overall value 2. Cost of bidding 3. Just in time procurement limits the number of long-term relationships and reduces the number of suppliers 4. Subcontracting is also an obstacle
Contract administration	<ol style="list-style-type: none"> 1. Lack of capacity and resources to meet compliance requirements 2. Complexity of payments schedules and systems
On-going relationship management	<ol style="list-style-type: none"> 1. Lack of communications regarding expectations 2. Unplanned/unrealistic demands

Source: Liao, Orser, and Riding, 2017

⁴ The 2017 OECD survey on strategic use of public procurement to support SMEs.

As public procurement can play an instrumental role in socio-economic development, supporting SMEs in the procurement process has become a key interest to policymakers. Subsequently, governments try to facilitate SME participation in the procurement process through various means and approaches to ensure that competition remains fair.

Approach 1: Division of contracts into lots

Using several separate public procurement contracts (“lots”) enables SMEs better access, considering the administrative or financial burdens. By promoting SMEs in the market and offering tender participation to smaller business representatives, dividing contracts into lots helps develop competition in the market. The directive 2014/24/EU on public procurement, for instance, indicates that how and when to split contracts into lots has to be completed on case-by-case bases and that “there is no one size fits all” approach. Country and market specifications also have to be taken into account; accordingly, a contracting authority needs comprehensive knowledge regarding specific market working processes, moreover, the potential impacts on every stakeholder have to be considered. Thus, a contract could be divided in several ways: geographical division, service type, value, etc.

SIGMA⁵ brief 36 (2016) outlines several directives for the division of contracts into lots:

- “Divide or explain” – contracting authorities have the right to decide on whether to divide a contract, however, their justification is compulsory;
- How many lots SMEs can bid for at the same time has to be defined in advance and indicated explicitly;
- Limits can be set on the number of lots each economic operator can bid for;
- Limits can be set on the number of lots an economic operator can be awarded;
- Combined lots can also be permitted.

From 2017 OECD data, 83% of the countries surveyed⁶ reported on the strategic use of public procurement to encourage the division of contracts into lots to facilitate SME participation. One German case identified in the report serves as a helpful example for this approach:

The division of contracts into lots is compulsory in Germany, as defined by the law. The German government requires public contracts to be either subdivided into partial lots by quantity (partial lots) or by special items in the contract (trade-specific lots). While the implementation of this provision is challenging for the contracting authorities, and thus necessitates specific assistance in the design of tenders, the legal requirements resulted in the increased participation of SMEs. In order to assist the contracting authorities, the German federal government created a partnership with a consultancy firm to develop an electronic tool to support decision-making and to generate lots using algorithms. Nationwide data on the number of

⁵ SIGMA (Support for Improvement in Governance and Management) - a joint initiative of the OECD and the European Union.

⁶ 32 OECD countries and 5 non-OECD (Bulgaria, Columbia, Costa Rica, Thailand, and Ukraine).

employees, sales, and production values characterizing different industries each contributed to the proper the function of the tool, and thus appropriate decision-making. The tool was applied to any industry relevant to public procurement processes, moreover additional sectors could also be added thereafter. Based on the data, the tool then generated a suggested split of the market.

Division of contracts into lots	
Justification/motivation/reasoning	Risks
<ul style="list-style-type: none"> - Promotes SMEs and new entrants to the public procurement process - Fosters competition - Avoids dependency on a single supplier - Promotes tender participation - Heterogeneity reduces the scope for market-sharing arrangements 	<ul style="list-style-type: none"> - Trade-off between competition gains and efficiency losses - Excessive technical difficulties or expenses - Necessity to co-ordinate with different contractors for lots

Source: Author's compilation

Approach 2: Joint bidding/consortia rules

In the process of public procurement, governments can address the financial and technical capabilities of SMEs through another channel, namely using joint bidding or consortia rules. Via consortium bidding, two or more economic operators (SMEs) are able to act together and submit a bid for a large and complex contract within the public procurement process. This may either be through a previously established consortium or a group of bidders who unite for a specific contract. When two or more firms submit a single bid, they operate on a temporary, rather than long-term agreement. This approach allows suppliers to compete where they may otherwise not have the scale, equipment, geographic reach, or expertise to handle the contract individually, or they would not meet the minimum turnover requirements to bid independently. Furthermore, this approach offers economic operators the opportunity to rely on the capacities of other entities.

Different countries use various types of joint bidding, for instance in France there are types of liabilities required for different forms of consortia, thus SMEs choose to form either: groupement solidaire, which requires members of the consortia to be financially committed to the performance of the whole contract (joint-and-several liability consortia); or, groupement conjoint, in which each economic operator is responsible only for the performance of its allocated share (joint-liability-only consortia). However, the rules for creating consortia must be precisely specified for economic operators. The consortium bid must also produce real efficiency gains for all members and the contracting authority.

Joint bidding/consortia rules	
Justification/motivation/reasoning	Risks

<ul style="list-style-type: none"> - Combined services to create innovation and consistency - Small companies can be adaptable and innovative in their service provisions - Allows suppliers to compete where they may otherwise not have the scale, equipment, geographic reach, or expertise to handle a contract independently 	<ul style="list-style-type: none"> - Concerns about collusion in the market, reducing competition - The financial assessment of consortium suppliers may be very complicated, if each operator offers different services - Management and procurement time for the contracting body may increase
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Source: Author's compilation

Approach 3: Simplify bidding and procurement requirements for SMEs

One of the major hurdles SMEs face in participating in public procurement is the complexity of the procurement systems and processes. Standardizing procurement documents thus contributes to this issue. Document templates can be used for standardization, and this approach ensures a reduction in administrative burdens not only for SMEs, but also for contracting authorities. This method might be adapted in several ways: integrate e-procurement platforms; clearly establish public procurement rules; and adapt the use of procurement instruments and tools for lower-value contracts. It is notable that advertising opportunities for competitive procurement procedures facilitate SMEs, which benefit from enhanced visibility and easy access due to obligations to publish these opportunities on e-procurement systems.

For example, Canada adapted a standardization for simplifying solicitation⁷ and contractual⁸ documents for suppliers. These templates are part of a commitment to public services and procurement, which promote a common image. Their terminology was also standardized, and contracts simplified by using plain language. Ireland has also adopted similar simplification approaches in its public procurement processes.

Simplify bidding and procurement requirements for SMEs	
Justification/motivation/reasoning	Risks
<ul style="list-style-type: none"> - Greater consistency and uniformity - Use of templates reduces the administrative burden - Better understanding of public procurement processes 	<ul style="list-style-type: none"> - Certain types of contract still require specially designed documents

⁷ **Solicitation documents** are used to request a quote, bid, or proposal from potential suppliers to provide the required goods, services or work.

⁸ **Written documents** that define the roles and responsibilities under the construction contract, which are legally-binding to both parties (owner and contractor).

Source: Author's compilation

Approach 4: Encourage prime contractors to subcontract via SMEs

In many instances, SMEs participate in public procurement in the form of subcontracting. However, their representation in this manner is often not taken into account. Participating as subcontractors allow SMEs to avoid being the prime contractors and thus competing with larger firms for significant or complex public procurement contracts. Their relative sizes, limited resources, or limited specializations may deter SMEs from solely performing entire contracts or jointly tendering alongside other economic operators. Accordingly, subcontracting may offer a safe solution for SMEs to facilitate their entry into the public market. Governments try to ensure timely payments not only for prime contractors, but equally for subcontractors. This would thus also allow them to monitor SME participation in public procurement processes.

As an example, in 2013, Korea implemented an electronic platform for government contracts in order to better manage its subcontractors. This platform addresses issues related to transparency, poor practices, manual processes, post-award demands for price reductions, delayed payments, and non-payments. This system also allows project owners to manage subcontracting effectively. Furthermore, project owners are legally required to approve subcontracts following an examination of propriety and price. This approach allows the Korean government control over the numbers of SMEs involved in procurement processes and the ability to monitor their readiness for the public market.

Encourage prime contractors to subcontract via SMEs	
Justification/motivation/reasoning	Risks
<ul style="list-style-type: none">- Avoids large and complex contracts- Fewer administrative burdens for SMEs- Timely and fair payments for SMEs- A mechanism for monitoring the share of SMEs across contracts	<ul style="list-style-type: none">- Low level of transparency and accountability of payments between prime contractors and subcontractors- Risk of dual contracts if subcontractors are not monitored- Inclusion within an implicit political market

Source: Author's compilation

Approach 5: Provide SMEs with preferential financial treatment

Receiving timely, predictable payments from the government is a crucial factor for SMEs to help encourage their participation in public procurement processes. If payments are not made promptly, it could pose an additional risk for SMEs (SIGMA, 2016), as cashflow and liquidity might be adversely affected by payment delays (OECD, 2017).⁹ Another major barrier for SMEs are the excessive requirements for participation in public procurement markets. Disproportionate technical and financial requirements, alongside inadequate financial guarantees, might exclude SMEs from the process. For solving the latter issue, proportionate qualification levels and financial requirements should be set. While in eliminating late payment, some countries have implemented a system of timely and advance payments, putting legal limits on an acceptable payment period for public procurement contracts.

The European Union has created a directive (2017/7/EU) for combating late payments, which compels the contracting authorities to pay for any service and goods within 30 days. This directive is particularly aimed at protecting SMEs in order to improve their competitiveness. The directive incorporates rules for public authorities, who are also obliged to pay for goods and services within a limited period. Moreover, compensation, recovery costs, and statutory interest rates are considered if the directive is violated. The EU directive, constructively, provides member countries with the opportunity to adapt these rules to their own existing laws and regulations. A report from the European Commission (2016) showed that, even though the average payment period has started to slowly decrease, the contracting authorities did not respect the 30-day payment period and SMEs did not always acquire their interest, compensation, or recovery costs, largely for fear of damaging their commercial relationships. Nevertheless, this directive is in force and attempts to protect SMEs.

In Korea, the Public Procurement Service provides an upfront payment of up to 70% of the value of a contract. Moreover, for certain forms of contract, for instance orders on unit-price contracts, suppliers receive instant payments. Instant payments are received by SMEs within four working hours. While for upfront payments, the remaining 30% of the value is released within five days by the contracting authorities.

Provide SMEs with preferential financial treatment	
Justification/motivation/reasoning	Risks
<ul style="list-style-type: none">- No adverse effects of payments on firms' cashflow or liquidity- Proportionate qualification levels and financial requirements, and fair competition	<ul style="list-style-type: none">- Additional burdens for public officials avoiding relationships with SMEs

Source: Author's compilation

Approach 6: Preference programs with set-asides

⁹ Financing SMEs and Entrepreneurs: an OECD scoreboard.

Under a “set-aside” program a certain percentage of the selected governmental procurement contracts or the total spending is reserved, or set aside, for a targeted category of bidders that meet the preferential qualification criteria, such as SME status. Furthermore, SMEs can only compete against each other. The objectives of this approach is thus to reserve procurement and limit competition. The benefit of the set-aside option is that it produces rapid, visible gains and guarantees SME entry into the procurement process. In most cases, set-asides are established on an industry-by-industry basis within a country. The USA serves as a good example for detailing this approach:

Small, women-owned, and disadvantaged businesses are each covered by American preference programs with set-asides. At the federal level, annual targets and the percentage of the total value of contracts are established in order to be awarded to SMEs. The US scheme states that if the relevant public official fails to adopt the SME set-aside, the decision must be thoroughly justified, for instance, if the set-aside provokes a lack of adequate competition.

Preference programs with set-asides	
Justification/motivation/reasoning	Risks
<ul style="list-style-type: none"> - Visible gains to SMEs - Reserved share of procurement contracts, thus secured risk for SMEs 	<ul style="list-style-type: none"> - The exact impact is unclear - Cost and inefficiency - An implicit political market

Source: Author’s compilation

Approach 7: Regular tender training schemes for SMEs, advisory help, info-lines, and continuous engagement with SMEs

Free training and advisory services for SMEs are vital for boosting participation in public procurement tenders. During the initial stage, such training could discuss topics like changes introduced by new legislation, e-procurement systems, proposal development, and administrative issues. General and targeted public procurement training courses for SMEs have the potential to make SMEs better-prepared for participation in public procurement. These measures would increase the number of SMEs taking part in public procurement, which would foster the local economy, and at the same time public authorities would become better aware of SME specificities. Such training should be accessible from multiple locations and offer support to SME representatives as trainers, greatly enhancing its impact and attendance rates.

Italy has created over 260 SME public procurement training desks within 11 supplier associations across the country.¹⁰ The training desks deliver courses to local SMEs on the use of e-procurement tools. Central purchasing body experts train association staff, who subsequently train local SMEs free of charge. Procurement training desks maintain a fundamental role as reference institutions, as recognized by local enterprises. The practice has increased the number of SMEs participating

¹⁰ Developed by the European Commission, *Improving SMEs’ access to public procurement* (2016).

in tenders, and it has also changed the perception of the central purchasing body, which is increasingly seen as helping to foster business opportunities within a competitive and transparent environment.

Regular tender training schemes for SMEs, advisory help, info-lines, continuous engagement with SMEs	
Justification/motivation/reasoning	Risks
<ul style="list-style-type: none"> - Development of human capital - Long-run impact - Relatively cheap 	<ul style="list-style-type: none"> - One size fits all approach - Administrative costs - Might prove to not be enough

Source: Author's compilation

Approach 8: Price bid preferences

Price bid preference schemes are another approach that can contribute to SME participation in public procurement contracts. Bids from eligible SMEs are discounted by a given margin (e.g., 5%) and, if the lowest evaluated bidder is an SME, it is then awarded the contract. Price bid preference provides targeted assistance to SMEs in procurement tenders. The inverse method, which adds a percentage of a bid price onto larger bidders, is also applicable. Both methods have, essentially, the same effect and both cases highlight that SMEs are typically unable to compete at the same price points as large businesses.

Price bid preferences	
Justification/motivation/reasoning	Risks
<ul style="list-style-type: none"> - Direct SME assistance - Awards to SMEs 	<ul style="list-style-type: none"> - Might be inefficient - Implicit political market - Poor incentives

Source: Author's compilation

Key takeaways and recommendations

The key takeaways and pertinent details from this policy paper are summarized as follows:

- The division of contracts into lots is possible in the country, however, SMEs are still not offered appropriate opportunities because of other tender requirements;
- The government believes that introducing limits and preferential treatment for SMEs is discriminatory, and international organizations also do not favor this approach, however, the need for SME involvement is clear;

- New regulations are being planned for the standardization of contract language and formalizing subcontracting, however, as these approaches are not yet implemented they serve as bottleneck factors for SME involvement in the process;
- SME financial literacy and knowledge, focusing on the procurement process, should be improved upon and additional steps should be implemented to raise their awareness. The more publicity the public procurement system achieves, the more widespread relevant seminars and training will be disseminated. This will thus increase the participation of companies in the system, as well as improve the issue of governmental trust within companies;
- Better data tracking of SME participation will serve as an ideal source for implementing more efficient public procurement systems and requirements throughout the country;
- The existing requirements regarding company turnover should be modified and adjusted so that more companies are given opportunities to participate.

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