



The Jimmy Reid
Foundation

Using Our Buying Power to Benefit Scotland

- the case for change



Jim and Margaret Cuthbert

January 2012

Foreword

For the first report of the Jimmy Reid Foundation we wanted to pick a subject which showed how the big philosophical criticisms of the uneven relationship between government and big business are not simply the stuff of protest banners or of academic discussion. In fact, they are an analysis of the features of an economic and social system which is clearly not working as it should and they offer guides as to how to repair that system in a practical and workable way.

So our first report is on public procurement in Scotland, a subject which for most people is just about as mundane as political issues get. But in fact it is an issue which goes right to the heart of why policy-making which is too influenced by commercial interests is failing the general public. The Scottish Government and its agencies are spending more than £9 billion every year and yet little of this money is being directed at economic or social development in Scotland. We have a system, designed largely from the perspective of big business, which is treating almost a third of the entire Scottish budget as if it should have no policy role in growing the economy or improving our society.

The evidence in this report strongly suggests that while public sector procurement staff and the Scottish Government have the best of intentions, they are working against a system which makes it difficult to make the right decisions for Scotland. Small businesses are being shut out, contracts are being designed in a way that harms the Scottish economy, too much power is being granted to big corporations which face insufficient competition for contracts, the social dimension of government is being almost completely ignored and the specification of contracts is not giving the public what they need.

Almost all observers now accept that policy-making in Britain has been excessively captured by a political orthodoxy which has resulted in failure to protect the public interest in the face of commercial interests – even the Conservative Prime Minister now rails against what he calls ‘crony capitalism’. This report identifies three elements of that political orthodoxy which are leading to failures in procurement in Scotland:

- **Government is a technical process.** By pretending that running a country is the same as running a small enterprise, the highly complex business of balancing the needs of taxpayers, the users of public services and the policy goals of the government is reduced to a single simple question – how can we pay less? But the question is not simple – if saving us money today harms the economy, fails to improve society and costs us much more money tomorrow, is that a wise decision? The technical nature of Scottish procurement policy, being insufficient to address this question, simply requires people to plough on regardless.
- **Business leaders know best.** Far too much of the policy framework in Scotland has been defined and influenced by big business. There is an assumption that successful businessmen are best placed to tell us how to run the economy (and indeed government). This is a mistake – business leader may be very good at running businesses but an economy, a government and a nation are all more complicated than a business. If a business stops buying from a local supplier and shifts to an overseas supplier it does not

need to worry about the loss of jobs in the local supplier. A government does. And if a business finds a hole in the domestic supply chain it has no need to do anything other than go elsewhere. A government has a responsibility to the entire economy. There is a very big difference between economic development and business development.

- **What's good for corporations is good for you.** The EU sets legal limits to what can be done in a nation's procurement policy, but it is up to each country to write this into its own laws. When the UK did so it appears to have conflated the national interests with the interests of big corporations. There seems to be an assumption that the easier we make procurement for big business, the cheaper (and therefore better) things will be for us all. As we can see throughout this report, the evidence suggests something quite different.

But this is a positive report – and what we want people to take away from it is that a more creative and less narrow-minded approach to procurement could put a very big sum of money into play in the battle against Scotland's economic problems. We can create a virtuous cycle in which we keep more economic activity in Scotland and at the same time we can drag the quality of that activity upwards. We can boost research and development, training, the Scottish supply chain, the employment practices of Scottish companies and many more things. We just need to accept that a policy that seemed right to many people ten years ago is not right for Scotland now.

This is the most detailed and in-depth independent study ever undertaken into the £9 billion public procurement business in Scotland. If only we can strengthen the arm of the public sector in getting us real value for money from this public expenditure, we can get an immediate and sustained economic boost for the Scottish economy. And it need cost us virtually nothing.

In publishing this report we hope we have shown that a calm and careful assessment of the real impact of the excessive influence of a corporate worldview on Scottish policy is detrimental to our society and our economy. But our aim is to show how easy – and how transformational – it would be to take a different approach.

Robin McAlpine

Director

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(With thanks to Stephen Boyd of the STUC, Hugh Andrew of Birlinn Press and Grahame Barn of the Federation of Master Builders for their contributions)

“Whoever takes the important economic decisions in society ipso facto determines the social priorities of that society”

(Jimmy Reid, Rectorial Address, 1972)

Introduction

This paper concerns the economic and social development potential of public procurement in Scotland and the challenges we face in realising that potential. The amount of money spent on our behalf by devolved public bodies in Scotland was £9.2 billion in 2009-10. By any measure, this is a very large amount of money, representing about a quarter of all devolved public expenditure in Scotland. Properly used this could be a lever to help create jobs, skills training, business expansion, research and development, innovation, and new firm creation in Scotland while at the same time conforming to EU Directives on procurement.

It is therefore important to examine how that money is spent. This is not just a question of efficiency and whether we are getting value for money in the short term. It is important to know whether the way this money is spent helps (or indeed hinders) the Scottish economy. It is with this latter aspect that this paper is concerned.

The structure of this paper is as follows:

- **Section 1** gives some data about the nature of procurement spend in Scotland.
- **Section 2** sets the scene by giving two opposing views of how well the system of public procurement in Scotland is actually operating.
- **Section 3** provides background on the EU procurement directive, which is the framework within which public procurement activity has to take place.
- **Section 4** outlines the Scottish Government's approach to procurement policy. It describes how the EU procurement directive was implemented in Scotland and also considers other important factors like the McClelland report which have influenced the direction of procurement policy in Scotland.
- **Section 5** looks at examples illustrating how procurement works in practice.
- **Section 6** considers some specific further issues relating to framework agreements, monitoring and the role of Scottish Enterprise.
- **Section 7** looks at relevant information from other parts of the EU on procurement and the ways in which different countries have been able to operate within the framework of the procurement Directive.
- **Section 8** presents our conclusions and specific recommendations.

In summary, our findings are that the overall process of public procurement in Scotland is not working satisfactorily from an economic and social development perspective. In many cases, contracts have been made very large and there are significant barriers to participation by small and medium sized enterprises. Procuring bodies also find it difficult to reflect social and economic requirements in their procuring decisions. This reflects, to a large extent, the big business friendly/low burden approach which was adopted by the Office of Government

Commerce when it was implementing the EU Procurement Directive in England – an approach which Scotland chose to copy. It also reflects the particular thrust given to public procurement in Scotland by the McClelland report. This unsatisfactory outcome, however, is not inevitable. Evidence from elsewhere in the EU indicates that much more can be done within the scope of the EU Directive, for example to assist the involvement of small to medium sized enterprises. The final section of the report sets out a large number of specific recommendations.

1. The Size and Nature of Procurement

1. The following table, produced by Procurement Scotland, shows the breakdown of the £9.2 billion spend on devolved public procurement in Scotland by the types of body doing the procurement.

Table 1: Commodities Purchased 2009-10		
Public Body	Spend £ million	As % of total
Central Government	1,379.9	14.9
Local Authorities	4,770.7	51.6
NHS	2,087.7	22.6
Further and Higher Education	804.9	8.7
Police	145	1.6
Fire	50.3	0.5
Total 9,238.6		

The table shows that by far the largest buyer of goods and services was the local authority sector, followed by the NHS and the Scottish Government.

2. In fact, there are 122 different public sector organisations whose procurement spend is covered by the above table. The information in the table is derived from data on accounts payable supplied by the finance departments of these bodies and aggregated into what is known as the Spikes Cavell database which is one of the main sources of information on procurement expenditure in Scotland.
3. Another analysis from this database showing main categories of spend (of amounts greater than £250 million) is shown in the table below. Here it is possible that the data is less precise as spend is allocated to each category according to the main type of good offered by the supplier in the 'account payable' and the supplier may have supplied several different types of good in the one invoice. Nevertheless, it is clear that construction and the supply of construction materials is by far the biggest category of spend. Note too the importance of facilities management which includes some expenditure under the Private Finance Initiative, and the financial services category which involves 5.3 per cent of all procurement spend.

Table 2: Main Categories of Spend, 2009-10		
Main category	Spend £ million	As % of total
Construction and materials	2366	25.6
Social and Community care	1,255	13.6
Healthcare	819	8.9
ICT	768	8.3
Facilities Management	750	8.1
Public Transport	488	5.3
Financial Services	385	4.2
Environmental Services	328	3.6
Human Resources	289	3.1
Total all categories 9238.6		

Although it would be interesting to determine the split of contract value between Scottish suppliers and others, at present this is difficult as the address available for accounts payable data is that given by the supplier on the invoice, which can be a local office in Scotland of a multinational business.

2. Two Opposing Views of the Procurement Process

1. It is useful to start by giving two opposing views of the way the system of public procurement in Scotland currently operates.
2. The first view is demonstrated by an article in the Sunday Herald of 7 August 2011. The author is Brian Jukes, who is a Director of a consultancy specialising in the construction industry. According to this article, *"Many Scottish construction companies are dying a slow death, because the Scottish Government's flagship procurement policy excludes them from competing for public work."* This was happening because the Scottish government's procurement policies led to large, high value contracts which had the effect of freezing out smaller contractors. There was, according to the article, widespread business frustration with this, and incomprehension as to why the government had chosen to go this way. Similar views have been expressed by others, including, for example Grahame Barn of the Federation of Master Builders.
3. An altogether different view was given by Alastair Merrill, Head of the Procurement Directorate of the Scottish Government, in his news letter to staff, issued just before Christmas 2011. This takes an unrelentingly optimistic tone. He starts by quoting an unnamed leading figure from procurement south of the Border in the following terms: *"Thank goodness for devolution. If Scotland hadn't shown what was possible, we'd never had had the courage to try"*. Alastair Merrill then goes on to dismiss what he regards as five key myths about procurement in Scotland. Three of these myths, in particular, are relevant here. According to Merrill:
 - It is a myth that we interpret EU procurement law far more strictly than our European partners, to the detriment of Scottish businesses.

- It is not true that other EU states are far better at giving business to small to medium enterprises (SMEs). According to Merrill, 45 per cent of contracts by value, and 75 per cent by number went directly to SMEs: figures which, within the EU, are only bettered by Bulgaria.
 - It is a myth that Scottish businesses lose out unduly to companies outwith Scotland: according to Merrill. The proportion of cross border contracts is about, if not slightly lower than, the European average.
4. It is clear that these opposing views of the Scottish procurement process cannot both be correct. By the end of this report, we should be in a position to draw some evidence based conclusions about which is closer to reality.

3. Background: The EU Procurement Directive

1. The starting point for any consideration of public sector procurement has to be the framework set by the EU Directives on public procurement. The present Directive is Directive 2004/18/EC: though, as we shall see later, consideration is currently being given to modification of this Directive.
2. The Directive sets down, in a fairly prescriptive degree of detail, the various articles which had to be written into the laws of the individual member states. The fundamental principle, Article 2, is that of openness and non-discrimination in the award of public contracts. To achieve this openness all public sector contracts above a fairly low threshold size (€125,000 for procurement of supplies by central government, €193,000 for procurement of supplies by other public sector, €4,845,000 for procurement of works) have to be advertised community wide. This is typically in the Official Journal of the European Union (OJEU).
3. The OJEU advertisement for the contract must contain a full and detailed description of the specification of what is required from the contract, including details of any contract performance conditions. It is not possible to bring in at a later stage of awarding contracts any specifications omitted from the original advertisement.
4. The advertisement must also specify the criteria which will be used in determining the successful supplier(s). A key section of the Directive, Article 53, sets out the mandatory procedures which must be used in awarding contracts. Two basic approaches are permissible. One is to adopt the criterion of the lowest price among qualifying bids. The other is the criterion of 'most economically advantageous tender', which the Directive also describes as value for money. Which award criterion is going to be used, and, if appropriate, the detail of how the criterion is going to be applied, have to be specified when the contract is advertised.
5. The 'lowest price' approach to tender award is self explanatory. The concept of 'most economically advantageous tender', however, requires some explanation. A contracting authority which has chosen to go down this route has to specify in advance the specific criteria it will use to judge economic advantage, and the weightings which will attach to these individual criteria in the final tender decision. The specific criteria chosen have to be

related to the subject of the contract: and have to be non-discriminatory. But, subject to these constraints, the contracting authority has latitude about the criteria it selects. Article 53 itself states that the criteria shall be *“various criteria linked to the subject-matter of the public contract in question, for example, quality, price, technical merit, aesthetic and functional characteristics, environmental characteristics, running costs, cost-effectiveness, after-sales service and technical assistance, delivery date and delivery period or period of completion”*. In the preamble to the Directive, however, the discussion of Article 53 (paragraph 46 of the preamble) indicates that the intention is for contracting authorities to have the latitude to include economic and qualitative criteria, including environmental requirements and criteria aimed to meet social requirements. It is important to remember that, since this latitude has to be exercised in such a way that the criteria specified relate to the subject matter of the contract, then detailed and careful specification of the subject matter is an essential step.

6. From other parts of the preamble to the Directive, and from the Articles themselves, it is clear that those drafting the Directive were conscious of the need to have a degree of protection for certain special groups or certain types of activity. For example;
 - Paragraph 23 of the preamble, and Article 16f, deal with provisions to encourage research and development. In particular, research and development contracts are not covered by the Directive, except those where the benefits accrue exclusively to the contracting authority *and* the funding is solely provided by the contracting authority. In practice, this means that many, if not most, R&D contracts are outwith the scope of the Directive.
 - Paragraph 28 of the preamble, and Article 19, enable contracts to be reserved to shelter workshops or sheltered employment programmes.
 - Paragraph 32 of the preamble, and Article 25, deal with provisions to help small and medium sized enterprises (SMEs). The preamble makes it clear that those drafting the Directive thought it was advisable for contracting authorities to include provisions on subcontracting. Article 25 states that the contracting authority may ask or may be required by a Member State to ask the tenderer to indicate in his tender any share of the contract he may intend to subcontract to third parties and any proposed subcontractors.
 - Paragraph 33 of the preamble indicates that it is permissible to stipulate contract performance criteria – provided these are not directly, or indirectly, discriminatory. As that paragraph states, such criteria may *“be intended to favour on-site vocational training, the employment of people experiencing particular difficulty in achieving integration, the fight against unemployment or the protection of the environment. For instance, mention may be made, amongst other things, of the requirements - applicable during performance of the contract - to recruit long-term job-seekers or to implement training measures for the unemployed or young persons”*.
7. Another important aspect of the Directive relates to framework agreements. A framework agreement is an arrangement whereby, on the basis of an OJEU invitation to tender, a contracting authority sets up an agreement with one or more successful tenderers, to last for a period of no more than four years. During the life of the agreement, specific contracts may then be ‘called down’ from the approved list of tenderers (provided these contracts are within the terms of the original contract specification) without going through the process of re-advertising each specific contract down the OJEU route. Such framework agreements are particularly entered into by central purchasing agencies acting on behalf of a group of public bodies - for example a group of universities.

8. What emerges from the EU Procurement Directive therefore amounts to a fairly mixed picture. On the one hand, there is a heavily prescriptive element to the Directive and the Directive involves the specification of procedures which are burdensome and likely to be costly and cumbersome to implement. On the other hand, those drafting the Directive were also clearly aware of the importance of being able to protect various disadvantaged groups, of taking social, economic, and environmental issues into account, of encouraging research and development, and of the economic importance of SMEs. A number of exemptions and provisions were written into the Directive to allow for these needs. As we will see, when the Directive came into effect in the UK and Scotland, these provisions relating to the needs of the economy and special groups were, for a variety of reasons, underplayed.

4. The Scottish Government's approach to procurement policy

1. The Scottish Government has devolved responsibility for the development and application of public procurement policy. It was therefore for the Scottish Parliament to implement EU public procurement law: and in principle, this could have been done independently of Westminster.
2. In practice, in 2005/06, when it came to translating the EU procurement Directive into Scots Law, the administration then in power at Holyrood decided that it would implement the regulation separately from the rest of the UK (rather than extending English regulations to Scotland by means of a Sewel motion) but nevertheless proceeded on the basis that the Scottish regulations would mirror those being developed in England by the Office for Government Commerce (OGC). The effect is that the relevant regulations in Scotland (the Public Contracts (Scotland) Regulations 2006), are in almost all respects identical to the corresponding regulations in England (the Public Contracts Regulations 2006).
3. The decision of the Scottish government to mirror the English regulations is not merely constitutionally curious, it also arguably amounts to a serious mistake. The approach of the OGC in drafting the English regulations has been criticised (for example by the STUC) as being focused on the goals of minimising business burdens. OGC appears to have put little focus on either the desirability of retaining as much economic value as possible within the UK's boundaries or on facilitating the scope which exists within the EU regulations for achieving wider environmental, social, or economic goals. For example:
 - Article 25 of the EU Directive, dealing with sub-contracting, states that "*the contracting authority may ask or may be asked by member state to indicate what share of the tender it is proposed to sub-contract*". It was thus left open to the individual states whether, on enacting this Article, they would choose to make it mandatory for contracting authorities or leave it optional. In the English regulations, (and hence in the Scottish), the OGC chose the optional route: so weakening a provision which was designed for the benefit of SMEs.
 - Article 27 is another case where the EU Directive leaves the choice open to the individual state whether to implement on an optional or mandatory basis. If implemented

mandatorily, the effect would be that tenderers for contracts would have to confirm that they would comply with relevant obligations relating to taxes, environmental protection, employment protection provisions and working conditions. The OGC (followed by Scotland) decided not to make this provision mandatory.

- Article 53, in defining the concept of economic advantage for deciding the award of a contract, used the form of words quoted above in paragraph 5 of the preceding section, which gave a list of specific criteria introduced with the words “for example”. Regulation 30(2) in the English and Scottish regulations gives the same list but misses out the words “for example”, thus giving a more restricted impression of the kind of criteria which could be used. In particular, as we noted in the preceding section, it is clear from the preamble to the EU Directive that it would be possible to include other criteria relating to social and employment issues: but this aspect is not brought out in the English or Scottish regulations.

4. At about the same time as the EU regulations were being enacted in Scots Law, another important development was taking place which was also going to have a profound effect on the direction of procurement policy in Scotland. This was the review of public procurement in Scotland carried out by John McClelland, commissioned by the then Labour/LibDem Scottish Executive, and which reported in 2006 (McClelland, 2006).
5. The McClelland review was intended to report on the structure, skills and practice of public procurement in Scotland, and to identify opportunities for improvement. The review was conducted with a distinct agenda of efficient government. In practice, it was largely driven by the desire to achieve cost savings and only gave what amounted to token reference to the need to achieve corporate and social responsibility, or to the wider social and economic effects of procurement policy.
6. The way in which the McClelland review concentrated primarily on cost saving may be explained in part by McClelland’s own background. In the Foreword to the review, McClelland noted that he had *“conducted this work personally to ensure my own experienced participation is a cornerstone of the analysis and review”*. His own experience was solidly grounded in business, having been, for example, Vice President of Worldwide Operations for IBM’s personal computer company before joining Digital Equipment Corporation in 1995 as a Senior Vice President.
7. In fact, this focus on cost saving represented a change from the way in which Scottish procurement policy had been developing. In December 2001, the then Scottish Executive had published a guide intended to be used at a strategic level to develop and monitor local authority procurement policy, in which Best Value would play an integral part (Scottish Executive, 2001). The guide noted that *“a procurement strategy can enable an authority to put its own stamp on the approach taken to identifying possible options, appraising those options, and putting them into practice”*. And that *“even prior to a full statutory framework, local authorities can align their procurement strategy with policies for sustainable economic development, environmental policies (green purchasing), equalities, and ‘fair contracts’ with small businesses and the not-for-profit sector”*.
8. The McClelland review made a number of far-reaching recommendations: the status and professionalism of the procurement function should be raised, centralised procurement agencies should be developed, collaborative procurement and the use of pooled contracts should be encouraged, every public sector organisation should report regularly on the cost savings achieved through better procurement, and better information systems should be developed to monitor the operation of the procurement process.

9. In the light of the McClelland report, the Scottish Government set about expanding or establishing specialised procurement agencies so that most of the public sector ended up covered by such agencies. Procurement Scotland was set up in 2008, for central government. Scotland Excel was established in the local authority sector, building upon existing local authority networks, and Advance Procurement for Universities and Colleges (APUC) was established for the higher and further education sectors. In addition, specialist procurement bodies have been set up for functions like Health, Fire and Police. A major part of the activity undertaken by these bodies has been in setting up systems of framework agreements for the provision of specific goods and services which their members may then draw down. Typically, therefore, a public sector body will have a choice for an individual procurement decision as to whether to call down a framework agreement or whether to go out and procure directly, and itself go through the procedures laid down by the EU Directive.
10. The Scottish government, mainly through the agency of Procurement Scotland, has taken, and is taking, a number of actions designed to improve the efficiency of the procurement process, both for buyers and suppliers. For example, it set up the important portal Public Contracts Scotland with the intention of providing a readily-accessible and convenient source of information both on public contracts being tendered and on potential suppliers. It published an extensive set of guidance, called 'the procurement journey', designed to help buyers and incorporating standardised processes and templates. It has produced corresponding guidance for suppliers, 'the supplier journey'. It has developed a 'Quick Quote' tool for smaller contracts. It is developing a standard pre-qualification questionnaire and database, designed to reduce the burden on suppliers of demonstrating compliance with pre-qualification conditions. And it has published guidance, albeit fairly weak guidance, on the possibility of splitting large contracts into lots: "*splitting the requirements into lots may ensure that specialised suppliers are included for specialised requirements*". Procurement Scotland has put a lot of effort into these initiatives, which are clearly valuable. But as we shall see in the next section, these actions in themselves do not guarantee that the procurement process is actually working satisfactorily from an economic development stance. (Note that, following a recent reorganisation, Procurement Scotland as such no longer exists: but its functions continue within the wider Procurement Directorate of the Scottish Government.)
11. Other actions undertaken by the Scottish government include:
 - the establishment of a Public Procurement Advisory Group intended to provide an ongoing framework for dialogue about, and influence upon, procurement practices as they affect suppliers. This body has, however, been criticised for failing to resolve an inherent internal contradiction: with employers' desire for reduced burdens on business not necessarily being consistent with the special measures which might need to be taken to further economic and social goals.
 - A valuable initiative was the report 'Community Benefits in Public Procurement' produced jointly by the Scottish Government and COSLA in 2008 (Scottish Government and COSLA, 2008). This report described the work of a pilot programme intended to facilitate the use of community benefit criteria in public contracts – particularly criteria relating to targeted recruitment and training. It concluded that it was feasible within EU procurement law to develop and include such criteria in public contracts.
12. In 2009, when the Scottish Government published its sustainable procurement action plan for Scotland (Scottish Government, 2009) it defined its overall purpose as being "*to focus government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing, sustainable economic growth*". It defined

sustainable procurement as “a process whereby organisations meet their needs for goods, services, works, and utilities in a way which achieves value for money on a whole life basis and generates benefits to the organisation, but also to society, the economy, and the environment”. The action plan is, however, a disappointing document: for many of its recommendations, it is difficult to see how they can be converted into meaningful action. For example, one principal recommendation is to “establish a formal ‘sustainability’ test which confirms customer requirements have been tested for sustainable social, economic, and environmental factors”. Perhaps the disappointing nature of this report was inevitable, given the woolly and ill-defined nature of the very concept of sustainability on which the plan is based. The action plan is to be followed by a Sustainable Procurement Bill, which, it is proposed, will be put before the Scottish Government towards the end of 2012. It will be a major challenge for the Scottish Government to make sure that the Bill rises above the level of the original action plan.

13. Overall, at least in its more public utterances, the Scottish Government expresses itself fairly well satisfied with the progress it has made on public procurement. It points not just to evidence of cost savings, but also gives itself credit for supporting SMEs when it makes statements like “since the launch, over 50,000 suppliers have registered on the portal, 84 per cent of which are SMEs. 73 per cent of contracts advertised on the portal are awarded to SMEs”. (Scottish Government, 2011). As we shall see, however, this statement is by no means as meaningful as it sounds and the public procurement process in Scotland is not operating as much to the benefit of the Scottish economy either as it could, or as the more public statements of the Scottish government imply.

5. Procurement in Practice

1. Despite the Scottish Government’s stated priority that procurement expenditure should support a sustainable economy, and despite the efforts to make sure that SMEs have an appropriate share of this expenditure, nevertheless it is clear that the process is not working satisfactorily in Scotland’s interests. There is plenty of anecdotal evidence for this; it is easy to find widespread expressions of dissatisfaction that in practice small and local firms in many industrial sectors find it difficult to participate in public procurement contracts: and that apparently irrational decisions are often taken, with firms with local expertise and locational advantage being passed over for large enterprises which may not be located in Scotland at all. Similarly, it is easy to find anecdotal evidence of procurement decisions which are not optimal from the point of view of the end user; for example, schools which are built to inadequate specifications or contracts with remote suppliers where, in the case of component failure, there may be inordinate delays before spare parts are available. Evidence that the public procurement process is not working satisfactorily goes beyond the anecdotal however, as we now show.

Scotland Excel

2. Scotland Excel develops and manages contracts on behalf of local authorities and related bodies for the supply of goods and services. Currently, there are 46 collaborative projects in their contract portfolio. A study carried out by two of the present authors in December

2010 looked at the firms who had won some of the key contracts let by Scotland Excel (Cuthbert and Cuthbert, 2010a). What was found was that, for many of these contracts, the vast preponderance of the successful bidders came from outside Scotland. Updating this work shows, for example:

- For waste containers (total value £50 million) there are 16 recommended suppliers; one is an independent Scottish company, 14 are English, one is Irish.
- For early learning materials (total value £26m) there are eight recommended suppliers; one is from Scotland, six from England and one from Ireland.
- For trade tools and sundries (total value £10m) there are seven recommended companies, of which only one is headquartered in Scotland.
- In classroom activity materials (total value £16m) there are eight companies of which at most two are in Scotland.
- Street lighting materials (total value £23.1m): this contract was divided into six lots, but only eleven companies feature in total of which two are Scottish, although several others have distribution outlets in Scotland.

Procurement Scotland

3. The Cuthbert and Cuthbert (2010a) study also looked at the contracts let by Procurement Scotland (these contracts are mainly framework agreements). The same sort of picture emerged from this aspect of the study. We have updated and extended this work for the present report using Freedom of Information to request details from the Procurement Directorate of the Scottish Government on contracts listed on their website (the Procurement Directorate, it will be recalled, has now subsumed the activities of what was formerly Procurement Scotland).
4. In total there are 49 contracts with a total value of £789 million. This is dominated by three utilities contracts totalling around £400 million and an IT managed services contract. Among all listed contracts, the number of companies competing for each contract varies as follows:

Contracts with only 1 company tendering	2
2 tendering	3
3 to 5 tendering	19
6 to 10 tendering	15
11 to 50 tendering	6
51 plus tendering	3

(In one contract the number competing was not given).

5. Overall, in only 21 of the 49 contracts is there a Scottish headquartered firm among the successful suppliers to the contract. Of the 49 contracts, 31 have been awarded to a single supplier: 9 of the successful 31 firms are headquartered in Scotland. For the remaining 18 multi-supplier contracts, 13 of these have at least one firm among the successful contractors headquartered in Scotland. However in three of these cases the number of successful suppliers is more than twenty, so the successful Scottish tenderers in these cases are still part of a large pool of competitors. Eight of the contracts were the result of mini

competitions on UK national frameworks. These are of a total value of approximately £70 million per annum. Only one of these contracts went to a Scottish headquartered company and its value was £0.7 million.

6. What is clear from the information regarding bidders for the contracts on the procurement website is how few Scottish companies actually put in bids. For example, in office supplies (£19.5m), in travel services (£35m) and in cleaning and associated services (£4.2m) there were no Scottish headquartered companies bidding. As regards successful bidders, Scottish companies are absent in areas such as office supplies, IT consumables, fuel cards, travel services, cleaning, cash collection, catering and associated services, mobile and desktop computing, IT peripherals, childcare vouchers and natural gas. While Scottish companies are reasonably well represented in a few areas (for example, design, print and publishing; web development; and marketing services), it is by no means clear why the distribution of Scottish firms across contracts awarded is so patchy.

PFI Projects

7. To take another example, a study carried out in 2009, again by two of the present authors, looked at the bidding process for the 37 schools PFI projects which had been commissioned in Scotland (Cuthbert and Cuthbert, 2010b), and found:
 - Strong evidence that, in many cases, the bidding process had not been competitive: of the 37 projects, two had only one bid at the final selection stage, twenty eight had two bids, and only seven had three bids. (It should be remembered that Treasury advice is that two or fewer bids potentially indicates a failure of competition.)
 - Evidence of a restricted pool of firms involved in the bidding process: taking all the projects together, the 79 bids at the final selection stage involves just 22 individual groups of firms.
 - The firms involved were predominantly headquartered outwith Scotland: of the 24 construction firms involved in the actual construction work (and here we are looking at firms, not groups of firms) only six were headquartered in Scotland.

Scottish Water

8. A similar picture emerges in another important area of public procurement – namely Scottish Water’s substantial investment programme (which runs at about £500 million per annum). In its delivery of its 2002/06 investment programme, Scottish Water embarked on a partnership which involved handing over a large part of its capital investment programme to the private sector. The vehicle was Scottish Water Solutions (SWS) which was partnership between Scottish Water itself, and two other companies, Stirling Water and UUGM. Scottish Water had a 51 per cent share in SWS, with the other two companies each owning 24.5 per cent. The partner companies were themselves owned by major players in the utilities and construction fields. Stirling Water was owned by Thames Water (25per cent), Gleeson (25per cent), KBR (Halliburton Brown & Root, 25per cent) and Alfred McAlpine (25per cent): UUGM was owned 60 per cent by United Utilities, 20 per cent by GallifordTry and 20 per cent by Morgan est. SWS had no employees and was operated by seconded staff from Scottish Water and each of the partner companies. In other words, Scottish Water had handed over responsibility for large parts of its civil engineering programme, as well as management and R&D, to a partnership of large construction firms, none of which was headquartered in Scotland.

9. Nor was the situation described in the previous paragraph a temporary phenomenon as regards the water industry. When Scottish Water mounted a competition to determine its primary private sector partner for delivering a large part of its 2010-2015 investment programme, three consortia competed for the contract. These consortia consisted of nine firms in total, not one of which was headquartered in Scotland. The successful consortium Thistle, despite its Scottish sounding name, is made up of Veolia (a large French multinational), Laing O'Rourke (headquartered in England) and Jacobs Engineering (headquartered in California). For that part of its investment programme not covered by Thistle, Scottish Water has appointed what are called construction delivery partners (CDPs). Of the 16 CDPs, three are Scottish companies.
10. Scottish Water's bringing in of external partners has enabled it to undertake a significant degree of internal downsizing, with large chunks of its design, R&D, and specialist tendering expertise, as well as maintenance and construction capabilities, being outsourced. Does all this matter from the point of view of the Scottish economy? On the one hand, Scottish Water argues that this approach has resulted in cost and efficiency savings such that it has been able to provide water and sewerage services more cheaply than would otherwise have been possible. But on the other hand, the specific method they have used to improve efficiency, the outsourcing of high value functions like research and development, has almost certainly meant that the Scottish economy now has a reduced capacity in these functions. We would argue that Scottish Water, as a publicly owned corporation, could have approached its remit with a focus which was not so single-mindedly on short term cost reduction but one which also focused on the long term benefits to its own operation and to Scotland of adopting a procurement policy aligned with sustainable economic development. Such a policy could have assisted real growth in the Scottish economy by encouraging research and development, innovation, new business creation, business expansion, job creation, and by developing skills and training.

Scottish Futures Trust Hubs

11. In November 2008, the Scottish Futures Trust announced the creation of two pilot hubs in the South East and in the North of Scotland: these were the first of five planned hubs which would cover the whole of Scotland. The stated aim of the hub concept is to promote "*joined up services to local communities*". The hubs bring local authorities, Health Boards and other public sector and community bodies together with a private sector partner in order to provide planning, procurement, and delivery of community premises. The initial choice of partner is by OJEU competition, after which the successful partner then enjoys an extraordinarily lengthy concession period of twenty years or even up to thirty years. When a requirement emerges for the build or refurbishment of community premises, the private sector partner will be able to deliver this without a further OJEU competition. Value for money has to be demonstrated on each project and the public sector bodies who are members of the hub can use other suppliers but at the expense of going through OJEU. It is envisaged that the hub private sector partner may be involved via different modes of operation on different projects - including for example, strategic planning, arranging and providing funding, project delivery including build, and facilities management.
12. Of the five hubs, two are fully operational and two others have chosen their preferred private sector partner. For three of these four hubs the private sector partner is a consortium of companies all with headquarters outside Scotland. In the fourth case the partner is another consortium primarily of Scottish firms. For the hub where the preferred partner has yet to be chosen, almost all of the contenders are headquartered outside Scotland. According to the Scottish Futures Trust the current hub investment pipeline of projects across the two live

hubs stands at nearly £700m and when all five hubs are operational it's predicted that over £1.4bn of public sector infrastructure projects will be delivered by 2020. It is expected that the hubs will operate in a two-tier fashion, with the first tier private partners subcontracting to SMEs. This mode of operation raises questions about the relative market power of the first tier suppliers relative to the second tier subcontractors. Another aspect of hub operations which is problematic is the very low threshold which has been set, above which all contracts will fall within the ambit of the hub. Currently, according to the Federation of Master Builders, this appears to be set at £750,000, which is well below the EU construction lower limit of just under £4 million.

13. Again according to the Federation of Master Builders, the establishment of the North East hub is exacerbating the loss of construction jobs and apprenticeships in the North East - with further knock on effects as the reduction of apprenticeships leads to loss of college courses in the area.
14. The whole hub approach to procurement raises similar issues as arose in the discussion of Scottish Water above, but further compounded by the very long time periods for which the hub concessions are being awarded. Namely, is this approach of putting large firms in a preferential position in the procurement process consistent with achieving wider economic and social goals for Scotland? There must be serious worries that it is not. There are also serious issues about the extremely long concession period for the hub contracts; after all, the effect of the hub arrangement is very similar to the establishment of a single supplier framework agreement. Under the EU Procurement Directive, framework agreements are limited to a life of no more than four years. The legality of the hub 20 to 30 year contracts therefore should be tested against the Procurement Directive.

Heterogeneous Products: the case of book supply

15. The specific example of the supply of books illustrates another problem with the way procurement arrangements are currently working – a problem which is also likely to occur with other highly heterogeneous products. (We are grateful to Hugh Andrew, of Birlinn Press for alerting us to this problem). According to Hugh Andrew, in areas like the supply of books, procurement bodies tend to specify their requirements in terms of large contracts covering a wide-ranging form of aggregate supply. There may well be primary producers of books, and specialist suppliers who in specific areas of the contract might be able to offer a better deal – but who are not able to cover the whole contract area. The outcome is that such contracts tend to be won by large wholesale-type suppliers, even though the terms being offered may well be worse than could be offered by a range of specialist suppliers. The upshot, it is claimed, is not just poor value for money for the public sector. In addition, specialist suppliers and primary producers, who are often local firms, lose out to large wholesalers – who are often based out of Scotland.
16. We carried out an analysis of the last five general library book contracts awarded and displayed on the Public Contracts portal. The results were as follows:
 - An all-Scotland framework programme of between £15m and £22m for the supply of library books was awarded to seven companies: of these, six are wholesalers, all of which are headquartered in England or Northern Ireland. One is a bookseller of school books headquartered in Scotland.
 - A framework contract for library books issued by Tayside Consortium and worth £4m. This was awarded to two large wholesalers, both outside Scotland.

- A contract for library books issued by Renfrewshire, value not stated. This contract was split into two lots: the first lot went to two large wholesalers both headquartered in England. The second lot went to one of these wholesalers.
- A contract for library books issued by Falkirk, value not stated, issued to one large wholesaler headquartered in England.
- A contract for library books issued by Edinburgh, value not stated, to three large wholesalers all headquartered in England.

It is interesting to note that two large wholesalers each featured in four out of these five contracts. The analysis of this sample of library book contracts is therefore consistent with the comments from Hugh Andrew.

17. It would be wrong, however, to give the impression that every aspect of the operation of the procurement system has been negative. For example:
 - The Community Benefits Report already referred to above (4.11b) has been a positive initiative.
 - Following input from the STUC, the specification for the Clyde and Hebrides ferry tender in 2007 contained significant safeguards on protection of employment rights.
 - The recent contract for Fergusons to deliver two battery operated ferries: this was the outcome of the Low Emission Hybrid Ferries project, designed to develop the technology for diesel electric ferries with low emissions, low fuel consumption, and low lifetime costs.
 - The draft Scottish Budget 2012-13 states that it is intended to require recipients of major public contracts to deliver new training in the form of modern apprenticeships.
18. It is perfectly clear that the different layers of government (at EU, UK, and Scottish Government levels) are well aware that the current procurement arrangements are not working optimally at their respective layers. Evidence for this comes from the Green Paper on the modernisation of EU public procurement policy issued by the European Commission in 2011, and from the responses to the Green Paper by the UK and Scottish Governments (EU, 2011: UK Government, 2011: Scottish Government, 2011). The drafting of the Green Paper indicates that there has been a good deal of feedback to the Commission that the present EU procurement arrangements are too cumbersome and inflexible, and too costly to operate – particularly from the point of view of small contracting authorities. It also makes clear that the thresholds have been set too low. In relation to SMEs, the EU has also had a good deal of feedback that the qualification requirements set, and the need to produce evidence of satisfying these requirements, discourage SMEs from tendering for public contracts.
19. Similar points are made in the UK and Scottish government responses. The UK government makes the specific point that the complexities, and resulting costs, of the procurement process mean that contracting authorities tend to bundle their requirements into large contracts, which are unsuitable for SME involvement. The Scottish government response to the Green Paper points out that the EU rules are too focused on process: there was a need to simplify the rules and make the process of awarding contracts more flexible. The Scottish government suggested that interpretation of 'value for money' should be broadened to enable contracting authorities to take account of local economic impact. And they argued that the current rules were unduly cumbersome for contracting authorities in rural areas.

20. Overall, it is clear that, despite the positive developments cited above, the public procurement process in Scotland has been operating in a far from optimal fashion as regards securing wider economic and social benefits to Scotland.

6. Further Issues: Framework Agreements, Monitoring and the Role of Scottish Enterprise

1. In this section we consider three further areas; the operation of framework agreements, the arrangements for monitoring, and the role of Scottish Enterprise, where it turns out that there are major issues to be addressed.

Framework Agreements

2. In the course of preparing this report it became clear that there are issues surrounding the operation of framework agreements which might well adversely affect the chances of Scottish firms, particularly smaller Scottish firms, entering specific markets. The particular problems can be illustrated by considering the case of APUC. One of APUC's main functions has been to set up a system of framework agreements, of which it currently has 136, covering the types of goods and services required by its member bodies. APUC does not, however, advertise and negotiate each of these agreements itself. In fact, there are three main routes by which agreements come on to the APUC list:
 - APUC itself, or some other Scottish procurement agency, carries out the process of OJEU advertisement and tender selection to set up the agreement.
 - The process of setting up the framework agreement is carried out at UK level by a specialised body which has particular expertise in that specific field (e.g. Buying Solutions) and then APUC utilises this national agreement.
 - Or the agreement is advertised and negotiated by one of the regional higher education purchasing consortia which exist elsewhere in the UK (e.g., North Western Universities Purchasing Consortium or Southern Universities Purchasing Consortium). If a clause has been inserted in the original contract specification stating that the resulting agreement may be accessed by other higher education purchasing consortia, then APUC can bring the framework agreement into its own list.
3. Using Freedom of Information, we obtained details from APUC of how each of its framework agreements had been arrived at. It turns out that, of the 133 agreements for which details were obtained, 57 (43 per cent), were established by APUC itself or another Scottish purchasing consortium, 39 (29 per cent) by a UK purchasing agency:and 37 (28 per cent), by a regional purchasing body elsewhere in the UK.
4. The large number (37) of the APUC agreements which originate with regional purchasing bodies elsewhere in the UK is a matter of potential concern. Clearly, if a Scottish firm successfully becomes a supplier on an APUC negotiated agreement, and if that agreement is adopted by other higher education procurement agencies elsewhere in the UK, then

that could be good for the Scottish firm. But if Scottish firms are unaware that a framework agreement being advertised by, for example, the Southern Universities Purchasing Consortium might be adopted by APUC and extended to Scotland, they may well not apply. So the extensive use of this kind of arrangement may have the effect of limiting Scottish firms' access to an important part of the public procurement market in Scotland. Circumstantial evidence suggests that this could be happening. For the 37 framework agreements in the APUC list which originated with regional procurement bodies elsewhere in the UK, there were in total 152 supplier entries: of this number, only five were Scottish firms. In contrast, of the 57 framework agreements which originated with APUC itself, or some other Scottish procurement agency, there were in total 260 supplier entries, of which 74 were Scottish firms. There is, therefore, concern that the extensive use of framework agreement originating with regional purchasing bodies elsewhere in the UK may be restricting access by Scottish firms.

Monitoring

5. Another important aspect of the procurement system, and indeed one whose importance was stressed by the McClelland report, is the way in which the system is monitored. As we have seen, the Scottish government has taken the reassuring view that 73 per cent of contracts on the procurement portal went to SMEs. The source of the 73 per cent figure is Public Contracts Scotland, part of the Procurement Directorate of the Scottish Government, and is derived from the contract award information registered on the portal. This is a quite separate set of information from the Spikes Cavell database, which was the source of the expenditure data given in Section 1.
6. Let's take a look at this 73 per cent figure in the light of how the portal database actually operates. Specifically:
 - The Scottish government follows the EU definition of an SME as a firm with up to 250 employees: in fact, 99 per cent of firms in Scotland fall under this threshold. (As at March 2011, of the 307,770 businesses in Scotland, 98 per cent have less than 50 employees, 1.2 per cent have between 50 and 250 employees, and only 0.8 per cent have 250 or more employees. This small group of large firms, however, accounts for 46 per cent of employment and 63.5 per cent of turnover.) So within the Scottish context of managing procurement with economic development in mind, it is neither helpful nor meaningful to headline only the standard EU definition of an SME. The portal database does capture a much finer classification of firm size: this means that other more meaningful size bands could easily be used and quoted as well.
 - There is nothing to say that the SMEs are Scottish firms.
 - The size of firm recorded in the database is as reported by the firm itself when it is registering its particulars. No checks are carried out on this self-reported data. It is not clear, therefore, whether this size variable is accurate, or has been reported consistently. Where, for example, the reporting unit is the Scottish branch or depot of a larger UK or multinational firm, the person reporting may well have recorded the size of the local branch, the size of an intermediate company within a company grouping or the size of the overall parent group. So it is possible that some, possibly many, of the firms on the database that are actually classed as SMEs may not in fact be so.
 - The location of the firm as registered in the portal is the contact address as reported by the firm on its registration form. Again, where the form is being filled in by a branch

plant or depot, this may mean that firms are being classed as Scottish when the firm itself may have only a limited presence in Scotland.

- Making a statement in terms of numbers of contracts is of limited interest. Value of contracts would be much more meaningful.
 - There are particular problems as regards monitoring of the operation of framework agreements. We have confirmed with Procurement Scotland that what the portal records is the OJEU advertisement for the setting up of the agreement, and this only in the case where the agreement is set up by a Scottish procurement agency: further, call-offs from framework agreements do not appear on the portal. So as regards, for example, the APUC list of framework agreements, what would be recorded on the portal is the establishment of the 43 per cent of the agreements on the APUC list which originate in Scotland. The establishment of the 57 per cent of the agreements on the APUC list which originate with UK procurement bodies, or regional procurement bodies elsewhere in the UK, will not be recorded. Nor will the call-offs from any of the agreements be recorded.
 - Finally, for completeness, there is an issue about the size and location classification of the Special Purpose Vehicles that run PFI schemes. Typically, a PFI contract will be awarded to an ad-hoc company set up specifically to run the project, known as a Special Purpose Vehicle. The SPV is usually owned by a consortium of large businesses, such as construction, facilities management, and finance companies. Such an SPV is likely to be recorded in the statistics as an SME: this is actually highly misleading, since to all intents and purposes, the contract has actually been awarded to the owning consortium of large firms.
7. As noted in an earlier section, the primary purpose of the Public Contracts Scotland portal is to provide a market place for both buyers and suppliers. The database underpinning it is therefore an administrative system – a function which it performs well. The kinds of problem identified in the preceding paragraph are typical of the difficulties which arise when a database which is set up primarily for administrative purposes is then used for statistical purposes. A perfectly adequate administrative system may not offer the detail, consistency and accuracy of classification which is required for statistical purposes: and it may be difficult to achieve this standard without imposing additional cost burdens on the administrative system. There is a strong case for carrying out a research exercise to establish how well the information recorded on the portal for a sample of firms corresponds to their actual size, location, and ownership status. Without this, it is difficult to know what confidence can be placed in statistics derived from the portal system, and how much effort will be needed to make it fit for statistical purpose.
8. Given the above issues, the '73 per cent' claim of SME involvement issued by the Scottish Government is potentially misleading, and gives no reliable indication of how much of the Scottish public procurement programme actually benefits small Scottish businesses. There are therefore serious problems with the portal database which need to be sorted out before it can be used as an adequate monitoring tool. In particular, any monitoring system should:
- Distinguish between the setting up of framework agreements, and the award of individual contracts.
 - Capture all framework agreements, including those which may originate with non-Scottish bodies.

- Capture call-offs from framework agreements.
 - Make sure that information on size of firms is collected on a consistent basis
 - Include appropriate details on the status of firms, including location and ownership.
 - Make sure that contract award details are recorded for all contracts awarded. (In the latest information available from the Procurement Scotland website, in 2009 2,913 contract notices were published while only 1,734 contracts were recorded on the Public Contracts database as being awarded.)
9. In the list of requirements for the procurement monitoring system set out in the previous paragraph, the separate monitoring of framework agreements is a matter of vital importance. The factual information we have obtained in the course of this study, as reported in section 5, indicates that Scottish companies have very low penetration rates in many areas of framework activity. If framework agreements as they are currently operated do actually have the effect of penalising participation by Scottish firms, then the whole thrust of procurement policy via the establishment of centralised purchasing agencies and systems of framework agreements may have unwittingly established a dynamic which is acting against Scotland's long-term economic interests. Unless the operation of framework agreements is monitored very carefully, it will not be possible to establish how this aspect is developing and to make sure that appropriate corrective action is taken as necessary.
10. While still on the topic of monitoring there are also issues with the use of the Spikes Cavell database for monitoring. For example, when, in the course of this study, we asked Procurement Scotland for an analysis of the value of procurement orders which had gone to Scottish firms, we were informed that this analysis was not possible.

The Role of Scottish Enterprise

11. The role of Scottish Enterprise is to work with businesses across Scotland to stimulate economic growth and improve the business environment. It focuses on key sectors where Scotland has world-class technology, natural advantage or an existing critical mass. Scottish Enterprise also works with important growth industries to strengthen Scotland's economic performance. It therefore has the potential to play a pivotal role in improving the success rate of Scottish businesses in securing public sector contracts. An examination of the material on Scottish Enterprise's website in relation to procurement activities indicates that Scottish Enterprise plays the following roles:
- it raises awareness of public sector procurement.
 - it performs a signposting role, referring businesses to various parts of the Procurement Directorate such as the portal.
 - it advises businesses on the benefits of registering with various supply chain databases.
 - With regard to specific key sectors: taking the example of the construction sector, Scottish Enterprise's construction strategy is laid out in its Scottish Construction Industry Plan. Its priorities are captured in four themes, one of which is procurement. We quote *"The Scottish construction industry should encourage the public sector to become best practice exemplar clients. It should also promote greater understanding of the important role played by each participant within the procurement process. The industry has to recognise the important role that good procurement practice plays in*

the design, planning, delivery, and quality of a construction project.”

12. The thrust of Scottish Enterprise’s activity therefore appears to be advisory. Indeed, there is circumstantial evidence that in at least one important sector it is not regarded as having a key role in helping Scottish firms in obtaining public procurement contracts. For the food and drink sector, in the guide “Public Sector Procurement Opportunities: A Practical Guide to Supplying Food & Drink to the Public Sector in Scotland” (produced by the Scottish Agricultural Organisation Society and Scotland Food and Drink, with the support of the Scottish Government), there is no mention of Scottish Enterprise and the role which it could play in assisting firms.
13. The material reported on in Section 5 of this report recorded the very low penetration by Scottish companies in large parts of the framework agreements set up by Scotland Excel and Procurement Scotland. Indeed, as the information we obtained from the Procurement Directorate indicated, it is not just that there are low numbers of Scottish firms successful in bidding for framework agreements in many areas; it is also the case that there are large areas of activity where Scottish companies are not even bidding. This worrying situation suggests that there is a real need for much more pro-active assistance to be offered to Scottish companies to enable them to bid for, and achieve success in, framework agreements. The obvious body to provide such assistance is Scottish Enterprise.
14. It would thus be very valuable if Scottish Enterprise were to take on a much more active role. For example, it could assist companies to form collaborative ventures in order to tender for large framework programmes, or assist businesses towards R&D making them fit to take on public procurement contracts. It should also work with local authority economic development departments and procurement departments in securing these aims. There are specific, and welcome, instances where Scottish Enterprise has indeed played a pro-active role. For example, after a number of years in which it appeared that the public sector in Scotland was commissioning ferries overseas, and citing EU Directive rules as tying their hands, Scottish Enterprise worked closely with Ferguson Shipbuilders in Greenock to build a business development strategy which looked at workloads, potential to bid for future orders and diversification options. Ferguson were then successful in winning the contract to build a world’s first in environmentally friendly ferries - in a deal worth over £20 million.
15. What is needed is that such hands on activity by Scottish Enterprise is taken forward in a more co-ordinated fashion to cover all sectors where public procurement is an important market.

7. EU Experience on Factors Affecting SMEs’ Access to Public Procurement Markets

1. In this brief section, we consider some EU related information on what factors are important in determining SME access to public procurement contracts and we also report on relevant practices in some EU countries.
2. The first source we consider is a study carried out for the EU Directorate General for Enterprise and Industry on factors influencing SMEs access to public procurement markets

(EU, 2010). The study was carried out by GHK and reported in September 2010. It involved the statistical analysis of the award notices for 40,000 contracts over the period 2006-2008, and also questionnaires issued to about 1,200 companies.

3. The major conclusion emerging from the study is that large size of contracts is seen as the most important barrier to SMEs accessing public procurement and the effect of contract size is confirmed by the statistical analysis. *"The statistics confirm that the value of the public contract has indeed a major – arguable (sic) the greatest – influence on the extent to which SMEs can access these."*
4. The study also concludes that in addition to tender size, the nature of the work being tendered also has an important effect on SME participation. As the study notes, *"irrespectively from the contract value, breaking down tenders into lots does help in increasing SMEs' participation. Specifying partial tasks in a tender rather than opting for a general contractor, or setting up individual geographical service areas addresses SMEs' potentially more restricted skills base, technical capacities or action radius."* This conclusion is directly in line with the example we quoted in a preceding section, on book contracts in Scotland.
5. The study also highlighted other steps which can be useful in improving SMEs access to public contracts:
 - supplying more and better information.
 - improving the dialogue with SMEs.
 - simplifying the procurement procedure and relieving administrative burden.

It is worth noting that in Scotland major steps have been taken on all of these points by, for example, the establishment of the public contracts portal, quick quotes and the simplified pre qualification questionnaire.

6. Another useful source on what practices different EU countries actually adopt is a survey carried out by the Public Procurement Network (PPN) of the EU, and which reported in 2010 (PPN, 2010). Some examples of specific actions noted in this survey are as follows:
 - **Austria:** The statutory law of the federal central purchasing agency requires that the agency, when purchasing certain goods and services (like cleaning, IT, office and IT equipment, food, laundry, tools, electronics/electronic equipment and components) has to put out the tenders in a manner which allows SMEs to participate. Tenders are typically divided into lots, and there are commonly prohibitions on the maximum number of lots that may be bid for.
 - **Germany:** The Act Against Restraint of Competition requires public authorities to consider sub-division of contracts into lots. Division into lots is the rule except where sub-division turns out to be economically or technologically impractical. The principle of sub-division also applies to contracts let by private undertakings if they are procuring on behalf of a public authority: this provision plays a role mainly in the field of public private partnerships (e.g. PFIs). Sub-division of contracts is done either on the basis of size or into specialised sub-components.
 - **France:** Article 10 of the Public Procurement Contract Code provides that public procurement contracts are awarded in separate batches, *"except if the subject matter of the contract does not make it possible to identify separate provisions"*. Contracting authorities cannot restrict the number of batches for which a candidate can tender

but the contracting authority can limit the number of batches a single undertaking can obtain. Such a measure can be justified by the need to ensure security of supply chains, or for technical or economical reasons.

- **Hungary:** Under Article 50(3) of the Law on Public Procurements, public authorities have to check if the subject matter of the contract is suitable for division into lots. If it is, the contracting authority has to divide the procurement into lots in the contract notice.
7. The four countries cited in the preceding paragraph are examples where the sub-division of contracts into lots is mandatorily required by the laws of the relevant countries. In many other EU countries, the responses to the PPN survey make it clear that this kind of sub-division, while not being mandatory, is nevertheless actively encouraged. By contrast, the response to this part of the survey presented by OGC on behalf of the UK strikes a very lukewarm note: *“OGC has produced guidance that recommends that in some cases it is suitable to break down large ICT contracts and other large procurements into smaller pieces or lots – thereby enabling greater SME participation and reducing the level of risk associated with larger contracts”*. The OGC response, therefore, stands out in the survey as making little effort to assist SMEs by contract sub-division.
 8. This feature of OGC policy is consistent with the findings of the GHK report referred to earlier in this section. While reported as GB figures, the conclusions of the GHK report presumably refer primarily or exclusively to England. What the GHK report shows is that:
 - Compared with other countries in the EU, public contracts in GB tend to have a large average value (Figures 2.2 and 2.3 of GHK report).
 - GB is among the four lowest countries in the EU as regards the share by value of public contracts awarded to SMEs (Figure 3.1 of GHK).
 9. Overall, the evidence presented in this section:
 - Confirms the worth, from the point of view of encouraging SME participation, of smaller contracts and of suitably designed lots.
 - Shows that it is possible, within the framework of the EU Directive, to adopt a much more pro-active approach towards splitting contracts than has been adopted in the UK, even up to the point of making such splitting a mandatory requirement.
 - And suggests that OGC’s lack of an active policy on this point has severely handicapped SME participation in England.

8. Conclusions and Recommendations

1. Early on in this report, in Section 2, we gave examples of two completely contradictory views on how the public procurement system in Scotland was actually working. Having now looked at a number of specific examples of how procurement operates in practice, what conclusion can we draw about which of the opposing views is closer to being correct? And what factors account for the way the procurement system has turned out?
2. Much of the material in the preceding sections demonstrates that aspects of the process are certainly working in a far from satisfactory fashion, particularly from an economic development point of view. Despite the stated good intentions of the Scottish Government, the actions of that government in several important areas (water procurement, hubs, PFI contracts) have resulted in very large contracts which have put barriers in the way of small and medium-sized firms participating. Even in more traditional areas of procurement, penetration by Scottish firms in many areas is surprisingly low, as we have seen in relation to the operation of a number of framework agreements. The system set up to monitor what is actually happening is severely flawed: so flawed that the Scottish government has probably well overestimated the impact of its procurement policies. Of the two opposing views put forward in Section 2, in many areas the negative view is probably closer to the truth than the positive view expressed by the Government.
3. It is also clear that two dominant factors explain, to a large extent, why the system has developed in the way it has: these are the EU Procurement Directive and the legacy of the McClelland report. But while these factors may explain why the system has evolved in the way it has, they do not excuse the current imperfections in the system. After all:
 - Scotland did not need to copy the OGC in its big business friendly interpretation of the EU Directive.
 - We did not need to set up contracts in such large blocks, blocks which in many cases are too big for Scottish firms to cope with. In fact, within the framework of the existing EU Directive, there is ample scope to be pro-active in ensuring that contracts are split up – witness the legal requirement to do this in several EU countries.
 - We could make much more use of the other exemptions in the EU Directive, for example, on research and development.
 - There is no need for us to have adopted, to the extent that has been done, framework agreements negotiated by regional purchasing bodies elsewhere in the UK.
 - There is no obvious reason as to why the Scottish Futures Trust hubs should have such a long life, nor why the threshold for hub construction projects has been set so low.
 - And we should have been able to design and implement a monitoring system which tells us, more accurately and informatively, the characteristics of companies who are successful in winning public contracts in Scotland.
4. What this suggests is that there are issues of attitude and culture to overcome before lasting changes can be made to Scotland's procurement practices. There needs to be a fundamental change towards an attitude which is less inclined to favour big contract/big business solutions, and which adopts a more pro-active approach towards what can be achieved within the terms of the EU procurement directive. The Scottish Government is, justifiably, calling for further changes to the Directive: but such changes are neither a necessary nor a

sufficient condition for radical improvement to take place in Scottish procurement practices. If the EU directive changes, but there is no change in attitude, then we are likely to continue to repeat many of our current mistakes. Conversely, many improvements could be made now, without any change in the EU directive.

5. In this spirit, we conclude with the following list of specific recommendations:
 - A. Radically change the culture of procuring agencies, so that it is the norm to split contracts into relatively small blocks, unless there are over-riding reasons for not doing so. Consider introducing a law, along the lines of the examples cited in the preceding section, to make this process mandatory.
 - B. Exploit to the maximum extent the potential within the existing Procurement Directive to assist the local economy and social well-being. As well as the scope to assist SMEs by unbundling contracts there are important exemptions which have been inadequately exploited in relation to research and development and skills training.
 - C. Ensure that contracts let through the public procurement process contain adequate safeguards on pay, terms and conditions and pensions. (A good example of what can be done is the specification for the Clyde and Hebrides ferry services tender in 2007). In particular, Article 27 of the EU Directive should be implemented on a mandatory basis in Scotland. This would have the effect that tenderers for contracts would have to confirm that they would comply with relevant obligations relating to taxes, environmental protection, employment protection provisions, and working conditions.
 - D. *Forward Procurement.* Develop an intermediary function to be carried out by Scottish Enterprise, or other body. This would involve identifying gaps in the public procurement supply chain, and identifying potential innovative products for which there could be a public procurement demand (arising from universities, spin outs, R&D etc.) and then helping Scottish enterprises to exploit these opportunities. Examples of this type of activity are the 'Forward Commitment' procurement initiatives in Sweden and the US. These draw together a group of organisations to define a need (e.g., a more energy efficient IT system). Bids are then sought to deliver a product or service that meets this need. The specification of the need will include a range of criteria that must be met and the procurement group commits to purchasing a minimum amount of the new product or service provided these criteria are met.
 - E. Review the wisdom and legality of the Scottish Futures Trust hub arrangements.
 - F. Unless there are very good reasons to the contrary in any specific case, Scottish purchasing organisations should not adopt framework agreements which have been negotiated by regional purchasing bodies elsewhere in the UK.
 - G. Develop the role of centralised procurement agencies in assisting their members and clients. As we have seen, there is a potential tension between the specialised procurement agency approach, and the ability to represent specific social or economic needs in tender specifications – which is an essential step if such needs are to be reflected in the eventual award of contracts. This tension could be reduced if the centralised procurement agencies were to divert some of their effort into helping and advising their member organisations in developing their own tender specifications. This might make it much easier for their client bodies to develop OJEU advertisements reflecting their specific priorities.

- H. Exploit the potential of Scottish Enterprise and other economic development bodies: for example, to facilitate the formation of SMEs into consortia capable of bidding/ winning framework agreements and individual contracts.
- I. Ensure that all industry advisory groups for key sectors are working with the Scottish Government's procurement directorate to develop plans for their sectors.
- J. Develop the capacity of the small business sector to respond to opportunities in public procurement.
- K. Carry out a research exercise to establish how well the information recorded on the portal for a sample of firms corresponds to their actual size, location, and ownership status.
- L. Continue to improve the current arrangements for monitoring the operation of public procurement in Scotland. As detailed above, there are a number of weaknesses with the current system which need to be remedied. In particular, it is essential that the operation of framework agreements is separately, and carefully, monitored.
- M. Continue to lobby the EU to broaden the definition of value for money in the EU Procurement Directive so that it is easier to include support for local and economic well-being as a criterion.

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