

TAKING THE BRAKES OFF:

HOW SMEs CAN BE UNLEASHED TO DRIVE THE RAPID DIGITISATION OF THE PUBLIC SECTOR

AN ANALYSIS OF THE GOVERNMENT'S IT PROCUREMENT STRATEGY AND HOW IT CAN LEVERAGE SMEs TO ACCELERATE THE DIGITISATION OF THE PUBLIC SECTOR

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The UK might be leading in digital government, but could SMEs hold the key to unlocking even faster digital growth?

Most SMEs remain locked out of the public sector

According to a UN report, the UK is *the* world leader in digital government¹, ranking number 1 in the world ahead of other high-tech countries such as Australia, the Republic of Korea, and Singapore. Since the publication of the 2012 Government Digital Strategy, it has accelerated its ambitions in building and delivering more online services for its citizens, and in the 2015 Autumn Statement, the government committed to investing an additional £1.8 billion in digital technology and transformation projects across the public sector over 4 years². The **Government Digital Service** (or GOV.UK to you and me) remains the poster child of the government's digitisation strategy, itself gaining an additional £450m in funding to expand the range of services it offers in that same Autumn Statement.

While more can always be done, it is difficult to challenge the government's commitment to the digitisation of public services.

Coinciding with its digital ambitions, the government has also made numerous public statements about its intentions to improve competition in the public-sector marketplace by making it more accessible to SMEs, backing this up with a commitment to direct 33% of public sector procurement directly into SMEs by 2022. However, in contrast to its world-leading position in the digitisation of public services, the government's record for involving more SMEs in the delivery of public services is somewhat less impressive; research by the Federation of Small Businesses suggests that *"SMEs won just 19% of directly awarded public sector contracts by value."* during the previous 12 months (published in August 2017).³

Despite the launch of numerous policies and initiatives, many SMEs remain locked out of public sector contracts. This is to the detriment of the digitisation of the UK public sector.

Why SMEs hold the key to the digitisation of the public sector

The government's commitment to bringing more SMEs into the public sector is driven by more than a desire to support fledgling UK businesses and leverage lower costs. SMEs often have the most cost-effective and innovative approaches to solving problems, and because they aren't burdened with layers of bureaucracy, they are generally more agile. A SME can typically mobilise around a new idea far more quickly than a large company can, and with necessity being the mother of invention, the fewer resources available to SMEs often inspires more creative and efficient approaches to

¹ <https://publicadministration.un.org/egovkb/en-us/Reports/UN-E-Government-Survey-2016>

² <https://www.gov.uk/government/publications/spending-review-and-autumn-statement-2015-documents/spending-review-and-autumn-statement-2015>

³ <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/procurement-report-final-final.pdf?sfvrsn=0>

problem solving. In the technology sector in particular, it is often the new startups that bring disruption to an established industry. It is here where SMEs are playing a crucial role in digitisation, and why the government must do all it can to work with SMEs if it wants to leverage the benefits of digitisation throughout the public sector.

Whenever SMEs are unfairly prevented from pitching for new digitisation projects, the government's journey to digitisation is held back.

The government's approach to public sector procurement is the root of the problem

The challenge for the government is that its procurement process moves at a much slower pace than the change happening in the world today. IT transformation is a stark example of this. The public sector is trying to transform how it does business through the digitisation of its departments and agencies, but its outdated procurement model is slowing it down. Government procurement is simply not agile enough to work with SMEs, so it routinely misses out on accessing the most cost-effective and innovative approaches.

Large, unwieldy contracts with onerous terms can prevent an SME from bidding since the cost of having a legal review can be prohibitively expensive and not having a review is very risky. Most SMEs don't have the resources to undertake the thorough review necessary and to clearly understand their contractual obligations. This is very off-putting to small organisations who see only large, uninsurable risks of both liabilities and indemnities in these contracts. Crown Commercial Services is trying to address this with a shorter form contract, but this doesn't go far enough to help small businesses.

As a result of its slow procurement, many public-sector organisations are seeing a rise in "shadow IT" because the procurement of IT in government simply cannot keep up with the pace of change. The lack of an agile approach to sourcing IT leads to unsupported IT and the dangers that go with it, such as security vulnerabilities, exposure to risk, lack of control etc. SMEs can move at a faster pace and can provide services at a lower price, but unless procurement teams are willing to use the digital marketplace to source IT support, Shadow IT will continue to plague the public sector.

Why should the government work with more SMEs?

The government has been committed to bringing more SMEs into the public sector for nearly a decade. In 2010, Prime Minister Cameron appointed Lord Young of Graffham as enterprise adviser with a remit to overcome the government's "institutional bias" against small and medium sized businesses. Lord Young was tasked with writing a "brutally honest" report on how the government can prevent small and medium sized firms from being locked out of public procurement opportunities.

"I am particularly concerned about the shocking way in which small and medium sized firms are locked out of procurement opportunities by central and local government, and the rest of the public sector – for example, the NHS. I would like you to establish, within a month, an online forum on the No 10 website where small and medium businesses can tell their public sector procurement horror stories."

David Cameron, UK Prime Minister, May 2010 – July 2016

The benefit that SMEs can bring to the public sector are significant. The government recognises that SMEs can offer greater innovation, value-for-money and flexibility than larger providers, in addition to the positive ripple effect to the economy that supporting the growth of fledgling UK-based businesses brings. The National Audit Office agrees.⁴ SMEs are hungry for growth and have low overheads, so they will almost always deliver better value for money.

Recognising this, Cameron later delivered a speech on Government Procurement⁵ in 2011 where he highlighted some of the horror stories that SMEs had posted to the No 10 website. These included start-ups being told they had to provide three years of audited accounts despite the fact they'd only just started up, to organisations being told they could only compete for government contracts if they'd sold to government before..., to firms with brand new products simply being unable to tender for business because their product was so new it didn't have a category it could tender into. The government therefore sought to address these issues and bring SMEs onto a level playing field when tendering for public sector contracts.

⁴ <https://www.nao.org.uk/report/governments-spending-with-small-and-medium-sized-enterprises/>

⁵ David Cameron speech on government procurement, delivered on 11 February 2011, <https://www.gov.uk/government/speeches/pms-speech-on-government-procurement>

What has the government done to improve access for SMEs?

The UK public sector spends in excess of £200 billion⁶ on procuring goods and services from third parties every year, but far too little is spent with small firms. Over the last 12 months, the FSB estimated that SMEs won just 19% of directly awarded public sector contracts by value.

The government has committed to spending 33% of public sector procurement directly with SMEs by 2022. This is an increase on an earlier target of 25% by 2015, which would suggest the government has seen real tangible benefits of working with more SMEs.

Some of the most high-profile initiatives aimed at supporting SMEs in the public sector include the introduction of the Digital Marketplace, the launch of Contracts Finder (which lets suppliers find out about contracts worth over £10,000 with government and its agencies), plus the various framework agreements such as G-Cloud, Crown Hosting, and Digital Outcomes & Specialists to name but a few, which provide a common contractual environment between the public sector and its suppliers.

This paper will examine some of these initiatives in more depth later in the next chapter.

Is the government on track to hit its target?

It is very challenging to accurately judge the government's effectiveness in achieving its target of £1 in every £3 of public sector procurement being spent directly with SMEs by 2022. While the individual frameworks are very transparent - providing a summary of every £ spent with SMEs, to the exact £, in relation to other aspects of government spending is less clear. Often the official data from government will contradict those from independent sources:

- When looking at the Digital Services Framework specifically, the government can claim impressive results. Of the £163,561,061 sold through the Digital Services Framework up to 31st December 2017, "48% of total sales by value and 62% by volume... have been awarded to small and medium-sized enterprises (SMEs)."⁷
- In contrast, the FSB claims that only 23% of SMEs have worked for the public sector over the last year, despite government efforts to increase the amount of business it does with smaller firms.⁸
- G-Cloud data is just as confusing. Of the £65 million spent through G-Cloud 9, £37 million (57%) went to SMEs and £25.5 million to large companies. While

⁶ <http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN06029>

⁷ <https://www.gov.uk/government/statistical-data-sets/digital-services-framework-sales-up-to-31-december-2017>

⁸ <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/procurement-report-final-final.pdf?sfvrsn=0>

£37 million being spent with SMEs is encouraging, it is highly disproportionate when you consider that SMEs account for 72% of all the suppliers on the G-Cloud. Why is the figure for SMEs not higher?

Recommendations

In light of the continuing challenges faced by SMEs to compete for public sector contracts, we have a number of recommendations for the government to implement. We believe these will improve competition more fairly for businesses of all sizes and help to deliver better public services for all through digitisation:

1. Don't stifle existing relationships

While the public sector is actively trying to transform the way it works with suppliers to make it more accessible to SMEs, the rigid, rules-based approach to procurement is central to the problem.

The rigid, hands-off approach necessary to ensure fair and open competition inhibits the government's ability to build meaningful relationships with new suppliers, many of whom will be SMEs. While SMEs understand the need for a common approach, it is often relationships that drive business decisions. It is fair to say that most departments may have their preferred suppliers, and with legitimate reasons to do so (positive past experiences, familiarity with their processes etc.), but this raises the question; if they have their preferred suppliers, how much attention is truly given to the other suppliers on a shortlist? Are SMEs simply being used to make up the numbers on a shortlist, or to give the illusion of competition to keep incumbents on their toes?

Incumbents who are already on the ground have a clear advantage; they sit in the offices and work closely with public sector employees every day, so they are already far ahead when it comes to winning the next portion of business. SMEs need to be able to build these same relationships to be able to help unlock value and talk honestly about current and future projects, offering excellent advice on the best way ahead. SMEs don't just want the opportunity to respond to an RFP by saying "let us do this for you instead"; they want the opportunity to engage much earlier in the decision-making process, and where they exist, they can even suggest better and cheaper options than the approach in the RFP.

It is naïve to think you can remove the human element entirely from the tender process. The solution therefore is not to remove personal relationships entirely, but to embrace them at a much earlier stage in the tender process so that everyone is given a fair shot. You cannot help SMEs by forcing a wedge between existing working relationships, but you can give them a chance to forge relationships of their own. Within the Digital Marketplace there is scope for early engagement with Suppliers and it is notable that some public sector entities do make effort to engage with suppliers in this way.

2. Overhaul the framework agreements

It is clear the government has not thought about how the framework agreements are actually used by SMEs to generate business (and how government customers use them to find suppliers). They are unwieldy, difficult to navigate and often fail to match

contracts to the most relevant suppliers. There is also not enough of an incentive for public sector purchasers to use the frameworks.

The government must overhaul Contracts Finder, G-Cloud and other frameworks to make them more user-friendly and better at fulfilling their matchmaking role. Here are our recommendations for the G-Cloud, Contracts Finder and Digital Outcomes & Specialists frameworks specifically.

G-Cloud 10

The G-Cloud was first launched in 2012 to make it easier for public-sector bodies to procure commodity information technology services that use cloud computing. The G-Cloud consists of two parts:

- A series of framework agreements with suppliers, from which public-sector organisations can buy services without needing to run a full tender or competitive procurement process.
- The "Digital Marketplace", the online store where public sector bodies can search for services that are covered by the G-Cloud frameworks.

A specific aim of the G-Cloud was to open up procurement to SMEs. When it first launched, the G-Cloud boasted that 80% of its suppliers (over 700) were SMEs. In the latest available figures, the G-Cloud can claim that 56% of total sales by value and 64% by volume, from all reported G-Cloud sales to date, have been awarded to SMEs.

Despite these relatively high numbers for sales to SMEs, the G-Cloud remains an overwhelmingly difficult service to use. The latest incarnation of the G-Cloud, G-Cloud 10, is due to launch sometime in October 2018. We fear the same challenges will persist in G-Cloud 10:

It ain't no Google...

The fundamental challenge for the G-Cloud platform stems from the combination of the sheer number of suppliers listed on the platform (2,847 were approved for G-Cloud 9 for example⁹) with a search function that is largely ineffective at finding the most relevant suppliers for a given task. The G-Cloud therefore fails at its primary role as the matchmaker between buyers and suppliers. As a result, government purchasers often need to enlist the services of a third party to help them navigate G-Cloud and find the right SME suppliers to solve their problem. Additional deficiencies in the search function include:

- Filters are either not relevant (e.g. sellers/resellers) or are not business-solution focused, making it very difficult to find what you want.

⁹ <https://www.publictechnology.net/articles/news/g-cloud-9-supplier-list-revealed>

- Search results do not appear to be in any discernible order. On what basis does the G-Cloud search engine prioritise its results?
- Many service categories do not align to real-world use cases, forcing suppliers to shoehorn their proposition into a category which is not reflective of their service offering and, ultimately, making them harder to find.

All of these issues raise one fundamental question; if the G-Cloud cannot effectively match a need with a solution, what purpose does it serve?

Contracts Finder

Contracts Finder was first launched in 2011 to help suppliers find and bid for government and agency contracts worth over £10,000. All public sector contracts over £10,000 must now be listed on Contracts Finder. It allows service providers to search for contract opportunities in different sectors, find out what's coming up in the future, and look up details of previous tenders and contracts.

The government has refined the Contracts Finder over the years to make it even easier for suppliers, such as removing some pre-qualification questions for SMEs. This has helped, however the sheer volume of opportunities listed on the system make it very cumbersome and time consuming for SMEs to find meaningful business opportunities. The government has also extended its reach through discussion on various online forums and feedback sessions with suppliers. This activity, at the very least, ensures that opportunities are more clearly understood by the SME community.

Digital Outcomes & Specialists

The Digital Outcomes & Specialists framework was designed to be a more agile framework focused on the evolving field of digital outcomes. Incorporating Agile development principles, Digital Outcomes & Specialists is regularly reviewed and refreshed to continually incorporate lessons from previous iterations.

The challenge for suppliers when engaging with Digital Outcomes & Specialists is the sheer volume of requests and the number of companies bidding for the opportunities. A new request is posted almost daily, with 20-50 supplier responses per request not uncommon. This shows the extent of the time that is being spent by suppliers in bidding for work on the framework. But with little or no feedback or interaction with the end customer, it is simply a numbers game. Suppliers have no way of knowing why their bids are unsuccessful, so they cannot improve their likelihood of success. Their only hope of success is to submit enough bids that eventually one of them will be successful.

As it stands today, the Digital Outcomes & Specialists framework is unsustainable for most of the suppliers that use it. SMEs simply cannot afford to spend this much time bidding for work with no way to determine the likelihood of success. It would be very helpful for SMEs to be shown a model answer for this type of opportunity, particularly since the platform limits the number of words per answer and SMEs are struggling to find out what exactly the buyer is looking for.

3. Fairer terms for SMEs

SMEs typically face more challenging terms of business when compared to the larger firms, in particular payment terms. Whereas it is not uncommon for large suppliers to be paid within just 5 days (despite 30-day payment terms with the government), their SME subcontractors are only paid in 45-60 days by these suppliers.

When SMEs are subcontracting through a large supplier, it is common for the SME to be prevented from engaging with the customer directly in order to protect the working relationship of the named supplier. This approach is often detrimental to the service being delivered, since the SME is typically engaged because of its unique, specialist skills. Suppliers must be prevented from blocking such contact.

When an SME subcontracts through a large supplier, the margin it can charge is often fixed by the contract (e.g. 5%). This does not improve competition or mitigate costs for the customer – it merely protects the high margins of the outsourcer at the expense of the SMEs that are left working for rates that are unsustainable. Government contracts demand specific insurance policies, for example, but allow virtually nothing in overheads to fund such policies nor other Company overheads, which although generally lower than large companies, still need to be covered.

4. Introduce more realistic Risk Analysis procedures

When the government undertakes risk analysis of a project, the big consultancies are still often seen as less risky and more politically acceptable. This is despite track records of poor delivery, high costs and inefficient (sometimes risky) business models. Recent incidents involving companies such as G4S (2012 London Olympics, Immigration Detention Centres,) ATOS (Disability Testing) and Serco (Overcharging for Tagging Prisoners, Yarl's Wood Immigration Detention), show that underperformance, and even incompetence, is no barrier to winning repeat Government business. Some contracts have been in place for decades with only occasional pauses when something goes wrong.

At the same time, SMEs are seen as higher risk due to their lower headcounts and shorter trading histories. It can be very misleading to categorise a business by its full-time employee count. In some sectors, particularly IT, it is very common for businesses to have a low number of Full Time Employees (FTEs) while having access to a large pool of specialist contractors for a specific project. In this instance a business may be unfairly disqualified from tendering for a contract due to arbitrary

categorisations based on headcount. In this example a SME is no less flexible than a large supplier, as both would not have specialist IT talent sitting on the bench – they would both procure from the same pool of contractors for the job at hand.

The government needs to be more realistic in how it applies weight to different perceived risks of a supplier (e.g. how critical is the number of full-time employees to the delivery of the project, if the company is relatively new, what is the combined personal experience of the individuals that make up the company, what is the financial backing of the company etc.). The government should also place far more weight on any previous project failures, particularly if they have been repeated a number of times.

5. Be more transparent

A real challenge for measuring government success in working with SMEs is how companies are categorised, since some companies can be found categorised as an SME on one framework and a large supplier on another. At the same time, some companies are classed as “other”, which further muddies the waters.

In light of these contradictory statistics on SME’s involvement in the public sector, we would encourage the government to publish the value of every contract that is awarded (not just those on the framework agreements).

It is also worth pointing out the sheer breadth of companies that qualify as SMEs. An “SME” is defined as anything with just one employee to 250. This is a very broad scale. A company with 220 employees can hardly be compared to one with 5 employees, yet they can both fulfil the government’s SME “quota”. Where on the scale is the government focusing? What proportion of government contracts are awarded to businesses with fewer than 9 employees (termed “micro-businesses” by the government’s own definitions) for example vs. those with 200+?

In order to establish how much work is awarded to SMEs of different sizes, the government should publish the employee count of every supplier that is awarded business, not simply whether they are an SME or not.

6. Lower the cost of doing business with the Public Sector

The cost of competing for business within the public sector remains a significant barrier for SMEs. As previously mentioned, the sheer volume of opportunities on Contracts Finder and the Digital Marketplace means that SMEs spend a lot of time submitting tenders with a low chance of success due to the high number of competing entries. What’s more, since each tender takes a significant amount of time to submit, most SMEs cannot compete for public-sector business alone or they would soon go out of business. At the same time, procurement deadlines are often not being adhered to, so tenders can take much longer than anticipated, causing an additional strain on a company’s cash flow if they are relying on public sector business.

SMEs that are serious about competing in the public sector must also participate in costly promotion events such as trade shows and exhibitions. In spite of the move towards wholly digital procurement processes, the awareness and relationships generated from such shows remains necessary for generating business with the public sector.

The Government has taken steps to address this, such as abolishing pre-qualification questionnaires for low-value contracts, launching Contracts Finder, and more recently launching a shorter, more user-friendly public sector contract which cut around 50,000 words of the existing Crown Commercial Service (CCS) contract, reducing it to just over 20 pages.

The government must build on this momentum and take further steps to reduce the cost of pitching for public sector business.

7. Commit more government resources to effectively manage SME suppliers

There is an inherent conflict in the government's policies of austerity and its desire to work more directly with SMEs. At face value the two policies would appear to support each other; the government wishes to reduce its expenditure and SMEs generally offer better value-for-money. The conflict derives from the practicalities of working with SMEs instead of large suppliers, since doing so introduces significantly more suppliers on a given project. Austerity has led to reduced headcounts across government departments, including those in procurement who are tasked with managing government suppliers. This means the government is disincentivised from working with SMEs. Why would you appoint ten SMEs for a project when the additional overhead of managing so many suppliers might undermine any savings you gain from working with them? In this scenario simply appointing one of the large outsourcers looks much more attractive.

If the government is serious about supporting more SMEs in the public sector it must commit to employing more dedicated Contract Managers with professional contract management backgrounds to support a more diverse supply chain.

The appointment of an SME representative to government (Emma Jones) is a good step forward since she is accessible directly to SMEs and can more directly influence the ministers responsible for the promotion of the SME agenda.

8. More honestly appraise the risk of SME engagements by looking at all factors such as quality of delivery, access to bespoke skills, value for money etc.

Employee count, for example, must not be used to unfairly discriminate one supplier against another during the procurement process, particularly when the number of full

time employees will have no bearing on the supplier's ability to deliver (since both the large supplier and the SME will hire contractors from the same pool of talent anyway).

9. Leverage SME consortiums

Many SMEs are unable to win public sector business by themselves because they do not have the right credentials on paper. As a result, many are forced to subcontract through the large suppliers. This is grossly inefficient since it needlessly funnels a proportion of the cost as a margin to middlemen.

A better approach is to enlist the services of SME consortiums. Many SMEs have built partner networks or consortiums with other SMEs to help them deliver on larger projects. These consortiums will often consist of niche skills you cannot find anywhere else, let alone in bigger consultancies. By leveraging their partners, SMEs can also scale far more effectively than their headcount would suggest.

10. We're all in the Brexit Boat – Let's start rowing!

Brexit is impacting on every aspect of the machine of government, and procurement is no exception. On the one hand the prioritisation given to delivering Brexit has naturally resulted in some projects being put on hold (e.g. HMRC stopping or delaying transformation projects to ensure customs system is ready for Brexit¹⁰) while on the other it may create opportunities for British companies to deliver more public services in the future if the UK government is no longer obligated to put tenders out across the EU.

The implementation of an orderly Brexit is the number 1 challenge for the government and must take priority over everything else. The government must do all it can to remove uncertainties about the process for business.

Using big consultancies often funnels money outside of the UK and ignores the passion SMEs have for high quality delivery that boosts the British economy. In this regard Brexit can be an opportunity for UK SMEs to deliver more public services and bring better social impact and more direct benefits to regional economies.

¹⁰ <https://www.computerweekly.com/news/252439082/HMRC-to-stop-or-delay-transformation-projects-to-ensure-customs-system-is-ready-for-Brexit>

Closing remarks

The government is turning to digitisation as the means to improve the delivery of public services and lower the cost of the machine of government. SMEs, not the large outsourcers, are often the best placed to lead a digitisation transformation project because they are the most nimble and adaptive to change and new technologies. Despite its efforts to improve access for SMEs, the government's rigid and slow approach to procurement continues to make it difficult for SMEs to work with the public sector. This in turn is slowing down the government's efforts to lead the world in digitisation.

By applying the recommendations in this white paper, we firmly believe the government can encourage more SMEs to enter the supply chain and compete on an even footing against the established players and accelerate digitisation across the country.