

Small and Medium Sized Enterprises and public procurement regulation: the division of public contracts into lots

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Small and Medium-Sized Enterprises (SME) are at the **heart of the economy** of any country. Moreover, they create significantly more employment than larger companies, train more people, and provide economic stability even during an economic crisis. SMEs are therefore also essential for a sustainable economy. However, their share of public contracts is often deemed insufficient.

Legislative techniques directed at increasing the participation of SMEs in public procurement include: the division of larger contracts into smaller lots, the reduction of 'red tape' bureaucratic hurdles, the limitation of participation requirements, requirements regarding the supply chain - such as direct payments to subcontractors, and reserving contracts to SMEs. This paper discusses one of these techniques: the division of contracts into lots.

Neither the **2011 UNCITRAL Model Law on Procurement** nor the techniques to favour SMEs covered in the Guide to Enactment (at 5-6) provide for the division into lots. In many countries, it is not practiced. This is also because the division into lots may have disadvantages. It might undermine the effectiveness of procurement when it is not technically or economically feasible, when the number or size of the lots is not geared towards the market in which they are to generate competition, or when the different components of a contract are highly dependent on each other and there is a need to coordinate them. Awarding a larger contract lowers administrative costs and increases buying power and economies of scale.

However, it is **argued** that the UNCITRAL Model Law on Procurement (with a basic provision) and Guide to Enactment (setting out details) should provide for the division into lots to increase SME participation in public procurement, based on the EU model. While the previous Directive 2014/18/EC merely tolerated the technique, **Article 46(1) of the new EU Public Sector Directive 2014/24/EU** now expressly and specifically provides that contracting authorities may award contracts divided into separate lots while they are free to determine the size and subject-matter of such lots. According to Article 46(4) Directive 2014/24/EU, EU Member States may also *require* rather than just allow the division into separate lots in their national laws transposing the Directive. Therefore, France and Germany could continue their already long-standing regimes of compulsory division into lots. However, in cases in which this has not been made obligatory by the transposing national law, such as in the UK or Austria, contracting authorities shall indicate the main reasons for their decision *not* to divide into lots. This means that, while the default approach suggested by the Directive is the division into lots and Member States have the option to make this obligatory for all or parts of the contracts subject to the Directive and their transposing national laws, the new Directive does not require the division into lots, as the decision not to divide a contract into lots merely requires a communication of the reasons, the "divide or explain principle". If the contract is divided, bids for multiple lots are allowed to keep large companies interested while encouraging SME participation.

First, **economic theory** supports the division into lots. Public contracts can be complex and of substantial size and value, requiring considerable financial resources and technical expertise. SMEs will often be excluded from these contracts simply because they lack the capacity to manage such a large contract in its entirety. Therefore, there is some indication that a division of large public contracts into smaller lots - geographical lots, and/or technical lots - would extend the supplier and provider base beyond large companies to SMEs. This could increase competition and value for money, provided the division has no parallel negative effects on competition, especially due to collusion. However, there is yet no conclusive empirical evidence that division into lots increases SME participation.

Second, the division into lots is **preferable compared to most other techniques to increase SME participation**. Techniques that aim to promote SMEs as subcontractors by intervening in the supply chain are too intrusive. This could undermine competition by discouraging the large companies acting as prime contractors from bidding for public contracts, and might even be the case for the requirement of direct payments to subcontractors. Cutting red tape, for example through the new European Single Procurement Document, may help SMEs, as it also helps large companies, but will not be sufficient on its own to increase SME participation. The reduction of participation requirements, such as minimum turnover – for example twice the turnover of the contract value – may increase SME participation but may compromise the interests of contracting entities in capable economic operators. Margins of preference for SMEs, for example allowing the most competitive SME to be x% more expensive than the most competitive large company, compromise competition and violate international trade principles. This is even more so when certain categories of contracts are completely reserved to SMEs. Finally, not including any technique to promote SME participation might permanently compromise competition and efficiency as SMEs continue not to bid for public contracts.

Finally, the division of larger contracts into smaller lots is **politically attractive**. While not violating obligations under international trade agreements, politicians and lawmakers of any political persuasion can do something for SMEs. This is important because these SMEs are or employ their voters. The UNCITRAL Model Law on Procurement should introduce the outlined flexible EU approach to the division into lots.