

# Questions on Notice

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Joint Select Committee on Government Procurement

Public hearing: Monday 8 May 2017, Canberra

Australian Small Business and Family Enterprise Ombudsman

## Assessing economic benefit

**1. Your submission notes that some foreign governments, including the UK include an assessment of ‘social value’ as part of value-for-money considerations.**

**a) How does this compare to CPR17 clause 10.30 which requires officials to consider how suppliers can benefit the Australian economy?**

*10.30 In addition to the considerations at paragraph 4.4, for procurements above \$4 million, Commonwealth officials are required to consider the economic benefit of the procurement to the Australian economy.*

1. The addition of Clause 10.30 to the 2017 Commonwealth Procurement Rules is a welcome addition but the current wording is too broad to be comparable to the UK Act. As we mentioned in our submission, governments are increasingly focussing on social value aspects in procurement as part of a value for money assessment. The UK Public Services (Social Value) Act 2012 requires public bodies to consider the economic, environmental and social benefits of a procurement approach to the community.
2. The UK Social Value Act 2012 applies to the procurement of services or the provision of services when combined with the purchase/hire of goods. The procurers must consider how the proposed procurements might improve the “economic, social and environmental well-being” of the relevant area and how to secure that improvement. This is mostly done at the pre-procurement stage and/or via consultations with the community and key suppliers/stakeholders. This means that the actual procurement process can be designed to achieve economic, social and environmental outcomes. It is intended to focus government procurement decision makers on external benefits as part of the value for money consideration. The new section 10.30 attempts to achieve this however the wording and use of ‘economic benefit’ will be open to wide interpretation by procuring officers.
3. Clause 10.30 only applies to procurements over a\$4 million. In comparison, the UK applies different thresholds when applying the Social Value Act depending on whether the contract is for services, works or some combination. Most thresholds are well below an equivalent of A\$4 million.<sup>1</sup>
4. In addition, the Australian CPRs do not explicitly require a social benefit consideration in the assessment of “economic benefit”. The economic benefit can be achieved solely by competitive pricing (as an example provided by the Department of Finance guidance note, *Consideration of broader economic benefits in procurement*).<sup>2</sup>
5. This is not to say that the existing clause 10.30 will not allow social benefits to be considered, as could a range of benefits. There is a “social outcomes” example on page

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<sup>1</sup> Crown Commercial Service, Procurement Policy Note: New Threshold Levels 2016, Information Note 18/15, accessed 17 May 2017 from [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/484497/PPN\\_1815\\_New\\_Thresholds\\_2016.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/484497/PPN_1815_New_Thresholds_2016.pdf)

<sup>2</sup> Department of Finance, Consideration of broader economic benefits in procurement, accessed 15 May 2017 from <https://www.finance.gov.au/sites/default/files/guidance-new-rules-10-30-and-10-31-16.pdf>.

three of the guidance note though this is not a specified criteria for assessing value for money.

We speculate that it is unlikely that this will occur effectively. Firstly, social value or social benefits (e.g. improvements in social cohesion) are more difficult to quantify than financial or even economic considerations. Secondly, assessing social benefits under the umbrella of economic benefits could lead to conflicting or inconsistent outcomes. For instance, a contract bid that aims to achieve positive social outcomes in a community might actually be more expensive than another bid that provides tangible economic outcomes for the community or nation as a whole.

Assessing a value for money outcome through the current narrow lense of “economic benefit” will likely lead to the proposal that provides the lowest “cost to outcome” ratio to win over a proposal that provides social benefits but at a higher “cost to outcome” ratio. Such a decision can be justified by procurement officers on the basis that competitive pricing and lower pricing provides the “economic benefit”. For social value to be considered as part of procurement processes and value for money assessments in Australian Government procurement, it needs to be given explicit consideration, alongside economic and environmental outcomes and explicit wording in the CPRs as part of a value for money assessment.

6. Because of the devolved structure of the UK government authorities implementing the Social Value Act 2012, many of the examples of social benefit achieved in the UK are based in communities and local areas. Similar local outcomes might not be the ‘norm’ for Commonwealth Government procurement in Australia but would be one of the challenges of implementing the new Commonwealth Procurement Rules. Further challenges/lessons are outlined below.

**b) Can the Australian Government learn any lessons from the UK’s implementation of the requirement to assess ‘social value’ as part of value-for-money considerations?**

7. The review of the UK Social Value Act was published in February 2015.<sup>3</sup> This review highlighted a number of implementation problems that will be relevant for Australia. For instance, it was found that a lack of awareness of the Act meant that take-up was low. It was also found that improper application of the Act arose from differing interpretations or understanding about how to define social value and include it in the procurement process. Problems around measuring/quantifying social outcomes also made it difficult for officials to assess the differences between social value outcomes between procurement contract bids. These three issues meant that implementation (particularly in the first couple of years) of the UK Social Value Act was producing inconsistent outcomes. These challenges are likely to be indicative of challenges expected in the implementation of Clause 10.30 and the CPR17.
8. Like the UK, Australian Government departments are likely to encounter problems assessing value for money due to measurement confusion for economic benefits. We recognise the Department of Finance guidelines have considered measurement of economic benefit by restricting the quantification of it to direct effects (or first round impacts). However, there is not any guidance for businesses bidding on contracts about how they can demonstrate and quantify the social and environmental outcomes. This will make it difficult for procurement officers to determine if, e.g. 20 additional staff employed is a more valuable economic benefit than a 2-hour interactive class to transfer knowledge to local businesses.

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<sup>3</sup> UK Government Cabinet Office, Social Value Act Review February 2015.

9. It is too early to determine the level of awareness and understanding of CPR clause 10.30 across procuring departments and agencies. It is likely that some departments and agencies will provide additional guidance around this clause which might lead to differing implementation practices across agencies.
10. The UK Government have also built in additional processes for dispute resolution and reward/acknowledgement for best practise outcomes around the Social Value Act. For instance, the UK Government has already recognised good practice in achieving social value through the Social Value Awards. Also the UK's Mystery Shopper scheme allows for anonymous investigation and dispute resolution around the implementation of the Social Value Act. As well as investigating supplier concerns about procurement practices, the Mystery Shopper carries out spot checks on individual procurements to check that the Act is being applied.

Some of these processes do not exist in Australia, such as the Mystery Shopper function, however, the Office of the Australian Small Business and Family Enterprise Ombudsman already provides a role that can provide a dispute resolution pathway around government procurement for businesses. ASBFEO has an advocacy function and an assistance function that is supported by legislation.<sup>4</sup> Under the assistance function, the Ombudsman responds to requests for assistance by an operator of a small business or family enterprise. The assistance requested can relate to a dispute with another entity such as a prime supplier or the Australian Government.

Through its advocacy function, ASBFEO can also undertake research and inquiries into legislation, policies and practices affecting small businesses and family enterprises. ASBFEO could use this function to check that application of the Act is not adversely impacting small businesses and family enterprises.

**c) Do you think CPR clause 10.30 will increase the value of SME participation in Commonwealth procurement?**

11. We hope so. The Australian Government currently has a commitment for non-corporate Commonwealth entities to source at least 10 per cent of procurement by value from Small and Medium Enterprises. As mentioned in our submission, this target is unambitious compared to other countries.

The UK has a target of one third (33 per cent) of the value of Government procurement spending going to small and medium-sized businesses (businesses employing 250 employees or less) by 2020.<sup>5</sup> The previous target was for 25 per cent by 2015.<sup>6</sup>

The US Government has a long-standing preferential treatment policy with a target of not less than 23 per cent of prime federal contracts by value go to small businesses.<sup>7</sup> This target is supported by legislation that also ensures the participation of "small business concerns from a wide variety of industries and from a broad spectrum of small business

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<sup>4</sup> Australian Small Business and Family Enterprise Ombudsman Act 2015, accessed <https://www.legislation.gov.au/Details/C2015A00123>.

<sup>5</sup> UK Government, Big opportunities for small firms: government set to spend £1 in every £3 with small businesses, accessed <https://www.gov.uk/government/news/big-opportunities-for-small-firms-government-set-to-spend-1-in-every-3-with-small-businesses>.

<sup>6</sup> UK Government, Small business benefited from £12.1 billion in government spending in 2014 to 2015, accessed <https://www.gov.uk/government/news/small-business-benefited-from-121-billion-in-government-spending-in-2014-2015>.

<sup>7</sup> Section 15(g) of the US Small Business Act, accessed [https://www.sba.gov/sites/default/files/Small\\_Business\\_Act.pdf](https://www.sba.gov/sites/default/files/Small_Business_Act.pdf). To be an eligible 'small business concern', businesses must satisfy the U.S. Small Business Administration's (SBA's) definition of a small business concern, along with the size standards for small businesses. Small Business size standards differ by industry and are published by the SBA at [https://www.sba.gov/sites/default/files/files/Size\\_Standards\\_Table.pdf](https://www.sba.gov/sites/default/files/files/Size_Standards_Table.pdf).

concerns within each industry”.<sup>8</sup> The U.S. Small Business Administration also assists small businesses to access procurement through the supply chain.<sup>9</sup>

12. CPR clause 10.30 is unlikely to increase SME participation in direct Commonwealth procurement due to the threshold requirements outlined in the clause though may contribute to an uptake in indirect participation as subcontractors.

The economic benefit guidelines published by the Department of Finance state that suppliers could demonstrate an economic benefit by: “using SMEs in delivering goods and services, such as a subcontractor or a supplier”. Current procurement reporting requirements mean that we will not know if this actually happens. Neither will the Department of Finance or the Australian Government since there is very little visibility of subcontractor participation, conditions or monitoring by procuring agencies.

ASBFEO has received complaints from SME subcontractors who have been used by prime suppliers in their tender bids but then subsequently dropped once the bid is successful. There has been no repercussion for the primes or recourse for the SME subcontractors. Situations such as these have implications for how economic benefit is measured in value for money considerations. There should also be better monitoring of subcontractor participation throughout the life of procurements.

13. While encouraging prime suppliers to engage with SMEs is a welcome development, we do have some concerns about this. As mentioned in our submission and during our appearance before the Joint Select Committee, our office and the offices of State Small Business Commissioners have received many complaints from SMEs who have been treated poorly by prime suppliers. It is essential that the Australian Government consider how these subcontractor arrangements are managed and monitored.

For example, conditions enjoyed by prime suppliers should also be made available to businesses in the supply chain. These include 30-day or less payment times and an effective dispute resolution process that does not penalise the complainant. We believe our office is one avenue that already provides this dispute resolution function. For instance, ASBFEO mentioned at its appearance before the Joint Select Committee that it is currently investigating a number of government procurement cases via its assistance function. These cases relate to the treatment of subcontractors, including complaints around payment terms. ASBFEO is using the powers outlined in its legislation to request information and documents from all parties involved in these particular procurement processes. Depending on the findings of these inquiries, ASBFEO may then assist with dispute resolution.

14. One approach which we believe may be useful for wider consideration is the Department of Defence new panel arrangement for Defence Organisation Support Services (DOSS Panel). This panel has proposed mandating a percentage based SME participation for their integrated service contractor arrangements to require large primes to use small providers from the panel under the panel rates and conditions. This is an example which could be applied to other government arrangements to provide subcontractors with terms and conditions similar to that enjoyed by prime contractors.

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<sup>8</sup> SBA, Government-Wide Performance FY2015 Small Business Procurement Scorecard, accessed [https://www.sba.gov/sites/default/files/files/FY15\\_GOVWIDE\\_SB\\_Procurement\\_Scorecard\\_Public\\_View\\_FINAL.pdf](https://www.sba.gov/sites/default/files/files/FY15_GOVWIDE_SB_Procurement_Scorecard_Public_View_FINAL.pdf).

<sup>9</sup> SBA, See Agency Small Business Scorecards, accessed <https://www.sba.gov/contracting/finding-government-customers/see-agency-small-business-scorecards>.

**d) Can you make any practical suggestions regarding how officials can ensure CPR17 clause 10.30 is applied consistently and transparently?**

15. The wording of Clause 10.30 is open to interpretation and the guidelines provided by the Department of Finance support flexibility in interpretation. This could result in unintended outcomes in achieving “economic benefits”. The guidelines leave room for departments to develop criteria for assessing value for money for each individual contract. Ultimately, we believe the present wording will lead to inconsistent outcomes across the Commonwealth.
16. ASBFEO recommends that additional and more specific guidance on the consideration and measurement of economic benefits (particularly social benefits) be developed and promulgated. This would assist procurement officers to achieve the best value for money with a clearer understanding of what clause 10.30 is expecting them to consider. In addition having to document how value for money is achieved through economic, social and environmental criteria would sharpen the implementation approach used.
17. ASBFEO recommends a review be conducted by the Department of Finance in a year’s time to assess how effectively departments and procurement officers are applying the clause. Outcomes of this review might be the development of further guidance materials or a framework if it is deemed this is the best course of action. We would be happy to assist the Department of Finance to undertake this role for the Government.
18. Under the Australian Small Business and Family Enterprise Ombudsman’s legislation, the Ombudsman has powers to undertake research and inquiries into legislation, policies and practices affecting small businesses and family enterprises. The Ombudsman also has information-gathering powers including the power to conduct, and take evidence in, hearings. Using these powers, ASBFEO has investigated complaints and handled requests for dispute resolution related to government procurement. Through our investigations, we have identified concerns about procurement practices, including accessibility, value for money assessments, and substandard payment practices and conditions down the procurement supply chain. As we go forward under the new CPRs, ASBFEO is in a unique position to identify any issues around the new clauses related to value for money and how they are implemented across departments. Themes arising from our investigations can help target further improvements in guidance around clause 10.30.

## Questions on Notice from Hansard

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**2) What needs to be done to arrest the stagnate—if not declining—percentage of total spend for SMEs? How can participation be improved? (Comment in respect to the new Commonwealth Procurement Rules and guidelines).**

19. There are a number of initiatives that could help address the participation of SMEs in Commonwealth Government procurement. This includes:

- Improving the monitoring and reporting of small business engagement in government procurement. Data collection and reporting of the business size of prime suppliers needs to be improved. Also, improved data collection and reporting processes around subcontracted businesses would assist with transparency of small business engagement in the supply chain.
- Increasing the target for small business engagement above the 10 per cent by value threshold. The target should be raised to match the UK target by 2020, with an option to review the target once this is reached.
- Levelling the playing field by requiring procurement officers to adopt a “if not, why not” approach to breaking procurements into smaller, more accessible components to enable greater SME participation.
- Requiring government standard terms and conditions to flow through supply chains

These are outlined in detail below:

**How information about small business engagement in procurement is captured and reported needs to be improved.** If the Government’s goal is to improve small business engagement, we first need to be able to measure it appropriately. The only published data from AusTender on direct small business procurement is highly aggregated and obtained by matching AusTender data to other government datasets that do collect business size information. More detailed published information about direct small business procurement would assist in determining if the value and quality of procurement opportunities for small businesses are improving. Also, the Commonwealth Government (and the general public) currently does not have sufficient transparency of what is happening further down procurement supply chains. Improved data and transparency around small business engagement in the supply chains will make it more difficult for poor treatment of subcontractors to continue.

We do know that some government departments require certain information to be collected and maintained about prime suppliers and, for certain requirements, subcontractors such as security issues. Prime suppliers already collect a range of information about subcontractors for internal reporting purposes. We suggest that this information, which is already available, be provided to the procuring agency as a requirement of the procurement. That way the activities of the supply chain will become visible to agencies. Once collected, it can be used to inform the vendor profile of an agency’s supply chain.

**Targets for small business engagement in procurement need to be increased.** The Australian Government’s target for small business participation is unambitious compared to other governments. We would suggest matching the UK’s target.

**All efforts to ensure a level playing field for businesses of all sizes should be taken.** Procurement officers need to consider if the design of their procurement

precludes small businesses from tendering for the contract. For example, is the contract too large and complex and would breaking the contract into smaller parts be feasible? In some cases, breaking a job into smaller parts could actually save the Government money. ASBFEO have been made aware of instances where prime suppliers are paid a large sum of money to manage contracts with a few key subcontractors who are paid much, much less for their work.

**Subcontracted SMEs should be provided with the same terms and conditions as prime contractors on government procurements.** Some items requiring serious consideration by the government include the appropriate allocation of risk, payment terms, and the use of ASBFEO to assist with dispute resolution. An example of how to push protections down through the supply chain could be to have a mandatory requirement for a prime supplier to source subcontractors via government panel arrangements, with all of the same rates, and panel terms and conditions attached. An example of how to deal with payment terms could be to set up project bank accounts for public works projects or to require the flow through of payment terms down the supply chain. Both of these options have been implemented by the UK Government.

The Senate Economics References Committee report on Insolvency in the Australian Construction Industry recommended a 2-year trial of Project Bank Accounts on construction projects where the Commonwealth's funding contribution exceeded ten million dollars. It was recommended that this trial commence in July 2016 but it was never implemented. In the ASBFEO Payment Times and Practices Inquiry Report, released earlier this year, Recommendation 5 was for the Australian Government to mandate the use of Project Bank Accounts in public works and construction projects. ASBFEO is unaware if this recommendation is being considered.

**3) Send a copy of the Harvard Business School report that found significant economic benefit, job creation etc. from the 15-day payment times.**

20. The US federal government launched QuickPay in 2011 to accelerate payments by federal agencies to small business contractors to within 15 days. This policy was expanded to include subcontractors in 2012. A recent study showed a positive impact of this reform on employment and wage growth.<sup>10</sup>

The report is attached.

**4) Consider... Industry Participation Advocate of South Australia has made a number of recommendations about improvement and whether it should be a statutory role so that it is at arm's length and has some real teeth to deal with this. (dispute resolution context)**

The Industry Participation Advocate of South Australia has a role which is to: "review impediments to local participation in government contracts and work with local businesses and industry associations to increase the number of companies able to meet government tender requirements".<sup>11</sup>

The advocate can investigate individual issues and make recommendations to improve policy or drive procurement reform.

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<sup>10</sup> Barrot, J.-N. and R. Nanda. 2016. Can paying firms quicker affect aggregate employment? Working Paper 17-004. Cambridge: Harvard Business School.

<sup>11</sup> Industry Participation Advocate, Advocacy Framework, accessed <http://www.industryadvocate.sa.gov.au/upload/industry-advocate/ipa/advocacy-framework.pdf?t=1495080804411>

We believe this is a good role and one which we already perform for the Commonwealth to a certain degree. The Ombudsman's legislation includes both an assistance and advocacy function. The advocacy function includes:

- undertaking research and inquiries into legislation, policies and practices affecting small businesses and family enterprises;
- reporting and giving advice to the Minister on those matters;
- contributing to inquiries by others into those matters;
- contributing to developing national strategies on those matters;
- reviewing proposals, legislation and other items relating to those matters and advising the Minister on them;
- promotes best practice in dealing with small businesses and family enterprises.

ASBFEO already has powers to investigate cases, compel the production of information and documents and require witnesses to attend hearings. The office's assistance function provides dispute resolution options.

In undertaking our advocacy function we already have a number of cases related to Commonwealth Government procurement which we are progressing. We are also undertaking a specific investigation into Government procurement. This investigation is looking at outcomes on large Commonwealth public works which affect small business subcontractors.