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FOR WHAT COMES NEXT

Procurement challenges when working as or with SMEs

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Introduction

The UK Government's Procurement Act 2023 reinforces a clear agenda: to increase the participation of Small and Medium Enterprises (SMEs) in public sector procurement. This reflects the significant advantages that SMEs can bring to government contracts, including agility, innovation, specialist expertise and the ability to deliver value for money. Their involvement not only drives diversity and competition in supply chains but also contributes to regional economic growth and resilience.

For large organisations, partnering with SMEs in the context of public sector procurement offers opportunities to access niche capabilities and deliver more flexible, innovative solutions. Yet, these partnerships are not without challenges. Large firms often struggle with concerns around SME capacity, compliance with complex procurement frameworks, and aligning delivery standards with the expectations of government clients.

From the SME perspective, engaging with larger partners can be equally demanding. SMEs may face power imbalances in negotiations, difficulties meeting contractual requirements, or barriers in navigating lengthy and resource-intensive procurement processes.

This paper seeks to explore many of the common challenges encountered on both sides of these relationships within UK public sector procurement. By examining these tensions, it aims to identify ways to strengthen collaboration, unlock SME potential, and realise the Government's vision for more inclusive, effective supply chains.

Who are we?

We are the Procurement sub-group, part of the Justice and Emergency Services Management Committee (JESMC). We represent the full spectrum of techUK Justice and Emergency Services suppliers within the tech space, from very large global organisations all the way through to SMEs and start-ups. We are dedicated to fostering stronger collaboration between buyers and suppliers, promoting closer partnership, effectively communicating stakeholder challenges to the tech sector, and helping our industry drive positive impact.
When we work on our JESMC mission we leave our business cards outside the room!

Challenges

The following is a non-exhaustive list of common challenges that large organisations encounter when working with SMEs during procurement exercises.

1. **Flow down of terms**: some terms are specific to certain roles, services or deliverables and should reflect the party with responsibility for successful delivery of them, which is not always possible given the size of the SME (i.e. some terms may be too excessive for a SME to take on). This can necessitate the larger organisation providing cover for the SME, which can be problematic for internal governance.

Approach to resolution: Government contracts should incentivise prime contractors to pass on equitable terms to SME partners. Generally, larger organisations should adopt fair contract conditions, such as prompt payment practices, proportionate liability and shared risk.
However, there may be instances where larger organisations have to share responsibility for terms with the SME(s). In such cases, early agreement should be reached on the exact split of the terms, the associated delivery responsibilities and importantly, who is responsible for the management of the delivery. This will give clarity to the SME from the outset and will allow the larger organisation more time to complete internal governance.

2. **Risk Allocation:** Similar to the above, risk analysis can show that unproportional levels or risk could lie with the services or deliverables that are to be delivered by the SME, but the SME may be too small to take on such levels of risk by themselves. Again, the larger organisation is required to provide risk cover for the SME, causing internal governance challenges.

   Approach to resolution: Similar to the above point, larger organisation may have to assume a level of risk on behalf of the SME. Agreement on the exact nature of this arrangement should be reached early on and may require the SME to forgo a level of remuneration in lieu of the risk cover provided by the larger organisation. The details of the arrangement should be made clear to the buying organisation for transparency.

3. **Margin Stacking:** SMEs may have certain margin expectations which the larger organisation would like to dilute for competitive reasons. Similarly, there may be instances where the larger organisation may want to add margin on to the stated SME margin before passing on to the client. This is often justified by claiming they are covering admin/processing overheads or providing risk/terms cover which the SME can't take, and which needs to be paid for in terms of additional margin.

   Approach to resolution: Revealing early sight of margin expectations on both sides is essential and needs to be fed into the competitive pricing process. If margin expectations are not able to be met, it is better to uncover this early so that each party has time to identify alternative actions. The buying organisation will typically want to see a breakdown of the margin (especially in teaming arrangements), so being able to show a clear and justifiable split across all parties will enhance transparency.

4. **Margin Dilution:** Organisations that are mandated to comply with US GAAP principles are required to recognise and report on margin across all elements of their deal, including SME margin. This typically has a dilutive effect on the overall deal margin (e.g. for simplicity, if a large organisation has 50% of a deal and wants 20% margin, and an SME has the remaining 50% of the deal and only wants 10% margin, the larger organisation would be required to report the overall deal margin at 15% to be US GAAP compliant, thereby diluting their margin). This is problematic for internal governance, especially for larger organisations that need to report their numbers to the market.

   Approach to resolution: Some products and associated services can be offered to the client on a resale basis, which allows separate reporting of margin, thus avoiding margin dilution. This requires specific contractual arrangements to be in place between the larger organisation and the SME and also between the larger organisation and the client. There are also restrictions on the types of services and deliverables that can be included in resale arrangements. This may be useful for SMEs that offer products or product-specific services.

However, for large service-based engagements, there is no easy answer to this issue, and the larger organisation has to make a choice between increasing the margin they apply to the SME to maintain their desired margin, which risks making the bid less competitive from a pricing perspective, or accepting a lower overall margin and trying to get this through internal governance.

5. **Allocation of Roles & Responsibilities**: Need to have absolute clarity of which organisation is responsible for which roles throughout the entire lifetime of the deal. This can be problematic during sub-contracting negotiations as both organisations may have capability in a certain area and want to do a particular role. Also need to ensure responsibilities reflect the overall split of the deal size (for instance, there is no point in an SME doing 30% of the roles if they are only getting 10% of the revenue).

   Approach to resolution: As stated previously, gaining early clarity over which party takes responsibility for which roles throughout the entire lifetime of the contract is essential. In the majority of cases, roles should be assigned to the party with the best/most relevant capability. If both parties have similar capabilities, agreement on workshare and associated management should be reached. Alternatively, one party can forgo workshare in one area where they have capability if they gain a suitable split of responsibility in another area.

   Joint delivery models should be explored and encouraged where SMEs can build scale through collaboration and where larger organisations can sponsor SME development by sharing tools, methods and training.
   Generally, the split of workshare should be reflected in the other terms of the deal, i.e. flow down of terms, revenue split, etc. Each side should also have 'step-in' rights which allows one party to assume a role originally assigned to the other if they are not able to perform that role to the desired level.
   Larger organisations should position SMEs as equal partners where they add specialist value, and the client/buying organisation should have clear line-of-sight site to the SME contributions.

6. **Allocation of Business Development Costs**: Business development costs can be prohibitive for SMEs. Generally speaking, each party is responsible for their own BD costs, but problems can arise when the SME is required to follow the BD process of the larger organisation which can be more rigorous/in depth and may therefore require more effort and time (and cost).

   Approach to resolution: Again, there is no easy fix for this. One approach is for the larger organisation to cover some of the BD costs of the SME, and for this to be reflected in the overall deal margin, i.e. the larger organisation takes the risk of covering all or more likely some the SME BD costs in return for increased margin during the deal (although this can typically prove problematic to get through internal governance).

Another approach is for the larger organisation to allow the SME a level of relief from the internal governance for their part of the response. However, this runs the risk of the part of the response that the SME generates appearing sub-standard (or at least significantly different) relative to the rest of it.

7. **Allocation of Sales & Revenues**: Generally speaking, allocation of sales and revenue follow the allocation of roles and responsibilities. However, this may not be the case of the larger organisation is required to provide cover for risks/terms or if they have covered some of the SME BD costs.

   Approach to resolution: Whilst government frameworks should incentivise prime contractors to pass on equitable terms to SMEs, it is the responsibility of both parties to reach early agreement on the allocation of sales and revenues. Being able to reach agreement on this at the outset demonstrates to the buying organisation that a mature, understanding and equitable relationship exists between the two parties, which bodes well for resolving any delivery or commercial issues during the deal term.

8. **Parental Company Guarantees**: PCGs can be problematic for larger organisations that are not UK-based but can also be problematic for SMEs if they are either don't have a parent company or are too small to provide the level of guarantee being requested.

   Approach to resolution: Firstly, government buying organisations need to be cognisant of the level of guarantee being requested when they are insisting on a level of input from SMEs. If such a requirement is included in a procurement and is proving a significant challenge for the parties, then this should be fed back to and discussed with the buying organisation. The ensuing discussion should then focus on the justification for the requested level of guarantee.

9. **Named Personnel**: Both organisations (large and SME) need to be cognisant of the terms related to Named Personnel and need to take whatever steps necessary to ensure that personnel included in the Named Personnel list are protected, included having rigorous succession plans. They also need to be very cognisant of the associated penalties.

   Approach to resolution: Both parties should agree which personnel should be included in the Named Personnel list within a contract and should confirm that these named personnel have the ability and capacity to meet the terms of this clause. It is recognised that committing a full-time (and typically experienced) resource to a single contract can be challenging for an SME. However, each side should be accountable for their own compliance with the terms of this clause, so should therefore ensure that they are comfortable with signing up to the terms, especially the associated penalties.

10. **Governance/Escalation arrangements**: These are required for any procurement process and should provide mitigation against signing up to bad contracts. Larger

organisations typically tend to have a more in-depth governance process which can require the SME to put more effort into governance process.

Approach to resolution: All governance and escalation process steps should be very clear and agreed by both organisations at the outset and should be aligned to and support the associated governance processes in the main deal with the client. Other governance/escalation processes which are specific to the sub-contract may exist, but these should also be made clear and agreed between the two parties at the outset.
Joint planning, integrated teams and open communications should be adopted where possible to bridge differences in pace and style, and larger organisations should provide structured guidance and onboarding support to help SMEs meet assurance, governance and security requirements.

11. **Consequences/Penalties**: Similar to the flow down of terms and risk challenges above, these should typically reflect the roles of reach party. However, care needs to be taken to ensure that the penalties are not unbearable to the SME (i.e. there is no point in the SME going bust if they have to pay a penalty, leaving the larger organisation with potentially a hole in their delivery capability for the deal).

    Approach to resolution: Similar to flow down of terms and risks, these need to be clearly understood and agreed at the outset. If penalties are overly burdensome for an SME, then the larger organisation may have to provide a level of cover. Step-in rights may also be relevant under such circumstances, i.e. if the SME has failed to perform a role to the extent that they have incurred a significant penalty, the larger organisation should have the right to step-in and assume responsibility (and gain the associated financial benefit) for that role.

12. **Social Value**: Social value requirements can often prove opaque and can lead to differences in approach to responding. Consequently, both parties should reach a common understanding of both the intent and the details of the requirement at the outset and should agree on a response.
    Furthermore, despite bold and genuine intentions, SMEs often find it less easy to assign a full-time resource to take responsibility for driving their social value agenda due to capacity and cost challenges. They typically therefore have less of an impact compared to larger organisations, which can lead to lower marks.

    Approach to resolution: Firstly, it is incumbent on government buying organisations to be clear about their social value requirements and the associated marking scheme that will be applied to the responses. Government buyers should also be cognisant and take account of the relatively limited ability of SME suppliers to impact social values. That said, both parties should be clear about their relative contribution to the social value requirement in order to ensure transparency.

Conclusion

The UK Government's commitment, reinforced through the Procurement Act 2023, highlights the importance of ensuring SMEs have a greater role in public sector procurement. This paper has explored the practical challenges that arise when large organisations and SMEs work together in this environment. Challenges such as flow-down of terms, disproportionate risk allocation, margin management, governance processes and cultural differences illustrate the complexity of balancing innovation and agility with the assurance and governance required for major contracts.

For large organisations, SMEs bring valuable expertise, flexibility and innovation, but working with them can raise governance and compliance hurdles. Conversely, SMEs benefit from the scale, resources and client access of large partners but face challenges around contractual terms, capacity and negotiation power. These tensions can create friction if not addressed early and transparently.

The way forward lies in fairness, collaboration and clarity: equitable contract terms, proportionate allocation of risk and responsibilities, joint governance models and open recognition of each party's contribution. By fostering genuine partnerships, facilitated through compliance with standards such as ISO44001 and BS11000, large organisations and SMEs can together meet government expectations, deliver stronger outcomes for the public sector, and realise the broader policy aim of building more diverse, resilient and innovative supply chains.

Further information

techUK

techUK is a membership organisation launched in 2013 to champion the technology sector and prepare and empower the UK for what comes next. It is the UK's leading technology membership organisation, with more than 1,020 members spread across the UK. We are a network that enables our members to learn from each other and grow in a way which contributes to the country both socially and economically.

By working collaboratively with government and others, we provide expert guidance and insight for our members and stakeholders about how to prepare for the future, anticipate change and realise the positive potential of technology in a fast-moving world.

Justice and Emergency Services (JES) Programme

The Justice and Emergency Services programme provides a forum for Justice and public safety stakeholders from national policing bodies, local forces, fire and rescue and justice partners, to collaborate with tech industry.

The programme serves as a platform for exploring the latest innovations, discussing challenges, and building networks while advocating for the role of technology in enhancing public safety services. The programme has a number of working groups that facilitate regular collaboration between the public and private sectors.

Groups include Digital Justice, Driving Interoperability in Policing, Public Safety and Security SME Forum, Fire Innovation Forum, VAWG and RASSO Tech Working Group.

JES Management Committee

The JES programme is overseen by an elected board of 28 techUK members responsible for setting its strategic direction. The committee has identified three key priorities for their 2024/2026 tenure: Demystifying AI, Digital Skills, and Procurement.

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