Chapter 5

ANALYZING LOCAL AND SME PARTICIPATION IN PUBLIC PROCUREMENT – EVIDENCE FROM SEVEN FINNISH MUNICIPALITIES

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INTRODUCTION

The procurement volume of municipalities and their subsidiaries comprises the majority of the public procurement in Finland, corresponding to 32 billion euro of a total of 52 billion euro (Kivistö and Virolainen, 2015). Joint municipalities account for 6 billion euro of this total. Compared with other countries, Finnish public organizations are very municipality centered.

The monetary definition of procurement is anything that creates an invoice. Prier and McCue (2009) refer to the American Bar Association's Model Code for Public Procurement, which defines public procurement as "buying, purchasing, renting leasing or otherwise acquiring any supplies, services or construction."

One of the objectives in the new public procurement directive 2014/24/EU (European Commission, 2014) is "facilitating in particular the participation of small and medium-sized enterprises (SMEs) in public procurement." The Ministry of Economy and Employment ordered a report on SME perceptions of present public procurement for use in deciding on the national legislation (TEM, 2014). The main conclusions were that the public market is interesting for enterprises of all sizes, the majority of SMEs are well equipped with electronic means, and they welcome easy procurement procedures, small contract values, and publishing business opportunities for

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procurement under threshold values. In Finland, there is a national threshold value of €30,000 for supplies and services, which is proposed to increase to €60,000 in the new national legislation based on the directive above.

On the other hand, the same directive states that "Contracting authorities shall treat economic operators equally and without discrimination and shall act in a transparent and proportionate manner" (Chapter III, article 18). According to this principle, local enterprises should not be favored in procurement above the threshold values. Local employment is, however, an important political goal in municipalities. Many municipalities have stated that they are a good place for an enterprise. Some municipalities have small procurement systems in use, publishing under threshold business opportunities to local suppliers.

PWC (2014) estimates that in EU-27 countries, SME access to public procurement is 27% below the share of the national economy. In Finland, PWC used the SME share from the state procurement unit Hansel, which corresponds to 1.6% of the national procurement volume. From this figure, it is not possible to draw conclusions.

Kidalov and Snider (2011) analyzed small business policy in the United States and the European Union. They found several aspects of public procurement policies. One of the differences in the policies are the size caps: the European Union has one cap in all industries, whereas the United States has individual caps considering both the sizes and competition environment in different industries. In the United States, there are also certain procurement programs for innovation targeted at SMEs. Kidalov and Snider concluded that SME access to public procurement is still an overall policy but without exact procedures.

Nicholas and Fruhmann (2014) questioned the existence of SME policies, indicating that the SME policies are fuzzy, and the policies treat SMEs as one group. They also concluded that political goals will dominate economic motivations. One of the aspects in SME policies is the economic benefits to local communities from local sourcing (NERA, 2005).

The existing literature focuses on SME access to (PWC, 2014; Kornecki, 2011) and perceptions of and experiences with public procurement (Karjalainen & Kemppainen, 2008; Loader, 2015; Loader & Norton, 2015; Flynn & Davis, 2015). Marketing and tendering behaviors were analyzed by McKevitt and Davis (2013), market orientation was reviewed by Tammi et al. (2014), and SME participation in tendering was examined by Flynn et al. (2015). SME success in tendering was studied by Stake (2014).

Loader (2011) created a survey on SME policies in local governments in the UK, and Nijaki and Worrel (2012) reviewed local procurement policies in an archival research study in the United States.

Sustainability includes buying locally, but many other issues affect local communities. Brammer and Walker (2011) performed a large survey on sustainable procurement, and local and SME procurement were found to be two of the most significant factors of sustainability across all continents. Other studies on sustainability aspects include those by Walker and Preuss (2008), Nijaki and Worrel (2012), and Lehtinen (2012) on food sustainability.

Local procurement was investigated by Qiao et al. (2013) and Williams (2014) and under spatiality terms by Cabras (2011) and Mamavi et al. (2014). Qiao et al. (2013) reviewed all kinds of preferential programs, and they found that local procurement in most programs, but they found that many respondents felt that preference programs violate free competition and may cause higher prices and make purchasers' work difficult. The authors suggested further research on gains, costs, success rates, monitoring, and alternative solutions. Williams (2014) investigated local preference in one municipality environment and recommended an evaluation of whether the preferential treatment results in a beneficiary outcome or not. Mamavi et al. (2014) found that there is a correlation between construction work and more local suppliers, whereas the opposite is true in goods and services. Cabras (2011) analyzed the procurement volume of one county in the UK, mapping the spatial distribution of procurement volume. He found that social services and construction have the greatest procurement volumes, and specialized consulting and other specialized services concentrated in the Greater London area. He also analyzed the dynamic effects of procurement by surveying suppliers about their first tier subcontractors.

Brulhart and Trionfetti (2003) studied the effects of public procurement on enterprises on a cross-national level and found that in a perfect competition environment, there is an insignificant impact on national suppliers, whereas if the country is a major public user of certain products, it will enhance the enterprise sector.

Erridge (2007) analyzed the employment of the unemployed as an additional requirement for suppliers. The results showed that this was realized with marginal or no additional cost.

The majority of the available studies comprise surveys either of SMEs or public entities and qualitative papers on policy matters, while Stake (2014) used mathematic models.

Public procurement data are generally from procurement notices (Kornecki, 2011; Mamavi et al., 2011; PWC, 2014). Stake (2014) did not specify the data source used, but it is likely to be competition results from eTendering software. If the data source is procurement notices, the research is focused on tenders over the EU threshold values (€209,000 or higher), unless the national legislation requires notices under EU threshold values or the public entity voluntarily puts a notice under threshold value.

In our paper, we analyze municipalities' invoice data, which covers 100% of the procurement value. Apart from procurement over threshold values, it also covers the procurement under threshold values, and from other public entities, as well as procurement that falls outside the procurement directives. For a detailed analysis, see Kivistö and Virolainen (2015). Using the data of seven municipalities, we analyze distribution according to different supplier types and share of local procurement and create a calculation method for employment and local tax revenue.

The scientific contribution of this paper is a broader view of public procurement by using invoice data instead of public procurement notices. The broader data raises the supplier role of other public entities. It also has its effects on SMEs and local procurement. Managerial contributions will be the local procurement potential and the effects on sustainability reporting.

METHODS

The data used in this study are secondary data from accounts payable or from accounting of the municipality. The reliability of the data is ensured by the fact that organizations must provide an official annual report containing profit and loss accounting and a balance sheet. The classification of invoices to different accounts is likely to be made according to the recommendation by Heinonen (2012). In principle, we should have 100% of invoices and procurement volume of all suppliers.

Any possible inaccuracies in the data come from the system the data is from: invoice handling systems may have parallel systems for confidential invoices, in-house organizations may have simplified routines, and payments can be made through clearing accounts or in cash. There is a possibility that the person delivering the data has not read the data delivery instructions and delivered either too much or too little data. A major part of these inaccuracies was encountered by comparing the figures from the annual report to the aggregated data. There may also be classification errors regarding which year and which account the data belongs. The possible errors might come from decentralized invoice handling, which may involve someone unfamiliar with the recommendation of accounts. Connecting supplier data to invoices may cause incompatibility errors. However, these are minor problems.

The invoice data were connected to suppliers and their addresses to determine the location of the supplier. The location information of the major suppliers was checked using company webpages to determine whether they were located in the municipality. Usually, the invoicing address was the company's headquarters. Companies' postal numbers were also reclassified to a municipality. The judgement used to classify an enterprise as local was based on the type of business. Construction, catering, and cleaning were classified as local, whereas local financial and insurance services were classified to headquarters.

Suppliers were classified into public, third sector, and big, medium, and small enterprises according to EU rules. The turnover of the companies was retrieved from a credit information company.

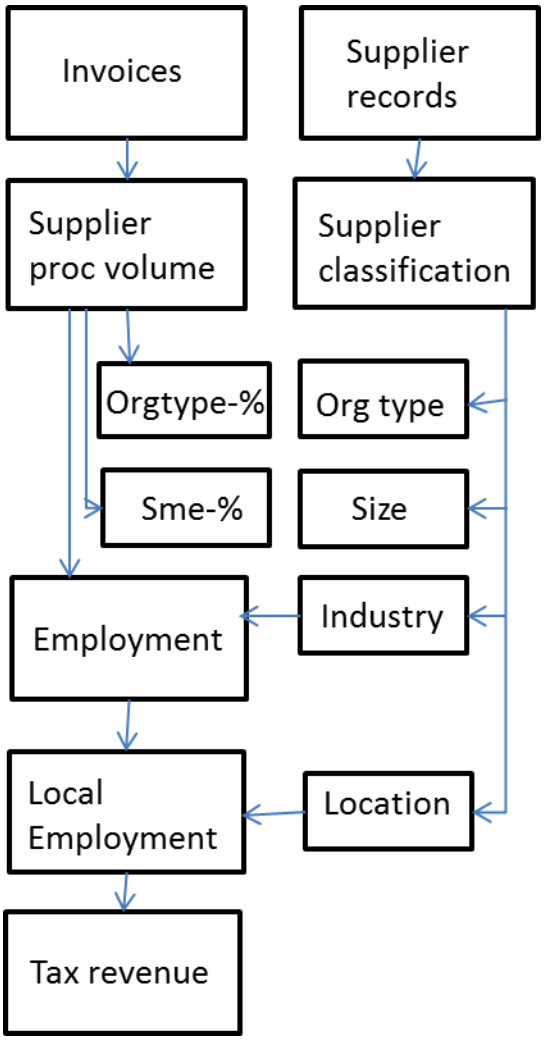

Figure 1: The calculation process

In the first case, local employment was calculated on a regional level; in four subsequent cases, it was calculated on the municipality level; and in the two last cases, it was calculated on a consolidated municipality level, focusing on external suppliers and thus eliminating the volume by in-house suppliers.

The analysis of the data itself and the calculation results was done using the Gioia method (Gioia et al., 2013). This method is normally used with qualitative archives, but we use it here for numeric calculation results based on invoice data (archival data). The Gioia method is especially well suited to exploratory research.

RESULTS

The cases are from seven municipalities from different parts of Finland. Espoo is the second largest municipality and is situated in the Helsinki metropolitan area. The metropolitan area is characterized with rich employment possibilities. Rauma is the second largest municipality in the Satakunta region and is situated 50 km south of Pori, which has double the population of Rauma. Kokkola is the largest municipality within 120 km. Porvoo is 50 km from Helsinki; Sastamala is 50 km from Tampere, which is the center of the second largest region in Finland; and Lappeenranta is largest municipality within 85 km, and Imatra is 40 km away from Lappeenranta.

Table 1 shows the data source difference between measuring procurement notices and invoice data. In addition, a number of procurement notices did not show any value.

	EU	National	Under
Espoo	405 637 373	56 007 034	21 213 502
Rauma	39 275 523	20 738 731	8 310 330
Kokkola	110 026 677	23 229 161	11 020 371
Porvoo	53 667 184	22 469 830	10 607 317
Sastamala	13 733 356	12 999 692	5 795 566
Lappeenranta	32 582 560	12 304 059	7 115 199
Imatra	22 311 305	10 292 640	6 410 245
Data capture	Notices	Beyond notices	

Table 1: Procurement volume from non-public suppliers

The results are described using the data structure of Gioia. On the left, there are the first order concepts, in the middle are the second order themes, and on the right are the aggregate dimensions. Using these dimensions, we are able to look at procurement from SMEs and local suppliers.

Large % of public suppliers / location		
Share of the third sector suppliers / location	General public sector structure	
Large % of inhouse suppliers		
Large% in public suppliers	Municipality structure	Organizational structure
Trade between in-house organizations		
Large SME share among enterprises		
Large enterprises' local offices	Enterprise structure	
Speciality suppliers are nationwide		
Hardly any cross-border trade		
Supplies from national wholesalers		
Dedicated suppliers in manufacturing	Supply network	
Distance to the larger municipality		
Large enterprises' local offices		
SME access compared to the share of GNP	Procurement SME policy	
Employment potential varies between industries		
Greatest potential in social- and healthcare and construction	Procurement strategy	Procurement decisions
The second biggest potential in labor-intensive services		
Local procurement first tier	Monitoring	
Local procurement actions second tier		

Figure 2: Data structure

A large share of the public suppliers is due to the legislation. The Finnish public organization structure is very municipality centered. Every municipality has to be a member of a hospital district, a joint municipality for the care of disabled people, and a regional council. The membership means that the municipality procures the services from these organizations. The location of the central hospital greatly affects the share of local procurement.

The second indication of the general public sector structure is the size of the third sector. The state monopoly, the Slot Machine Association, is governed by law and funds projects by third sector associations.

The effect of the general public sector structure is shown in Figure 3. It shows the distribution of procurement by supplier organization type, revealing that public suppliers account for half of the procurement volume.

In addition to the general public sector structure, there are in-house organizations made by local decisions. These are partly enforced by recent legislation to form limited enterprises from the municipality units that produce services for the market.

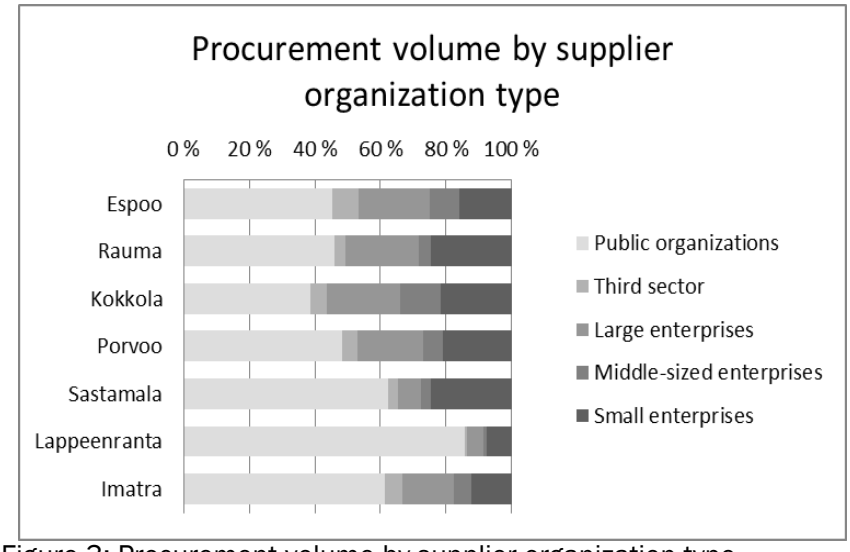

Figure 3: Procurement volume by supplier organization type

The municipality structure effects are presented in Figure 4. There are structural differences between the municipalities concerning subsidiaries in energy production and distribution: Kokkola has in municipal limits; Rauma, Porvoo, and Lappeenranta have subsidiaries; and Espoo buys electricity from a private supplier. The catering and cleaning operations in Sastamala and Lappeenranta are done by a subsidiary, and Imatra has subsidiaries in construction and technical services. Lappeenranta has all its social services and healthcare in a joint municipality, whereas the other municipalities have their own operations within the municipal organization. Lappeenranta has also established a limited company for financial and ICT services. One of the reasons for having limited companies is the establishment of the social services and healthcare union, which uses the same kind of services both in Lappeenranta and Sastamala. Rauma and Kokkola also have large commercial ports within their municipal limits.

Figure 4 also shows that municipalities procure services from other municipalities. Rauma procures social services from Pori, and the same kind of procurement is seen in Sastamala and Imatra.

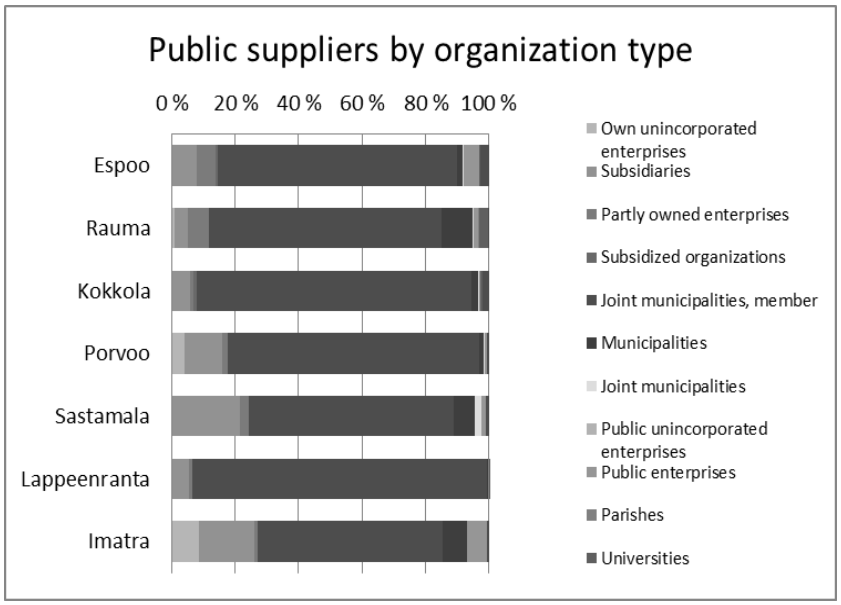

Figure 4: Public suppliers by organization type

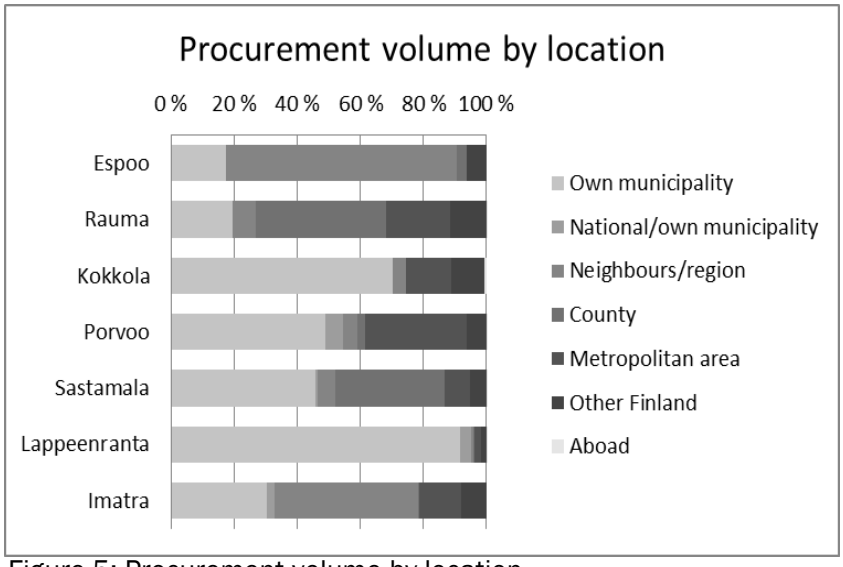

Figure 5: Procurement volume by location

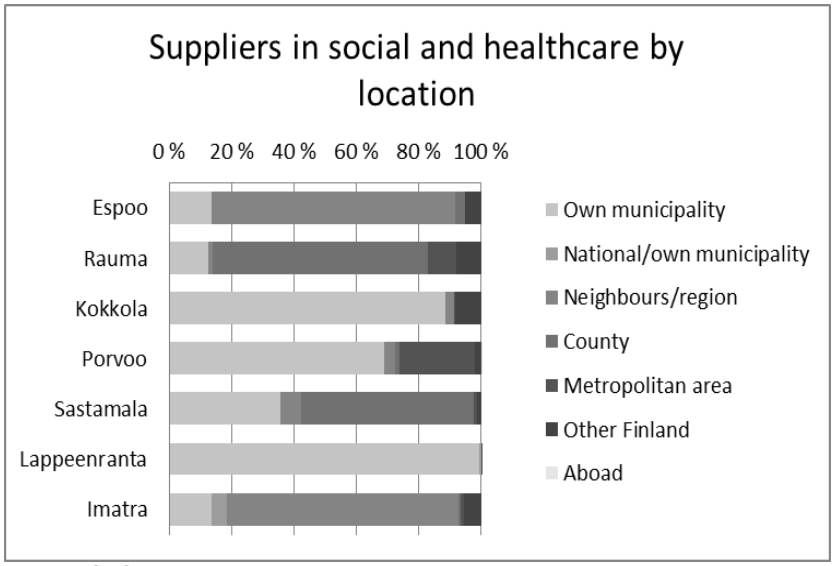

Figure 6: Social services and healthcare suppliers by location

Lappeenranta has the largest share of procurement volume in the municipality due to the large share of public suppliers—both joint municipalities and in-house subsidiaries—located in Lappeenranta. The percentage is high because Lappeenranta procures social services and healthcare, not just specialized healthcare like the other municipalities. On the other end is Espoo, with a procurement volume of less than 20% from Espoo suppliers. One of the explanations is again social services and healthcare, the operation of which cannot be divided between Espoo and Helsinki. Originally, the analysis of Espoo was made at the regional level, showing a high percentage.

One interesting comparison is between Rauma (20%) and Kokkola (70%), where the population, the number of enterprise locations, and the number of personnel in the enterprises are at a similar level. Rauma has had a procurement organization for two decades, and Kokkola has had a procurement manager for three years. Kokkola has also merged with neighboring municipalities in the past four years. Both municipalities have started communicating with local enterprises. The best explanation for the local supplier share is the location of the central hospital; Rauma procures healthcare from Pori and for Kokkola the central hospital is in Kokkola. In addition, there are several other social services produced in the Pori area, whereas Kokkola is the major location for other social services. This situation is shown in Figure 6. One of the explanations for the difference is that Kokkola is an overall better location to make business. Rauma suffers from its proximity to Pori (50 km), whereas any municipalities that are larger than Kokkola are more than 120 km away. This situation can be seen in Figure 6 and in Figure 8.

The trade between in-house organizations is clearly seen in the analysis of Lappeenranta. For Lappeenranta (Lpr) and Imatra, the analyses looked at external procurement. Looking at the consolidated information from Lappeenranta, the municipality has several organizations in its consolidated annual report. The procurement volume was collected from seven different financial systems and 23 out of 28 organizations. The remaining five organizations had a different ledger, and they were small. One (an energy producing company) was majority owned by a large company and therefore classified as a supplier. The share of in-house procurement is seen in Table 2.

Organization	subsidiaries (whole/part)	inhouse procurement	external procurement
Lappeenranta (itself)		270 607 000	46 572 453
Lpr Housing Services Ltd	4/0	8 349 000	10 011 808
Lpr Energy Ltd	3/1	33 855 757	40 369 179
Lpr Business Ltd	11/0	2 637 000	17 449 804
Saimaa Support services etc	0/2	2 802 000	10 174 107
South Carelian Waste Ltd	0/1	769 000	10 093 757
Saimaa Univ of Applied Sciences	0/1	379 000	5 942 477
Partly owned organizations	0/5	2 128 000	4 863 229
Joint municipalities	0/4	2 051 000	13 334 726
Lappeenranta (consolidated)		323 577 757	158 811 540

Table 2: Lappeenranta procurement volumes

Figure 7 shows the share of SMEs in the procurement volume. The greatest percentage occurs in Sastamala (80%) and the smallest in Espoo and Imatra (ca. 55%). The enterprise structure in Sastamala mirrors the share of procurement from SMEs.

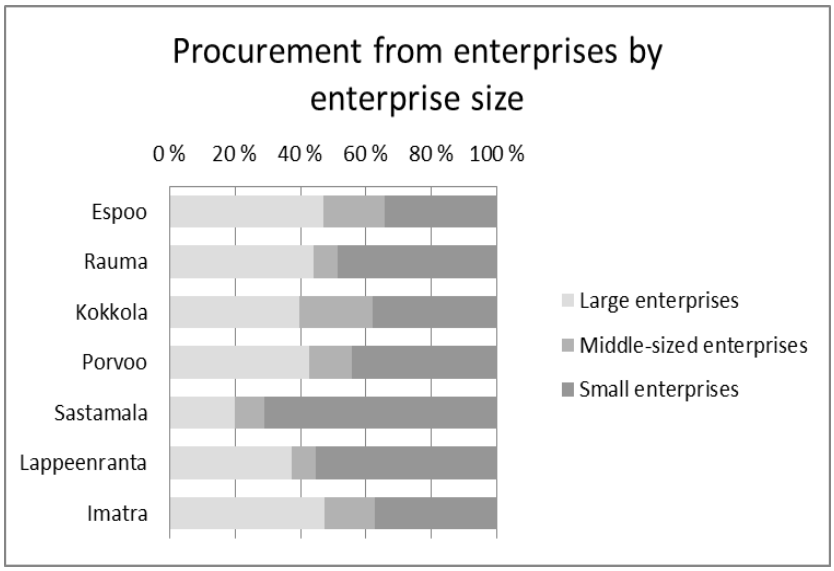

Figure 7: Procurement from enterprises by size

To determine what the equal share of SME access would be, we used the municipal procurement statistics and calculated the share of SMEs for every industry. The differences between industries are large, ranging from 37% in the manufacturing industry to 84% in professional services. The calculation shows that the share of SMEs should be 61%.

The municipalities buy supplies from wholesalers, either national or regional. In Rauma, a successful stationary wholesaler has a great proportion of the sales from the municipality, whereas the cleaning products supplier is not successful and the procurement volume is directed to Pori. Lappeenranta has a regional supplier of cleaning products. Most of the municipalities do not have a regional supplier of foodstuffs, which is one of the aspirations of local politicians.. In the construction industry Porvoo and Lappeenranta are chosen by the largest enterprises as good places to have an office.

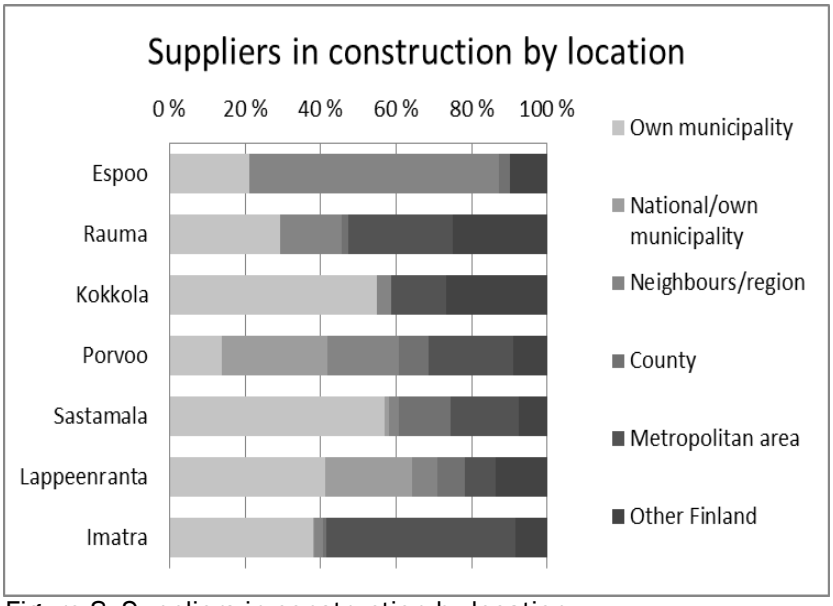

Figure 8: Suppliers in construction by location

TOL 2008	Turnover/ employee	Salaries / employee	Proc vol local	FTE local	Local mun tax 1000€
C Manufacturing	428,60	43 566	65 960	0,2	1,14
D Electricity, gas, steam supply etc	1 093,00	49 067	947 673	0,9	7,33
E Water supply etc	335,10	34 691	17 186	0,1	0,29
F Construction	181,10	34 631	5 368 320	29,6	168,68
G Wholesale, retail trade	482,60	33 895	875 830	1,8	10,07
H Transportation and storage	176,20	34 672	2 918 972	16,6	94,40
I Accomodation and food service	103,70	23 738	4 731 471	45,6	164,28
J Information and communication	208,30	52 720	1 545 820	7,4	67,98
K Financial and insurance activities	1 225,34	55 275	1 000 897	0,8	7,88
L Real estate	390,20	36 299	1 354 467	3,5	20,86
M Professional, scientific and	134,80	42 254	1 783 712	13,2	94,65
N Administrative and support	84,00	26 652	4 775 002	56,8	236,45
P Education	95,10	32 825	160 413	1,7	9,01
Q Human health and social work	84,70	30 335	18 676 312	220,5	1072,98
R Arts, entertainment and	275,80	27 361	18 984	0,1	0,30
All			44 241 017	398,8	1956,31

Table 3: Sastamala public procurement effects on local employment and municipality tax

When looking at procurement decisions, we must first consider the SME policy. The policy makers are usually from the national level, but implications can be on a local level. The figures show that the SME share of public procurement is equal to SME share of GNP. The procurers could be satisfied with measures not to exclude SMEs by formulations in the tender documents

Major procurement decisions are connected to the share of local suppliers and their employment potential. The employment creates the municipal tax revenue. The calculation of employment from procurement volumes was made using the following procedure.

Municipalities have a national recommendation regarding the accounts compatible for delivering the financial date for the national statistical bureau (Heinonen, 2012). From this recommendation, we chose the accounts including procurement (customer service, other services, supplies, the parts of subsidies including procurement, and investments). Each of the accounts was connected to a specific industry classification (TOL, 2008) used by the national bureau of

statistics. Further, the procurement volume was converted to FTE employees using the turnover and number employed from statistics: "Enterprises by industry and turnover, 2013-2014" In the case of public suppliers, the corresponding figures from the private industry were used. This number will give a robust estimation of employment.

The tax revenue of the municipalities was calculated based on the same statistics using salaries and the number of people employed, giving the annual salary by employee and converting it to municipality tax using the calculation rules from the tax administration.

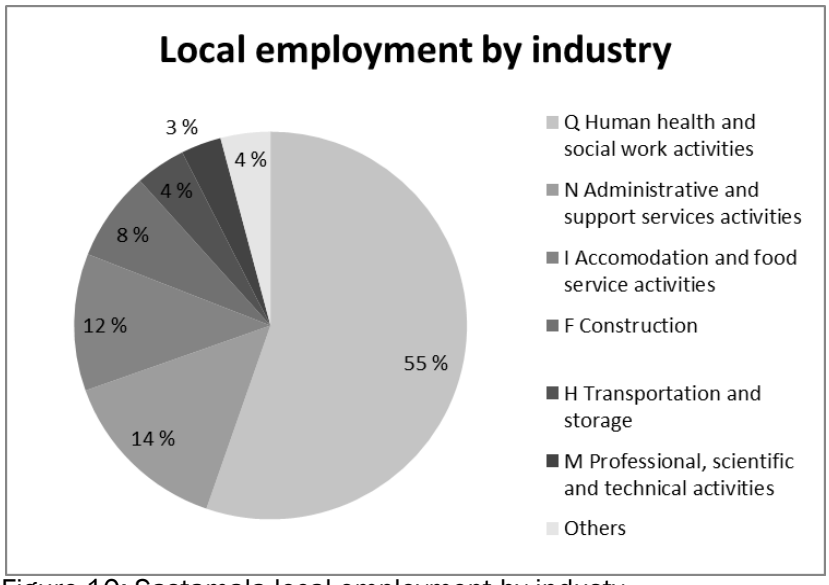

Figure 10: Sastamala local employment by industy

The municipality tax is based on the assumption that employees also reside in the same municipality in which they work. This is likely in the case examples where the municipality is surrounded by smaller municipalities, whereas in the metropolitan area and in larger regions, it is unlikely. However, the assumption gives a robust estimation of the tax revenue effects on the municipality.

SME and local procurement are parts of sustainable procurement, as already presented in the literature. Therefore, they are well suited to corporate sustainability reports showing the share of SMEs and

local suppliers on the first tier level. The additional level could present the measures and figures on the second tier level, as presented by Cabras (2011).

DISCUSSION

The aim of this study was to analyze the local and SMEs access to public procurement in seven municipalities. We used invoice data to analyze procurement distribution to different supplier types, and share of local procurement. We also draw a calculation method for employment and local tax revenue. Our findings are that this type of analysis was new to municipalities and the access to local companies was an interesting contribution to be further developed within municipalities.

The study has three different types of implications. First, there are some policy implications: In the literature it seems that the existence of SME policies is motivated by innovations, company growth, or the local economy. To achieve these effects, we should use innovation policy, growth policy, and local procurement policy because the average SME does not produce those values. Many of the previous researchers seem to motivate SME policies with innovation arguments without criticism. From SME policy viewpoint in the European Common Market recent studies in Finland (TEM 2014) and this study, and in Sweden by Stake (2014), show that SMEs can take their equal share of the public procurement either in competition or in procurement practices under threshold values. We should consider measures that do not exclude SMEs from obtaining their share of the turnover. From equality point of view this could be the motivation for SME policy, whereas otherwise any type of organization should be equally treated.

Local procurement can be enhanced with a procurement strategy, especially in labor intensive industries such as social services and healthcare, construction, and professional services. There is little to no effect on the national level, unless there are economies of scale in special services for narrow social groups. Conversely, there can be effects at the international level on specialization, as shown by Brulhart and Trionfetti (2003).

Procurement policies on SME and local enterprises are well suited in the sustainability framework. Public entities could measure SME

local enterprise access by industry (Kidalov & Snider 2011). An additional view could highlight even second tier suppliers.

Second, as a scientific contribution, this research develops a research method using invoice data and extends the data captured to suppliers under the threshold values and to procurement outside the directives. It also gives a more detailed description of the supply network characteristics than the existing research and raises the question of in-house suppliers.

Third, this study provides also some implications for practitioners. With an active procurement strategy, it is possible to achieve a greater share of local enterprises and increase a municipality's tax revenue. An analysis of what is not procured locally reveals the share of procurement that could be directed to local businesses. The recent developments in small-procurement systems focus mainly on under threshold values, representing a smaller procurement volume.

Further research should be directed to in-house procurement and using this rich database to quantify public procurement processes on a national level. Additional investigations could be made studying the dynamic effects of local procurement, as presented by Cabras (2011).

ACKNOWLEDGEMENTS

The author wish to thank their colleague Matti Riuttamäki for assisting me in the consultancy project with the municipalities, and Dr. Antero Tervonen for his guidance and comments on using accounting data.

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