

Risks of Small and Medium-Sized Businesses Attracting to Government and Municipal Procurement and Economic Growth

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Abstract: One of the strategic goals in the Russian Federation is to relieve social tension by increasing the number of people employed in the segment of small and medium enterprises (hereinafter - SMEs) up to 25 million people by 2024. In order to stimulate the development of this segment, the Government of the Russian Federation sets the task of expanding the access for SMEs to the procurement system. That's why the analysis of the existing mechanism for attracting SMEs to procurement is of interest. The primary purpose of the study is to investigate the peculiarities of SME involvement in procurement within the framework of two main laws operating in the sphere of procurement activity and problems arising in the procurement's organization and economic growth. The practice of procurement activity is accompanied by the emergence of risks that affect the procurement result. These risks are inherent both to customers and suppliers of procurement activities. In the article risks are classified by stages of procurement activity. In particular, risks of poor-quality performance of the contract arise long before the stage of its conclusion. In the conclusion, recommendations are made which can be directed to solving the issues of SMEs access to procurement.

Keywords: State and municipal procurements, customers and suppliers, small businesses, risks, fraudulent suppliers.

INTRODUCTION

The procurement system is aimed at solving the conflict of participants' interests of procurement activities. On the one hand, this system allows the customer to reduce the cost of products and promotes transparency in procurement and optimal use of the budget. On the other hand, it provides preferences to certain categories of potential suppliers. However, such preferences should not contribute to the dependency sentiment of potential suppliers. The study of the foreign practice of the SMEs participation in procurement was given attention by Sigatova, and co-workers (Sigatova 2018).

The need and difficulty of SMEs involving in the procurement system is increasingly attracting researchers, in particular the work of Harland was reviewed (Harland *et al.*, 2019). Bahaddad and his co-workers (2018), Saarela, (Saarela, *et al.*, 2018). A group of authors Gafurova, and his colleagues studied the issues of SME support through the procurement system, systemized data on the dynamics and structure of procurement in terms of small business participation (Gafurova 2016).

In their studies, Sabitova N.M., Khayrullova A.I. (2015), Karen, T. (2018) note that it is necessary to use the state regulation instruments: budget subsidies, lower tax rates, expand access to procurement for the SMEs development. According to Karen, T., the greatest effect is possible by increasing the volume of public procurement. Reis, P.R.C., Cabral, S. studied the impact of public procurement programs on contract pricing (Reis, and Cabral, 2015.).

To reflect the particularities of SME participation in the procurement system, we will consider the stages of procurement: procurement planning, contract execution, and evaluation of procurement results. At the stage of procurement planning the customer identifies the need for a product; the budget is determined; the preferred method of procurement; market analysis is carried out; the necessary information about the procurement is published; procurement procedure is ensured, including the acceptance of bids; evaluation of bids is carried out and the winner is determined; the draft contract is sent to the supplier for approval with its subsequent signing. At this stage the following risks are likely: professional training; large volume of documentation; cases of corruption; lack of motivation of participants and asymmetry of information.

At the stage of a contract execution the quality of production is controlled; the course of plan execution,

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its adjustment is analyzed; conformity of terms of contract execution is checked; in case of violation of the contract by the customer the corresponding actions in relation to the supplier are realized. The customer must identify a new supplier in case of not executed properly contract. This stage involves risks: a long time lag from planning to contract execution; seasonal price fluctuations and late execution of the contract.

Evaluation of the procurement results involves monitoring the following elements: time, price and reliability of suppliers. The following indicators are analyzed: share of late orders, deviations in purchase prices, share of deliveries not corresponding to contracts, etc. It is characterized by the following risks: the lack of a methodology risks for efficiency evaluation and effectiveness of procurement; corruption in the audit and monitoring framework; separation of powers of control bodies.

METHODS AND MATERIALS

The main method of this research is to study the legal framework procurement activities regulating in the Russian Federation. For today they are Federal Law of 05.04.2013 № 44-FZ "On the contract system for the procurement of goods, works and services the state and municipal need sensure" (hereinafter - the Law No. 44-FZ) and Federal Law No. 223-FZ of 18 July 2011 "On the procurement of goods, works and services by certain types of legal entities". (Hereinafter - Act No. 223-FZ). Within the framework of the Federal Law No. 44-FZ, procurement is carried out by state and municipal budget-funded entities and incentive measures are established for small business entities (hereinafter referred to as SMEs) and socially oriented non-profit organizations (hereinafter referred to as SONPOs) (the Fed. Law No. 44-FZ). Within the framework of Law No. 223-FZ, procurement activities are carried out, in particular, by state companies and natural monopolies, with a stimulating effect on SMEs (Federal law of the Russian Federation).

RESULTS AND DISCUSSION

Despite the fact that Law No. 44-FZ does not provide for the obligation of suppliers to submit documents proving the right to receive preferences, a potential supplier must be from the SME register. This Law provides for two ways of SMEs involving in the procurement system:

- i. Through tenders and auctions, requests for quotations and proposals, where the customer determines that only the SME and SONPO can participate;
- ii. Through the requirement in the notification that a supplier other than SME and SONPO must be required to engage SME and SONPO as subcontractors for the performance of the contract; in so doing, the specified percentage of work on the value of the contract shall be credited to the customer in the amount of purchases made from SME and SONPO.

According to Art. 30 of the Law № 44-FZ from January 1, 2014 customers are required to purchase from SME and SONPO at least 15% of the annual volume of procurement. The quota does not include failed purchases. The list of goods, works and services to be purchased from the SME approved by the Russian Government has been expanded. The Law increased the initial (maximum) price of the contract from 15 million RUB to 20 million RUB. Data on procurement of small business and SONPO for 2017-2018 are presented in Table 1.

Table 1 shows that in 2018, the total number of notices posted for SME and SONPO increased by 12.1 percent compared to 2017, representing 39.6 percent of the total number of notices posted. According to the Ministry of Finance of the Russian Federation, electronic auctions accounted for the largest share of SME and SONPO purchases - 82.1 percent of the total number of notices placed for them. The total amount of

Table 1: Data on Procurement of Small Business and SONPO

Indicators	years	
	2017	2018
Number of posted notices (pieces)	802 670	899 820
The volume of posted notices (billion rubles)	643,70	791,30
The average price notices (thousand rubles)	801,90	879,30
The average price of the contract (thousand rubles)	760,07	1150,00

Source: The official website of the Ministry of Finance of the Russian Federation. (https://www.minfin.ru/ru/document/?id_4=124945).

Table 2: The Number and Volume of Posted Notices, Contracts Concluded with the SME and SONPO (2018) (%)

Budget levels	Total number of notices	Total volume of notices	Total number of contracts	Total volume of contracts
For federal needs	19	17	15	21
For the needs of the Russian Federation subjects	50	48	54	52
For municipal needs	31	35	31	27

Source: The official website of the Ministry of Finance of the Russian Federation. (https://www.minfin.ru/ru/document/?id_4=124945).

notices in 2018 increased by 22.9% compared to 2017, the average price of notices - by 9.6%, the average contract price - by 51%. The number and volume of posted notices, contracts concluded with the small business and SONPO by budget levels in 2018 are represented in Table 2. This analysis shows that the largest share of placed notices and concluded contracts falls on fulfillment of needs of the Russian Federation subjects.

Following Law No. 223-FZ, quotas for the SME are also established. According to the Resolution of the Government of the Russian Federation № 1352 dd. 11.12.2014 the group of companies-customers, which should carry out purchases from the SME, as well as the rules of such bidding is determined. The volume of such purchases should be not less than 18% of the total annual value of the company's contracts; concluded according to the results of tenders in which only the SME participates - not less than 15%. The SME Development Strategy until 2030 implies an increase this quota up to 25%. The data on the SME access to the procurement under the 223-FZ are presented in Table 3.

The analysis shows that over the last 3 years the volume of procurement has almost doubled; the number of contracts has almost quadrupled; the number of SMEs with which contracts have been concluded has almost tripled. The leading customers in 2018 were: JSC "Russian Railways" - 260 billion rubles, PJSC "Rostelecom" - 106.1 billion rubles, JSC "GSC "Yugoria" - 75.1 billion rubles. The leaders in

terms of the volume of procurements from the SME among the subjects of the Russian Federation are: Moscow - 1,065.8bn Rub, St. Petersburg - 323.74bn Rub, Moscow region - 155.34bn Rub (website of the Ministry of Finance of the Russian Federation).

When participating in procurement, SMEs face problems of unfair competition and limited financial opportunities. Unfair competition affects the probability of participation of "one-day firms". Significant problems with the participation of SME in procurement are the small amount of funds intended for such participants, as well as the small percentage of SME participation in procurement.

Moreover, the Ministry of Economic Development of the Russian Federation considers low competitiveness of procurement to be an important problem in the implementation of the Law № 223-FZ. In 2018, over 90% of procurement was conducted on a non-competitive basis - at the "sole" supplier and using "other methods" (71%), and through the tender and auction - only 3% and 1% respectively, request for quotations - 1%. Customers use thousands of ways to determine the contractor, but often disguise the procurement from the "sole" supplier. Thus, customers seek to protect themselves from the purchase of low-quality products.

Analyzing the above, we can conclude that both laws are parts of the procurement system aimed at stimulating the SME development. However, the problems identified indicate that SMEs have a large

Table 3: Data on the SMEs Access to the Procurement of the Largest Customers

Indicators	years		
	2016	2017	2018
Amount of purchases from SMEs (trillion rubles)	1,511	2,086	3,1
Number of contracts (units)	109 058	159 885	402 103
The number of SMEs with whom the contract was signed (units)	35 651	47 794	104 837

Source: Official website of JSC "Corporation "SME" (<https://www.ranepa.ru/images/News/2018-01/23-01-2017-gf-pres-braverman.pdf>)

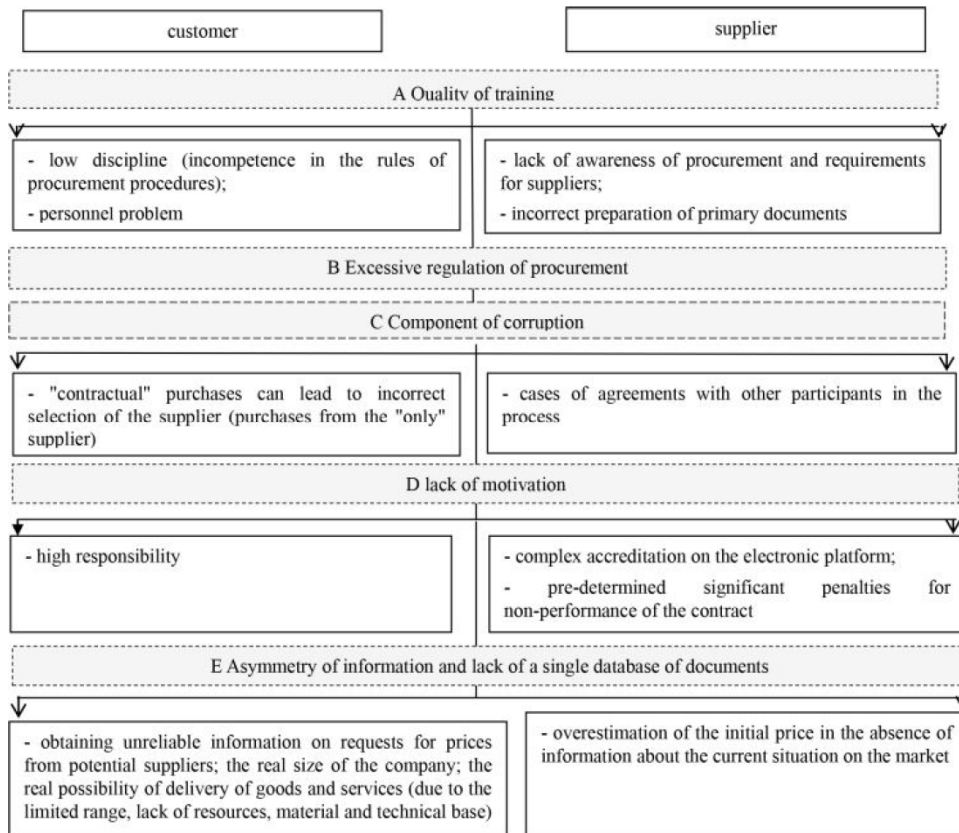


Figure 1: Causes of risks at the procurement planning stage.

Source: Author.

unrealized potential in public and municipal procurement.

The practices of procurement involve several risks inherent both to the customer (represented by the state) and to the supplier (SME). At the same time, each stage of procurement activity is characterized by risks affecting the result of procurement. Based on the available literature, we have grouped the risks of their cause depending on the stage of procurement.

Figure 1 shows the causes of risks at the procurement planning stage. Reasons of risks at the procurement planning stage, inherent to customers, are incompetence in the rules of procurement procedures, a personnel problem (occurs also because of absence of motivation in connection with the raised loading and high responsibility), a large volume of the documentation, and also asymmetry of information (reception of the unreliable information on abilities of firm qualitatively and timely to give production).

Suppliers are exposed to risks related to quality of professional training; excessive regulation of procurement procedures, which reduces the level of

competition among suppliers; the complexity of accreditation on the electronic platform.

Prolonged time lag from planning to contract execution is accompanied by risks of forced change of IMPC and purchase volume, as their preliminary calculations do not always coincide with market offers. The reasons for the risk may include the impact of objective external circumstances, including seasonal price fluctuations. Due to the specifics of SME finances, there are risks of untimely execution of the contract, in particular, due to their inflexibility. The size of the SME and lack of qualified personnel may contribute to inattention in studying the contract conditions.

Figure 2 shows the reasons for the risks at the assessment of procurement results stage. As the main goal of the public procurement system is to ensure transparency and economic spending of budgetary funds, it is necessary to establish an effective control system. Therefore, public and municipal purchases are controlled by several authorities at once. In addition, there is public control, as well as control to be exercised by the customers themselves. At this

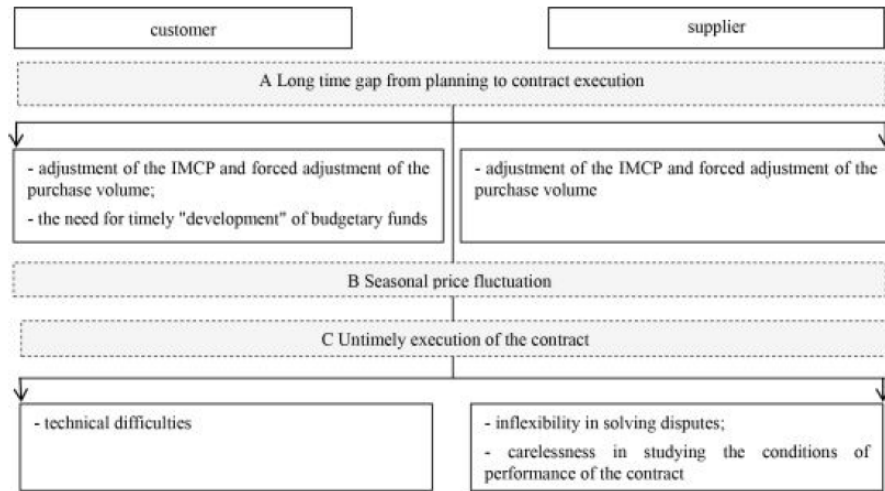


Figure 2: Causes of risks at the stage of contract execution.

moment, according to Chapter 5 of the Law No. 44-FZ, the controlling system of state and municipal procurement is included into the system:

Authorized bodies and organizations exercise control over customers, their contractual services and managers, members of procurement commissions. However, there are other participants in the procurement system:

- i. Operators of electronic platforms;
- ii. Authorized bodies;
- iii. Specialized organizations.

Obtaining a negative result of the procurement at the 3rd stage is also possible due to power separation of the federal control authorities. Since the holding procedures are controlled by the Federal Antimonopoly Service, and planning and execution of the contract by the Federal Treasury is makes it difficult to assess the holistic picture of procurement irregularities.

The above list of risks and their causes is not exhaustive. If the identified risks are minimized, SMEs will be able to freely enter the procurement market, and the contracts themselves will become an indispensable instrument of support for this segment of the economy.

CONCLUSION

In order to minimize the risks identified in the study and the unfair behavior of the procurement participants we offer some measures:

- i. To increase the transparency of the procurement activities, it is necessary to apply for a collegial

decision by involving special authorities responsible for the technical characteristics of the procurement, its volume;

- ii. In order to reduce poor discipline and increase customer awareness, develop model contracts and create a database of requirements for suppliers and purchased products;
- iii. In the case of improper execution of the contract, replace the dishonest supplier with the next procurement supplier selected in the planning phase; establish a registry of dishonest suppliers;
- iv. To reduce the number of purchases from the "sole" supplier, to establish for customers an exhaustive list of grounds for concluding such contracts with the IMCP justification;
- v. In order to reduce the conflict of interest of the participants, establish firm terms of contract;
- vi. To consider the possibility of incentive contract using the concluded in the establishment of the basic payment (for the minimum level of quality of production), and also the bonus payment paid to the supplier for the shortest terms of delivery and proper quality of production; it will allow to distribute risks between customers and suppliers.

In recent years, the Government of the Russian Federation at the highest level has paid attention to the problems of SME support and the awareness of its role in the growth of the country's economy. In the last few years, the Government of the Russian Federation at

the highest level has paid attention to the problems of SME supporting and understanding its role in the country's economic growth. Legislative measures of state support have appeared, in particular, in terms of expanding access of SMEs to the procurement system. Nevertheless, the existence of a conflict of participants interests in the procurement process requires the improvement of the procurement mechanism, including through the use of incentives to reduce barriers on the part of customers in attracting SMEs to purchases, as well as to improve the quality of contract performance by suppliers.

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