

# Izazovi konkurentnosti za mala i srednja poduzeća na tržištima javne nabave: slučaj BiH i Hrvatske

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# Challenging Competition at Public Procurement Markets: Are SMEs Too Big to Fail? The Case of BiH and Croatia

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Challenging Competition at Public Procurement Markets:  
Are SMEs Too Big to Fail? The Case of BiH and Croatia

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## **Challenging Competition at Public Procurement Markets: Are SMEs Too Big to Fail? The Case of BiH and Croatia**

### **Abstract**

This study empirically evaluates the role and perspectives for SMEs to successfully compete at public procurement markets. The government procurement markets in post-transition countries make a significant share of national economy and seemingly their importance rises in the times of economic crisis. The literature on public procurement and involvement of SMEs noted severe obstacles for companies to access public procurement markets, and the set of policies were established in the EU to promote SMEs' involvement in public procurement. This case study encompasses business sector in two post-transition countries, Croatia and Bosnia and Herzegovina (BiH) in order to explore competitiveness and entry barriers specifically for SMEs to participate at the public procurement market. We compare the views of managers and business people representing companies of the small and medium size on the level of competition and on the range and intensity of obstacles to participate at public procurement tenders, in terms of availability of resources, corruption risks, transparency and fairness of procedure, clarity of documentation, principles and standards achieved, price, deadlines and other dimensions of public procurement. If there are differences between the two countries, do they stem from the different EU membership status? Are there differences between subgroups of micro, small, and medium companies? In order to provide plausible answers to these questions, we use the empirical evidence collected through the survey of companies in BiH in 2014, and comparable data on Croatian companies surveyed in 2013. The findings are put in the context of public procurement as an opportunity to enhance growth and economic development in post-transition era.

**Keywords:** public procurement, small and medium enterprises, post-transition countries, competition

**JEL classification:** D73, H57, L25

## **Izazovi konkurentnosti za mala i srednja poduzeća na tržištima javne nabave: slučaj BiH i Hrvatske**

### **Sažetak**

Rad empirijski propituje ulogu i perspektive malih i srednjih poduzeća (MSP) u uspješnom konkuriranju na tržištima javnih nabava. Tržišta javnih nabava u posttranzicijskim zemljama čine značajan udio u nacionalnom gospodarstvu, a njihov značaj raste u uvjetima ekonomske krize. Literatura koja se bavi javnim nabavama i uključenošću MSP-a navodi ozbiljne prepreke s kojima se poduzeća suočavaju kad pristupaju tržištima javnih nabava. Na razini Europske unije (EU), uspostavljen je skup politika kojima se promovira uključenost MSP-a u javne nabave. U radu se istražuju konkurentnost i ulazne barijere s kojima su MSP suočena u pristupu tržištima javnih nabava u dvije posttranzicijske zemlje, Hrvatskoj i Bosni i Hercegovini (BiH). U radu se uspoređuju mišljenja menadžera i poslovnih ljudi iz MSP-a o konkurentnosti te o rasponu i intenzitetu prepreka s kojima se suočavaju u natjecajima javnih nabava. Prepreke sudjelovanju u javnim nabavama mogu se ticati raspoloživih resursa, korupcijskog rizika, transparentnosti i ispravnosti procedura, jasnoće natječajne dokumentacije, postignutih načela i standarda, cijene, rokova i drugih dimenzija javnih nabava. U radu se preispituje proizlaze li uočene razlike iz različitog statusa dviju zemalja u članstvu u EU-u te postoje li razlike između podskupina mikro, malih i srednjih poduzeća. Kako bi se ponudili uvjerljivi odgovori na navedena pitanja, u istraživanju se koriste empirijski podaci prikupljeni anketiranjem poduzeća u BiH u 2014. godini i usporedivi podaci prikupljeni od hrvatskih poduzeća tijekom 2013. godine. Nalazi su stavljeni u kontekst javnih nabava kao prilike da se potakne rast i ekonomski razvoj u posttranzicijskom razdoblju.

**Ključne riječi:** javna nabava, mala i srednja poduzeća, posttranzicija, konkurentnost

**JEL klasifikacija:** D73, H57, L25





## **1 Introduction**

The size of public procurement markets worldwide is impressive. For developed economies the ratio of government procurement markets to GDP is about 15 to 20 percent of GDP (OECD, 2012) and in the European Union (EU) countries, the share of public procurement is estimated to range between 10 and 25 percent (European Commission, 2015). The government procurement markets in post-transition countries make a significant share of national economy and seemingly their importance rises in the times of economic crisis. Previous research on public procurement and involvement of SMEs noted severe obstacles for companies to access public procurement markets, and the set of policies were established in the EU to promote SMEs' involvement in public procurement (European Commission, 2010b). Here most of the research is focused on the government procurers i.e., the demand side of public procurement markets and its (in)efficiencies. The shift to the supply side makes the new stream of research in developed countries, yet comprehensive assessment of post-transition economies is missing.

We build on existing EU studies and on preliminary research conducted for Croatia (Budak and Rajh, 2014) that provided insights into the functionality of the system from the business sector perspective. Its findings have revealed new issues in the public procurement system in Croatia, a post-transition country and a new EU member state. Real experience, attitudes and practices of Croatian companies involved in public tenders have shown to be more positive than what was expected intuitively, in particular regarding professional capacity and integrity of procurers and low level of informal payments and corruption risk in the process of public tenders. These two topics are worth exploring further, especially in comparison to other similar countries. However, the most intriguing finding for Croatia was that the low participation of SMEs in the public procurement market is not an issue. Therefore, we extend the analysis to Bosnia and Herzegovina in order to examine if this fact stands for another similar, but somewhat different, post-transition economy. By this comparative assessment we fill the gap in the scarcity of parallel studies in public procurement noted in the literature by Preuss (2009).

This study empirically evaluates the role and perspectives for small and medium enterprises (SMEs) to successfully compete at public procurement markets. The case study is based on the experience of companies in two post-transition countries, Croatia and Bosnia and

Herzegovina (BiH). Our motivation was to contribute to the debate on whether public procurement is an opportunity for SMEs to grow bigger through public investments, and what would in that case be the appropriate policy measures to enhance involvement of SMEs in public tenders. What capacities should be built both at the side of procurers and suppliers, and is the fine tuning of policies needed to adjust them to principal contractors and subcontracting companies? Are these policies in line with EU standards of public procurement? Are there differences observed between two countries that might stem from the different EU membership status? If micro firms experience different entry barriers compared to small and medium-sized companies, does it call for specifically designed policy answers?

In order to give plausible answers to these questions, we use the empirical evidence collected by the surveying companies in BiH in 2014, and comparable data on Croatian companies surveyed in 2013. The choice of these two countries in the region for a comparative assessment of SMEs in public procurement was not done by incident. Croatia and BiH have had similar problems in getting close to European standards although Croatia had successfully finished the EU accession process. Further, both nations have been severely hit by economic crisis that slowed down the after-war recovery of national economies. Historically, both states are former republics of ex-Yugoslavia, which might have shaped the perceptions and attitudes of business people in the region. The starting point of our assessment is narrative description of opinions collected in two country surveys. We compare specifically the opinion of managers and business people representing companies of the small and medium size on the competition and entry barriers. We asked them about the range and intensity of obstacles to participate at public procurement tenders, availability of resource, corruption risks, transparency and fairness of procedure, clarity of documentation, principles and standards achieved, price, and other dimensions. Finally we conclude with comparative pros and cons for SMEs to compete at public procurement markets. The findings are put in the context of public procurement as an opportunity to enhance growth and economic development in post-transition era.

The paper is structured as follows. First we proceed with literature review. A separate section is devoted to EU policy regarding SMEs and public procurement market competition. Methodology and data are described in section four and results presented in section five. The last section concludes with the discussion of main findings and policy recommendations.

## 2 Literature Review

Over 99 percent of the total number of enterprises in the EU are SMEs (Table 1). These enterprises create 67 percent of jobs and deliver 58 percent of the gross value added generated by private economy in the EU (European Commission, 2014b), which clearly indicates the substantial economic role of SMEs<sup>1</sup>. Nevertheless, the number of authors claim that SMEs participation in public procurement is very weak (Loader, 2013; Vincze et al., 2010). Data revealing the actual involvement of SMEs in public procurement are quite limited and no comparative and reliable evidence on SMEs in Croatia and BiH participating in public procurement is available. For illustration, European Commission (2010b) data show that on average in EU-27, SMEs secured 38 percent of the value of public contracts and 61 percent of the number of successful bidders.<sup>2</sup>

**Table 1 Number of Entreprises by Size in the EU-28, Croatia and BiH**

| Size        | Number of enterprises |                |               | Share of SMEs in total number of enterprises, in % |             |             |
|-------------|-----------------------|----------------|---------------|--|-------------|-------------|
|             | EU-28                 | Croatia        | BiH           | EU-28  | Croatia     | BiH         |
| micro       | 19,969,338            | 134,091        | 24,512        | 92.4   | 91.7        | 75.1        |
| small       | 1,378,374             | 10,091         | 5,841         | 6.4  | 6.9         | 17.9        |
| medium      | 223,648               | 1,722          | 1,981         | 1.0  | 1.2         | 6.1         |
| <b>SMEs</b> | <b>21,571,360</b>     | <b>145,904</b> | <b>32,334</b> | <b>99.8</b>  | <b>99.7</b> | <b>99.1</b> |
| large       | 43,517                | 388            | 300           | 0.2  | 0.3         | 0.9         |
| total       | 21,614,877            | 146,292        | 32,634        | 100.0  | 100.0       | 100.0       |

Note: Data for EU-28 and Croatia are for 2013-2014 based on Eurostat, and data for BiH are for 2014 based on national statistics.

Source: For EU-28 and Croatia, Muller et al., 2014; for BiH Central Bureau of Statistics, [http://www.bhas.ba/saopstenja/2014/SPR\\_2014\\_001\\_01-bh.pdf](http://www.bhas.ba/saopstenja/2014/SPR_2014_001_01-bh.pdf).

The position of SMEs at the public procurement market in post-transition countries is not clear-cut. Scattered national studies suggest there are discouraging barriers for SMEs to access public contracts (see for example Mitran (2011) for Romania, or Yakovlev and Demidova (2012) for Russia). New EU member states and ex-transition countries seem to

<sup>1</sup> See for example, Alpeza et al. 2015 report on Croatian SME sector, or Vanjskopoliticka inicijativa BH 2013 report on small businesses in BiH.

<sup>2</sup> Available data concern only successful bidders, but there is no data on actual attempts of SMEs to participate in public procurement process (both successfully and unsuccessfully).

stand worse when compared to old EU member states in terms of SMEs' participation at public procurement market. On the other hand, Vincze et al. (2010) evaluation of SMEs' access to public procurement market in different EU countries showed that SMEs have a stronger position in public procurement in smaller countries.

In this context, our study of SMEs and public procurement in Croatia and BiH could be influenced by the recent economic crisis as well. The two observed countries went through a slow post-war recovery and were severely hit by the 2008 crisis that plunged national economies into the prolonged economic recession. In times of crisis, some scholars and practitioners advise public investment to boost recovery. In Croatia and BiH government money and public sector are main generators of economic activity which consequently makes public procurement market even more appealing for SMEs; however, crisis might squeeze available resources of SMEs to compete. Although studies have suggested that SMEs were more resistant to the impact of the crisis compared to large enterprises, they also stress that they are recovering more slowly (European Commission, 2014b) thus affecting the competition at public procurement market where SMEs often act as subcontractors.

Contemporary public procurement practices incorporate three, often competitive strands of public procurement: commercial, regulatory and social strand (Erridge and McIlroy, 2002), and policy-makers seek to find the optimal combination between them. EU policies regarding SMEs and public procurement allow social consideration in contracting if such decisions comply with fundamental single market principles and freedoms (Kidalov, 2011). Studies of scholarly research and practitioners showed a strong, two-way relation between public procurement and competition. The lack of free and fair competition among private and public agents both at the supply and demand side, seriously threatens the level of competitiveness at public procurement market. Undesired level of competition could be the result of regulatory framework for public procurement, market characteristics, collusive behavior of bidders or other factors (UNCTAD, 2012). Free and fair competition might be limited by a set of factors, such as discriminatory regulations, preferential treatment in designing tender documentations and/or procedures, and all kinds of entry barriers. One obstacle for fair competition frequently observed in post-transition countries is corruption (Ateljević and Budak, 2010; Grødeland and Aasland, 2011). In a wider context it refers also to the conflict of interest, cartel deals, trading information and other irregularities in tender and contracting procedures (OECD, 2012). Safeguarding and enhancing competitiveness by opening public procurement markets to all

potential participants (along with applying money for value criterion) contributes to rational usage of resources and increases efficiency of the public sector as a whole.

The literature observes factors influencing SMEs' access to participate in the public procurement tenders from a different perspective, but several factors influencing the level of their participation are commonly recognized. The large size of the contract is recognized to stand as the most important obstacle for SMEs to access the public procurement market (European Commission, 2014a; OECD/The European Commission/ETF, 2014; Loader, 2005). SMEs are less involved in above-threshold contracts. Second, the share of contracts awarded to SMEs depends on the type of procurer and is larger in tenders of local authorities (Vincze et al., 2010; European Commission, 2014a). Third factor is tender procedure which has an impact on SMEs' access to public contracts. SMEs' participation is larger in open procedure or restricted procedure than in negotiated procedure (European Commission, 2014a). Furthermore, lack of time and financial and human resources are shown to be significant barriers for SMEs (Loader, 2013).

Studies on the success of companies in public tenders found the company size to be the relevant factor. In the public procurement processes medium-sized companies have proven to be more successful than micro-sized companies (European Commission, 2010b). On average SMEs in the EU have been performing well considering they secured 58 percent of public contracts in the period between 2006 and 2008. However, since the term includes various types of enterprises, it is necessary to analyze each type separately. Medium-size enterprises performed well, making up between 15 percent and 19 percent of public procurement suppliers. Also, there are almost no differences between medium and large companies when it comes to securing public procurement contracts. On the other hand, small and micro enterprises are lagging behind making up 10 percent and 5 percent of public procurement contracts, respectively (Vincze et al., 2010).

Public procurement is seen as an important mechanism of boosting national economic activity. The share of public procurement in GDP was 12 percent in 2013 in Croatia (Directorate for the Public Procurement System, 2014) and 13 percent in BiH in 2012 (Balkan Tender Watch et al., 2015). Therefore, policy-makers worldwide use public procurement to conduct economic policy measures, and the EU takes the lead in common market public procurement regulations and policies. For this purpose, EU standards and principles of public

procurement have been agreed whereas special attention has been devoted to the inclusion of small and medium-sized companies. EU regulatory framework defines national public procurement regulations and delineates behavior of agents in the EU member states or acceding countries. It means that EU directives apply in Croatia as a new EU member state and impose rules for the future development of public procurement system in BiH.

### **3 EU Directives and SMEs in the Public Procurement Market**

The importance of public procurement is recognized in EU strategic documents such as Europe 2020 Strategy for smart, sustainable and inclusive growth, and EU legislative acts that explicitly say that public procurement is one of the instruments based on market principles, used to achieve smart, sustainable and inclusive growth that enables the most efficient usage of public resources (European Commission, 2010a). Considering the performance of SMEs<sup>3</sup>, and referring to the EU's best practice codex to facilitate SMEs' access to public procurement contracts (European Commission, 2008), the EU upgraded the existing regulations in order to enable these enterprises to integrate more easily into the public procurement market. In the course of 2014 the new EU legislation relevant to public procurement has been adopted<sup>4</sup> (for review of the previous EU public procurement regulation, see Bovis, 2012). The main goal of the new legislation is to improve competitiveness and reduce discrimination practices in general. The new framework will support the already ongoing initiatives like JEREMIE (Joint European Resources for Micro to Medium Enterprises) that aim to improve the overall position of small and micro companies.

Prior to the implementation of the new directives, awarding of contracts was regulated by the Directive 2004/18/EZ. Ramsey (2006) argues that EU public procurement directives failed to open up public contracts to competition and therefore did not enhance efficiency and market

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<sup>3</sup> Micro enterprises are defined as enterprises that employ fewer than 10 persons and whose annual turnover or annual balance sheet total does not exceed 2 million euro; small enterprises are defined as enterprises that employ fewer than 50 persons and whose annual turnover or annual balance sheet total does not exceed 10 million euro; medium-sized enterprises are defined as enterprises that employ fewer than 250 persons and whose annual turnover or annual balance sheet total does not exceed 50 million euro. Large enterprises are above these thresholds. Commission Recommendation 2003/361/EC, [http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition/index\\_en.htm](http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition/index_en.htm).

<sup>4</sup> Directive 2014/23/EU for concessions, Directive 2014/24/EU for public procurement in general, and Directive 2014/25/EU for public procurement in the water, energy, transportation sectors.

liberalization as expected. There are a lot of legal insecurities and entry barriers due to the lack of clear rules for awarding contracts. Such a legal environment elicits a lot of missed opportunities for SMEs. Since the rules in the old directive were open to interpretation, developing a new framework was necessary to raise the efficacy of public procurement. This has been achieved by replacing the old framework with the Directive 2014/24/EU.

Some of the problems regarding SMEs and public procurement calling for immediate actions were previously noted in the academic literature. Carpineti et al. (2006) opted for facilitating the entry of SMEs to public procurement market by splitting contracts into lots. Equally, in its new directive the European Commission recommends that public procurers split large contracts into several smaller lots thus enabling SMEs to take part in the public procurement market pie. Splitting public procurement is expected to keep market competition alive and to lower entry barriers to SMEs. Special instructions on how to implement these recommendations are given in order to maintain fairness and non-discriminatory principles of public procurement<sup>5</sup>.

One of the existing barriers for SMEs' participation in public procurement are complex requirements for SMEs to fulfill, disproportionate to their economic and financial capacities. The new directive therefore envisages three basic criteria in terms of professional, economic and financial and technical capacities that have to be proportional to the volume of the public contract. Although there are no unified practices on contract size reduction across EU countries (Kidalov, 2011), the new EU directives recommend dividing contracts into smaller lots in order to make contracts suitable to business capabilities of SMEs.

Furthermore, in the EU there is a tendency to collaborate with large enterprises in order to utilize the economies of scale. For that reason it is necessary to monitor the centralization of public procurement purchases which in turn will ensure that SMEs have a representative share in securing public contracts.

Additional entry barriers in the EU are an administrative burden in public procurement procedures, in terms of mandatory submission of numerous documents, validation forms,

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<sup>5</sup> For EU public procurement principles, see more in Aviani, 2007.

certificates and licenses. The new unique procurement documentation system of the EU (e-Certis) would make the procedure simpler both for procurers and for suppliers.

Substantial changes in the Directive 2014/24/EU make subcontracting easier and more transparent, and the subcontracted payment could be effectuated directly from the procurer. This ensures a timely pay for SMEs engaged as subcontractors and it lowers their operational costs and risk.

Technical specifications should not stand as unjustified barriers for market competition, and public procurers should use all available instruments to enhance competition at their tenders. The novelty in the Directive is the new definition of the awarding criteria that favor the best offer in economic terms instead of (widespread and easier to manage) lowest-price criterion.

Enhancing the competitiveness of SMEs which are participating at public procurement markets by e.g. eliminating entry barriers, stands as a primary EU policy goal. The obstacles and policy responses that apply in that domain in two post-transition sample countries, Croatia and BiH, are assessed in the following analysis. First we describe methodology and data used.

## **4 Methodology and Data**

The empirical analysis is performed on the survey data of Croatian and BiH companies. The Croatian part of the study uses data on Croatian companies collected in a specially designed cross-sectional survey conducted in April 2013. The target population includes active businesses of all sizes. The stratified sampling procedure is applied with company size, region and business sector as control variables. There were three categories for company size (small, medium, large), six categories for region (Zagreb region, Northwest Croatia, Central and Mountainous Croatia, Slavonia, Dalmatia, Istria and Croatian Littoral) and 15 categories for business sector according to the NACE Rev. 2 classification, where sectors omitted from the sample were sectors considered not participating in public tenders. The total net sample size is 300 Croatian companies, where the share of SMEs is 90 percent. The sampling procedure combined stratified sampling and quota sampling, where the stratification variable is participation/non-participation in public procurement tenders. Namely, the sampling was



conducted by randomly selecting 200 companies and then filling the rest of the sample with 100 companies that had participated in public procurement tenders. The survey was administrated through telephone interviews (for details on Croatian survey see Budak and Rajh, 2014).

In BiH, two surveys have been conducted among the representatives of the business sector. The first large telephone survey in 2014 was conducted at the net sample of 2500 companies of all sizes and operating in all economic sectors over the entire BiH territory. The purpose of this survey was to identify the sample of companies with public procurement experience, i.e. the share of companies which have participated in public tenders in total business population. The subsample of 511 companies with public procurement experience was surveyed in detail by face-to-face interviews conducted in spring 2014 (for details on BiH survey, see Voloder, 2015b). The data of both surveys conducted in BiH are used in different phases of our analysis.

In the first phase, preliminary findings of large surveys on the entire population in Croatia and BiH have been qualitatively assessed and compared (results presented in Table 3). The core analysis performed in the second phase refers to SMEs only. For that purpose, only SMEs in terms of the number of employees were extracted in the survey databases: for BiH we used data from face-to-face interviews with managers from companies with up to 249 employees, and for Croatia, large companies were removed from the survey database as well. In that way, of the original large survey databases, only small and medium enterprises in both countries were extracted to perform the detailed analysis, totalling 725 companies. The large sample of SMEs surveyed assures the reliability of the analysis. Summary statistics on sampled SMEs is presented in Table 1.

**Table 2 Sample Characteristics, n=725**

| <b>Characteristics</b>     | <b>%</b> |
|----------------------------|----------|
| Size (number of employees) |          |
| Micro (1-9)                | 34.0     |
| Small (10-49)              | 44.2     |
| Medium (50-249)            | 21.8     |
| Country                    |          |
| Bosnia and Herzegovina     | 65.2     |
| Croatia                    | 34.8     |

When it comes to the questionnaire items used in the analysis, all questions and answers from both national surveys were first explored and described (results presented in Table 3). For the next phase of the detailed analysis, eight questions that tackle different public procurement issues were selected from larger questionnaires. Questions were selected based on their content and their availability in both-country questionnaires.<sup>6</sup> Initial data format for all questions were recoded in order to prepare them for comparative analysis. Chi-square tests were employed to test differences between BiH and Croatia.

## 5 Results

Two national public procurement systems were assessed from the point of view of participants who provided authentic insiders' evidence on the characteristics of their system. Although two country surveys that are not identically matching and therefore not directly comparable were considered, we employed a qualitative narrative analysis of the main features of the two countries' public procurement systems. It helped us identify main issues in both of them regarding the competition and entry barriers. Comparison was made in seven main areas of public procurement. Along the public procurement process, we examined the issues in tender phase (application criteria for companies to participate and quality of tender information provided, technical specifications and procedures); selection of suppliers in terms of awarding criteria applied and suppliers' deals; and post-tender stage referring to contracting practice. Special sections refer to appeals and cost assessment. Corruption risk and perceived trust in the public procurement system were compared as well. Summary of results is presented in Table 3.

In both countries, companies evaluate tender information as prompt and available and technical specifications as clear (although in BiH somewhat restrictive). The main variations in responses appear in tender qualification criteria (in Croatia they are considered clear and non-discriminatory, in BiH ambiguously defined and subjective) and procedures (considered transparent in Croatia and frequently misused in BiH). The major differences are noted in corruption and trust in the system. In BiH perceptions of corruption in public procurement is very high, and significantly more observed when compared to Croatia. In BiH over half of the

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<sup>6</sup> Questionnaires are available upon request.

respondents expressed their distrust in the system, and in Croatia that was the case of one in ten respondents. Although companies in both countries observed making deals in the supplier selection process it seems at the first sight that EU principles of fair and non-discriminatory procurement are better applied in Croatia than in BiH.

In Croatia, the situation seems to be different from the point of view of principal supplier and his subcontractors. More than one third of Croatian companies that have experienced public procurement have participated in it as subcontractors. This indicates opening up to SMEs is already taking place in Croatia. Main entry barriers identified for Croatian companies in general were the lack of capacities and resources. One part of companies surveyed had no business interest to participate and some were reluctant to participate because of their distrust in the system, corruption, informal payments and other unfair deals in (sub)contracting. It is interesting to note that companies in Croatia evaluated public procurement procedures better than one would expect and much better than companies in BiH.

Croatian respondents mainly do not agree that informal payments are necessary to get the public contract, and find the system well-designed and pretty effective in seizing the ever-existing corruption risk. The strengths of the Croatian system are seen in high transparency, well-prepared and clear tender documentation, and procurement is well-managed by competent staff. Croatian companies see public procurement practices in other EU countries and at the EU level as better and consequently have high expectations that EU standards become fully implemented in Croatia as well. At the time of the survey it was early for respondents to estimate the benefit of the EU membership since Croatia has been the new EU member state since July 1, 2013. The empirical analysis of the system at first sight indicated that SMEs in Croatia participate to a significant extent in the national public procurement market and that the development of SME sector is viable through public investment.

The main entry barriers to enhance competition at the public procurement market, and to build the competitiveness of SMEs to participate at tenders are limited human and other resources of the companies, in particular considering direct contracting for large business deals. The entry barriers and problems for BiH are different. First of all, the EU public procurement standards and best practices are not fulfilled, in particular when it comes to non-discriminatory and fair practices applied to all participants. The lack of transparency and high corruption risk, poorly defined qualification and awarding criteria, cartel deals and conflict of

interest jeopardize the efficiency and competitiveness on the BiH national public procurement market. Over a half of the companies see corruption as “greasing the wheels”; companies gain competitive advantage by paying bribes, using political connections and making other unfair deals to get the public contract.

The level of competition at the public procurement market in BiH is exposed to many obstacles (Voloder, 2015a). These are intentional misuse of the system in terms of cartel arrangements; deals between suppliers and public procurers in all phases of public tenders; restrictive terms of participating at tenders (e.g. high costs); lack of competences at the public procurer side. Public procurers lack resources and knowledge for complex tenders and contracts, and therefore prefer negotiation procedures directly with supplier(s) who have more expertise in the field. In line with this opinion, it is worth mentioning that the general consensus among Croatian and BiH companies is that policy-makers should promote the criterion of an economically best offer instead of lowest price criterion that is easier to apply.

Based on these findings we proceed with the comparative analysis with focus on SMEs only.

**Table 3 Survey Results: A Comparison between BiH and Croatia - Summary**

| <b>Comparison</b>                            | <b>BiH</b>   | <b>Croatia</b>  |
|--|--|---|
| Questionnaire objective: subject of research | Candidate selection criteria, scoring of offers. Technical specifications, procedure types, tender documentation price, legal protection of suppliers, contract implementation, corruption perception, trust in public procurement system: three stages of procurement: pre-tender, tender, post-tender - contract implementation. | Attitudes and experiences of business sector – suppliers about public procurement procedures, regulations, compliance with main principles of public procurement, achieved European standards and corruption risk levels in public procurement.                               |
| Respondents                                  | 2500 companies general sample, 511 companies participating in public procurement.  | 300 companies.  |
| <b>Tender</b>                                | Contracting authority sets up tender conditions in agreement with interest groups and/or with preferential suppliers.  | Restricted internal human and material resources of companies available for tender participation.   |
| • Information                                | Prompt and available.  | Prompt and available. Tender deadlines too short for 10 percent of respondents.   |
| • Qualification criteria                     | Subjectively appointed, often ambiguously defined and subject to different interpretations; restrictive.   | Clear and nondiscriminatory. Companies prefer to be involved in public procurement as direct contractors.   |
| • Technical specifications                   | Clear, but restrictive.  | Clear and well prepared.  |
| • Procedure                                  | Splitting of procurement into smaller amounts is a common occurrence, although forbidden by law. Urgency and other (un)justifiable reasons are too often misused to account for the choice of competitive dialog procedure instead of open procedure.  | Transparent.  |
| <b>Supplier selection</b>                    | Ambiguous assessment criteria. Prohibited deals among suppliers. Conflict of interest among participants in public procurement. However, half of the participants state that the most favorable offer is being chosen in a fair manner.  | Deals among suppliers present in subcontracting: subcontractors arrange collaborations with the main supplier in advance.   |
| <b>Post-tender stage</b>                     | Subsequent changes in contract conditions are a common occurrence. More than half of all contracts are subject to supervision and revision.  | Contractors are least satisfied with the achieved price, but are very satisfied with contract deadlines.  |
| <b>Appeals procedure</b>                     | Appeals are resolved promptly, transparently and fairly. Distrust in legal system in BiH stated as main reason among those unsatisfied participants who did not appeal.  | A share of unsatisfied did not appeal so as to not spend additional resources on procedures, and a part of them do not believe appealing would change anything.   |
| <b>Costs</b>                                 | Generally, costs ordained by law are reduced.  | Public procurement increases business costs for contractors.  |
| • Participation in tender                    | Purchase of tender documentation and submitting proof not regarded as excessive expense by half of participants.   | -   |
| • Appeals                                    | Fee amount for initiation of appeal procedure not among the main reasons why companies do not appeal tender outcomes.  | Companies do not appeal tender outcomes because they do not want to spend additional resources.   |
| <b>Corruption</b>                            | Perception of corruption in public procurement is very high, 88 percent of respondents. 20 percent of companies encounter corruption in public procurement. Half of respondents believe they were not awarded a contract because of corruption.  | High corruption perception in public procurement not confirmed by questionnaire (11 percent of respondents believe informal payments to be necessary to receive a contract). Only 1 percent of respondents believe not to have been awarded a contract because of corruption. |
| <b>Trust in the system</b>                   | 58 percent of companies do not trust the system.   | 10 percent of respondents demonstrate distrust in public procurement.   |

In the second phase of the analysis, eight areas of issues SMEs in Croatia and BiH are facing were identified. All issues are sorted by their estimated relevance for SMEs safeguarding competitiveness at the public procurement market (Table 4). Therefore, at the very top of the list is the degree of competition to which SMEs are exposed when applying to public tenders. The reported (dis)satisfaction with the achieved price of the public contract stands as a barrier for the company's future participation at tenders because of weak profit prospects. And if the contract price is publicly available, which is mostly the case, the unfavorable deal might deter other companies from participating in public tenders. Short tender deadlines seize competition at the public procurement tenders because if deadlines are too short, they may deter SMEs from applying. The EU principles of fairness and non-discriminatory treatment are reflected in the issues of transparency of tenders, perceived conflict of interest in public procurement and respondents' trust in the public procurement system. The last but not the least and according to the results a very important issue in public procurement is the perceived corruption risk. However, the perceptions of how public procurement is prone to corruption may not match the real corruption incidence. For issues SMEs are facing in public procurement, we examined differences between SMEs by country, and by size i.e., among micro, small and medium companies.

In order to test the differences between BiH and Croatia, the share of companies that agree with various statements about public procurement issues was compared and tested with Chi-square tests (Table 4).

**Table 4 Issues SMEs are Facing in Public Procurement, n=725**

| Variable   | BiH   | Croatia | Chi-square test              |
|--|-------|---------|------------------------------|
| Exposure to competition: Yes                                   | 12.6% | 92.6%   | Chi-square=337.54<br>p=0.000 |
| Dissatisfaction with the achieved price: Yes                   | 63.8% | 52.4%   | Chi-square=5.42<br>p=0.020   |
| Satisfaction with tender deadlines: Yes                        | 83.7% | 88.6%   | Chi-square=2.15<br>p=0.143   |
| Transparency of tenders: Yes                                   | 84.7% | 87.3%   | Chi-square=0.82<br>p=0.365   |
| Conflict of interest in public procurement: Yes                | 71.2% | 40.8%   | Chi-square=52.37<br>p=0.000  |
| Trust in the system: Yes                                       | 47.5% | 17.0%   | Chi-square=63.24<br>p=0.000  |
| Corruption risk in public procurement: Yes                     | 90.8% | 82.8%   | Chi-square=9.75<br>p=0.002   |
| Public contract awarded under the influence of corruption: Yes | 60.1% | 28.0%   | Chi-square=54.80<br>p=0.000  |

Our results indicate that there are significant differences between BiH and Croatia at  $p < 0.01$  level for the following variables: “exposure to competition”, “conflict of interest in public procurement”, “trust in the system” and “corruption risk in public procurement”. Also, there are significant differences at  $p < 0.05$  level for variable “dissatisfaction with the achieved price”. There are no statistically significant differences for variables indicating “satisfaction with tender deadlines” and “transparency of tenders”. “Dissatisfaction with the achieved price” in public procurement tenders is higher in BiH than in Croatia (64 percent vs. 52 percent).

Larger share of companies from Croatia, when compared with those from BiH, agree that they are exposed to competition in public procurement tenders in their respective countries (93 percent vs. 13 percent). On the other hand, larger share of companies from BiH, when compared with those from Croatia, agree that conflicts of interest exist in public procurement system of their respective countries (71 percent vs. 41 percent). Also, larger share of companies from BiH agree that public contracts were awarded under the influence of corruption (60 percent vs. 28 percent in Croatia). Although there are statistically significant differences between BiH and Croatia in the share of companies that agree that corruption risk exists in public procurement, both percentages are very high (91 percent vs. 83 percent). For Croatia, an intuitive assumption that SMEs are suffering from corruption more than other businesses is confirmed when compared to the low corruption perceptions of the overall sample (Table 3). Having in mind previous findings, the results for variable “trust in the system” might be considered somewhat contradictory. Although there seems to be more corruption and conflict of interest in public procurement system in BiH (based on companies’ answers), at the same time the trust in such system is much higher in BiH than in Croatia (48 percent vs. 17 percent).

We proceed with the analysis of differences among the sizes of SMEs. Micro companies up to 10 employees might have resources, business interests, negotiation power, and other characteristics substantially different from medium-sized companies up to 249 employees. The intuition of different entry barriers and challenges in front of micro, small and medium-sized companies competing at public procurement market is tested by an additional set of Chi-square tests (Table 5).

**Table 5 Company Size and Issues SMEs are Facing in Public Procurement, n=725**

| Variable   | Micro | Small | Medium | Chi-square test             |
|--|-------|-------|--------|-----------------------------|
| Exposure to competition: Yes                                   | 11.4% | 37.6% | 57.1%  | Chi-square=89.29<br>p=0.000 |
| Dissatisfaction with the achieved price: Yes                   | 63.7% | 61.3% | 56.8%  | Chi-square=1.57<br>p=0.455  |
| Satisfaction with tender deadlines: Yes                        | 81.9% | 84.5% | 91.3%  | Chi-square=5.91<br>p=0.052  |
| Transparency of tenders: Yes                                   | 80.9% | 87.0% | 89.9%  | Chi-square=7.32<br>p=0.026  |
| Conflict of interest in public procurement: Yes                | 67.0% | 62.3% | 55.4%  | Chi-square=4.83<br>p=0.089  |
| Trust in the system: Yes                                       | 40.2% | 39.4% | 30.6%  | Chi-square=4.44<br>p=0.109  |
| Corruption risk in public procurement: Yes                     | 91.0% | 88.1% | 83.5%  | Chi-square=5.22<br>p=0.074  |
| Public contract awarded under the influence of corruption: Yes | 58.6% | 49.7% | 37.7%  | Chi-square=14.19<br>p=0.001 |

We found statistically significant differences between companies of different sizes at  $p < 0.01$  level for the variables “exposure to competition” and “public contract awarded under the influence of corruption”, and at the  $p < 0.05$  level for “transparency of tender”. Differences at  $p < 0.1$  level were observed for “satisfaction with tender deadlines”, “conflict of interest in public procurement” and “corruption risk in public procurement”. There are no statistically significant differences for variables “dissatisfaction with the achieved price” and “trust in the system”.

The largest differences between micro, small and medium companies are observed for variable “exposure to competition”. More than half of all surveyed medium-sized companies agree that they are exposed to competition in public procurement tenders, while only one in ten micro companies thinks the same (57 percent vs. 11 percent). Larger share of micro-sized companies when compared with small and medium-sized companies agree with the statement that “public contracts are awarded under the influence of corruption” (59 percent vs. 50 percent and 38 percent). Small and medium-sized companies to a larger extent expressed their concern about the transparency of public procurement tenders, when compared with micro-sized companies (90 percent and 87 percent vs. 81 percent). On the other hand micro- and small-sized companies are less satisfied with the tender deadlines when compared with medium-sized companies (82 percent and 85 percent vs. 91 percent). A different pattern could be observed for variable “corruption risk in public procurement”, i.e. micro- and small-sized companies to a larger extent agree with the statement that there is a “corruption risk in public



procurement”, when compared with medium-sized companies (91 percent and 88 percent vs. 84 percent).

## **6 Conclusion and Discussion**

Comparative assessment of entry barriers to public procurement market in Croatia and BiH yielded several results that are worth discussing further. Our intuition was that SMEs in Croatia and BiH are too big to fail, in other words that these companies do not experience major obstacles when approaching public procurement market. In Croatia, half of the participants at public procurement tenders surveyed were small companies with less than 50 employees. Companies of that size are important to Croatian economy (representing over 98 percent of companies in Croatia). Generally, SMEs with up to 249 employees are relatively big firms in the context of a small country of Croatia and the same applies for BiH.

For the overall sample of surveyed companies in both countries, the major differences in entry barriers are noted in corruption and low trust in the system. In BiH, perceptions of corruption in public procurement are much higher than in Croatia. Less conflicts of interest and less corruption in public contracting in Croatia compared to BiH might be explained by higher awareness of the Croatian business sector of corruption risk. Since the focus of this research is the position of SMEs in public procurement, we discuss this part of our analysis in details. Low trust of Croatian companies in the system might stem from many diverse business experiences.

When it comes to the SMEs only, a huge difference is found on the level of competition to which SMEs are exposed. The competition at the public procurement market for SMEs in Croatia is much higher than in BiH. This might stem from the Croatian EU membership that facilitates access to the market and establishes tendering procedures and practices by opening up bidding processes to a large number of businesses. Companies operating at the EU market should have gained more trust in the system, yet this was not the case observed in the analysis. One of the explaining reasons might be that survey in Croatia was performed at the very beginning of the EU membership period. Another possible reason which remains to be explored further is that EU membership *per se* does not change the quality of public

administration, which is why business perceptions of national public procurement system remain low.

Considering the relative position of micro, small and medium subgroups of SMEs, our findings suggest that as the firm grows, the exposure to competition is higher as well. Maybe micro companies are more engaged in small-scale public contracts of local provisioning of specific goods and services that are not interesting to other companies to bid for. Possible local and small public contracting might explain also the higher perceptions of corruption of micro firms in distinction to the perceptions of small and medium-sized companies. On the other hand, micro firms have more trust in the public procurement system, which should not prevent them to continue applying to public bids. Other related issues were not claimed by micro companies when compared to small and medium-sized companies.

Compared to issues often present in the literature as obstacles for SMEs to participate at public procurement market, SMEs in both observed countries do not experience barriers in terms of tender deadlines, transparency and level of achieved contract price. However, SMEs involved or potentially involved in public procurement are facing different obstacles when compared to the EU average.

Some authors argue that SMEs' performance depends on national and regional legislation (Vincze et al., 2010). SMEs perform better on the local level since those tenders usually do not require large suppliers. Also, they are less successful at securing tenders launched by the utilities sector and central government bodies. This would imply that: (i) the quality of local institutions plays a significant role in the success of SMEs; (ii) central government institutions should take steps to facilitate SMEs' involvement in the procurement market. Further, contracts of higher value are less obtainable for smaller and micro companies. This could be the reason why medium-sized enterprises perform better than smaller companies. In order to support smaller businesses governments should introduce a practice of breaking down tenders. In this way, some unattainable tenders would become feasible opportunities and improve the position of micro and small companies on the public procurement market. Another solution would be to introduce a joint fulfillment allowing a few smaller companies to work together on a high-value tender.

One of the main goals of the new EU legislation is to ensure a better position for SMEs on the public procurement market. Croatia had a problem with corruption before the EU accession process was intensified, so it is intuitive to conclude that in the advanced EU accessing stage BiH will overcome its current problems i.e., resolve similar issues that Croatia was facing in the past. One could assume that BiH will attain a higher level of transparency, more competent public procurers, less corruption and above all, a higher level of competition at some point in the future along its EU accession path. However, it is worth noting that despite introducing EU standards in public procurement (at least in terms of regulatory framework) Croatian companies still experience irregularities and lack confidence in the national public procurement system. Here our views are in line with Preuss (2009) pointing out the importance of supporting policies, organizational culture and strategies in implementing efficient public procurement practices. We argue that there are no blank policies for post-transition countries. Instead of formal legislative prescription of EU regulations that may not be fully implemented, customized policies should be set up for every country, local government or type of public investment. However, high standards established through EU practices should stand as a higher rule in terms of rational allocation of public resources. Policy recommendations might be different for micro, small and medium-sized companies in the post-transition phase.

Official hard data on SMEs' involvement in public procurement for Croatia and BiH are missing, and this is valid for other post-transition nations as well. In this context, surveying the opinion of participating actors in public procurement is seen as valuable source of information. By acknowledging limitations of this research we set the outline of future investigation. This work fills the gap in the scarce knowledge on SMEs and public procurement in Western Balkans region and its findings and policy implications could be useful for other post-transition economies.

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