

## 02 The Economy

### An Analysis about the Effects of the Seoul Metropolitan Government's Procurement Policy for the Socially Disadvantaged Business

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#### Summary

The Seoul Metropolitan Government (SMG)'s policy efforts to increase the procurement of goods and services from the Hope Businesses have yielded the desired results: growth in the sales, employment and profitability of such companies.

#### 1. Introduction

**Hope Business refers to organizations which hire the socially and economically disadvantaged**

Many organizations have become increasingly committed to corporate social responsibility. Some of them, in particular, vigorously strive to make contributions to society by providing social services and creating jobs for the disadvantaged while engaging in business activities. They are called social enterprises. Among them include manufacturing facilities operated by the severely handicapped, social businesses, rehabilitation organizations, co-operatives, businesses with community interests, and disability-owned businesses. Compared to other conventional companies in general, social enterprises produce goods and services that are less competitive in terms of price. On top of this, they experience a greater extent of difficulty in securing markets and customers. Besides social enterprises, small or independent companies who work on a small scale also encounter the same

challenges. All these businesses that suffer from social and economic disadvantages in the market are referred to as Hope Businesses. As a means to help them, the Seoul Metropolitan Government (SMG) uses its procurement system. Since 2012, the SMG has taken numerous actions to improve the system for the Hope Businesses. In detail, it has relaxed the performance requirement which a company must satisfy if it is to enter the contract with city government agencies. Besides, it has been extending preferential treatment (in the form of extra credits) to Hope Businesses in the procurement bid. Furthermore, the SMG has implemented a contract system specially designed for the benefit of the Hope Businesses. It is the first such attempt in Korea. It has introduced a restricted bidding process for social enterprises to make it more feasible for them to participate in government contracts. Furthermore, a greater emphasis is now placed on corporate social responsibility.

## 2. Main Findings

This research first examines the current status of Hope Businesses in Seoul. Next, it gives recommendations on how the SMG can better support them in the future.

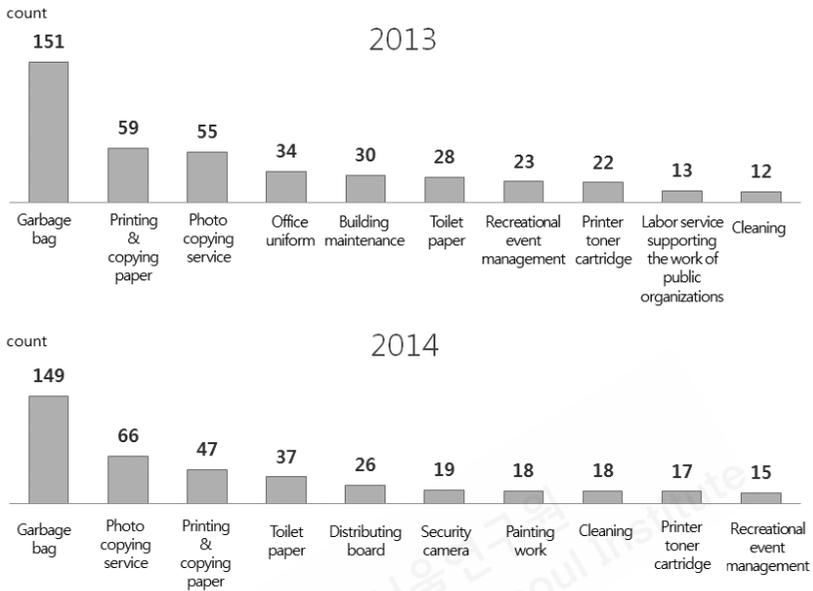
### **As of 2013, 24.9 percent of 13,235 Hope Businesses in Seoul did business with the SMG**

There were 13,235 Hope Businesses in Seoul as of 2013. It accounted for 1.7 percent in total number of small and medium sized enterprises in the city. The study has found that 3,293 (24.9 percent) of those Hope Businesses transacted business with SMG. The vast majority of them were small companies whose number stood at 2,724 (equivalent to 82.7 percent). The rest were 260 social businesses (7.9 percent), 102 disability-owned businesses (3.1 percent), 63 manufacturing facilities operated by the severely handicapped (1.9 percent), 63 co-operatives (1.9 percent), and 46 rehabilitation organizations (1.4 percent).

**Seoul has procured commodities worth about 1.3 trillion Won from the Hope Businesses in 2014. The purchase amount has jumped by 46.6 percent from the previous year**

In 2014, Seoul spent approximately 1.3 trillion Won on procuring goods and services from the Hope Businesses. The city's purchase amount has jumped by 46.6 billion Won from the previous year. From the perspective of the Hope Businesses, small companies earned the largest revenue (873.1 billion Won), followed by independent producers who work on a small scale (316.6 billion Won), social businesses (97.6 billion Won), and disability-owned businesses (22.7 billion Won). Meanwhile, autonomous district governments recorded the biggest purchase amount (530.2 billion Won). SMG and its affiliated organizations followed, each with the purchase amount of 392.2 billion Won and 387.5 billion Won, respectively. In 2014, Seoul purchased a greater amount of goods and services from the Hope Businesses than it had planned. More specifically, the purchase amount exceeded the target amount by 41.4 percent. Organizations funded or invested by the government, autonomous district governments, and the SMG each spent 84.5 percent, 138.2 percent, and 117.7 percent more, respectively, on acquiring goods and services from the Hope Businesses.

The study has discovered that small companies dominated 66.7 percent of the procurement transactions. Social enterprises except disability-owned businesses (i.e. social businesses, manufacturing facilities operated by the severely handicapped, rehabilitation organizations, co-operatives, and community interest companies) represented 7.5 percent of total transactions. The disability-owned businesses accounted for 1.7 percent. In product terms, garbage bags were the most frequently purchased item (149 transactions). Demand for disposable products such as printing, copying, and toilet paper was also relatively high. They are the ones that the SMG mostly purchases from the Hope Businesses. Yet, the city has been procuring an increasingly wider range of goods and services like security cameras, electric works, and outer wall construction since 2014.



Source: The internal data of SMG

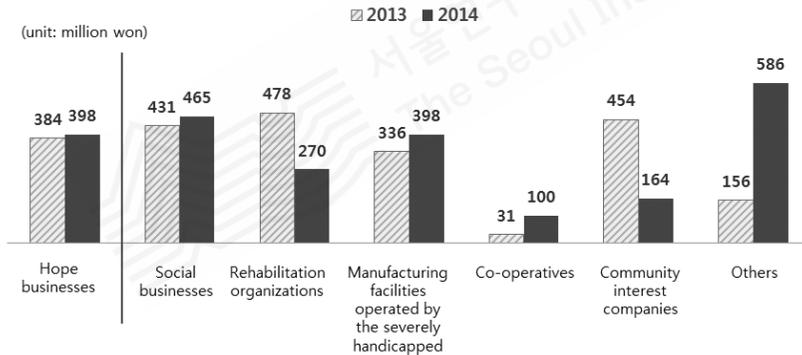
[Figure 1] No. of Goods and Services that Seoul Procured in 2013 and 2014

### Sales of the Hope Businesses have increased by more than 10 percent thanks to SMG’s procurement policy

SMG has been undertaking policy efforts to increase the procurement of goods and services from the Hope Businesses. In the study conducted to find out if such policy has yielded the desired outcomes, 33.8 percent of the Hope Businesses that were investigated believed that the policy is most contributory to sales growth; 25.3 percent considered that it most helped them tap into a new market; and 16.1 percent attributed increase in employment (which resulted from sales growth) to the policy. It has also found that the rate of sales growth has fallen by 7.8 percent point in 2015 compared to 2013. However, the rate at which price competitiveness and product quality improved has risen by 3.5 percent and 3.8 percent points, respectively. This

illustrates that not only does SMG's procurement policy contribute to growth in sales of the Hope Businesses, it also boosts their competitiveness.

In the meantime, 54.3 percent of the Hope Businesses that performed under contracts with the SMG in 2014 witnessed increase in transaction amount. The average transaction amount was 398 million Won, up by 14 million Won from 2013. Among items sold to SMG in a greater amount, products accounted for 32.3 percent. It represented the largest share, followed by labor services (12.4 percent), research and consultation (8.5 percent), and construction (6.8 percent). In the study, the Hope Businesses' sales figures and transaction amount also have been analyzed. According to the result, increase in the transaction amount has led to 10.5 percent growth in sales. For manufacturing facilities operated by the severely handicapped, social businesses and co-operatives, the contribution was particularly significant.



[Figure 2] Transaction Amount of Each Hope Business

**As a result of SMG's procurement policy, it has been reported that 54.3 percent of the Hope Businesses had "increase in profitability" and 48.6 percent enjoyed "expansion in employment"**

Many Hope Businesses reported that their sales went up thanks to SMG's procurement policy in 2014. 54.3 percent of them also enjoyed higher profitability.

More specifically, 15.1 percent found that their profitability has increased by less than 5 percent, whereas 15.5 percent saw the growth in somewhere between 5 percent and 10 percent. The rest 23.7 percent witnessed at least 10 percent rise in their profitability. However, the rate of profitability improvement has slightly dropped compared to 2013. This implicates that it has become more challenging for the Hope Businesses to secure net profits despite of sales growth resulted from the increased transactions. It may be due to the influence of external conditions.

SMG’s procurement policy also has borne expansion in employment among 48.6 percent of the Hope Businesses investigated. Social businesses and rehabilitation organizations, in particular, hired a large number of employees. Yet the rate of employment expansion has gone down by 3.1 percent point from 51.7 percent in 2013. It can be explained by a sharp fall in the number of Hope Businesses employing more than 5 workers. It countered the rise in small-scale employment. But a more fundamental problem is with the decreased rate of profitability. SMG’s procurement policy creates a cycle: First, it directly increases the public procurement of goods and services from the Hope Businesses. To meet increased demand, the companies expand their production and ultimately, their sales grow. As a result, their profitability goes up and this leads them to employ more people. Nonetheless, the rate at which the profitability of Hope Businesses rises has been weakened. Hence, less employment.



[Figure 3] Effect of SMG’s Procurement Policy to Increase the Purchase of Goods and Services from the Hope Business on Employment Expansion

## **The public procurement of goods and services from the Hope Businesses induces production worth 1.5 trillion Won and employment of 20,000 workers**

The macroeconomic effect of procuring goods and services from the Hope Businesses has been estimated by using the 2013 Seoul Area Input-Output Table. The result shows that 1.3 trillion Won spent by SMG in 2014 on the procurement had the inducement effect on the areas of production (nearly 1.5 trillion), value addition (1.1 trillion), and employment (19,124 workers) in the Seoul regional economy.

[Table 1] Macroeconomic Effect of SMG's Procurement of Goods and Services from the Hope Businesses

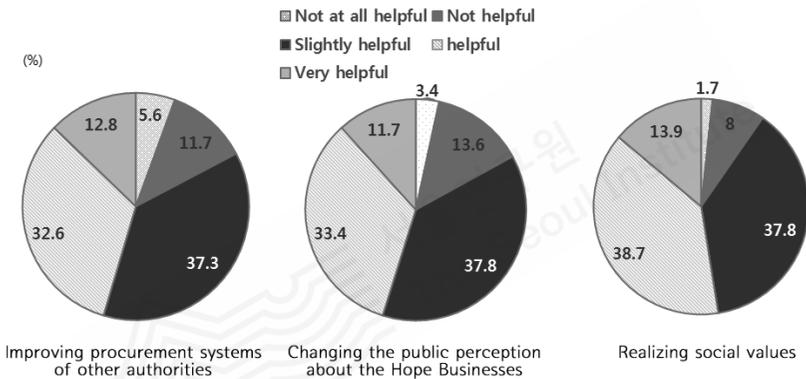
Category	Production Inducement Effect (100 million Won)	Value Addition Inducement Effect (100 million Won)	Employment Inducement Effect (No. of Workers)
Seoul	14,901	11,066	19,124
Nationwide	17,827	11,924	21,724

## **SMG's procurement policy for the purchase of goods and services from the Hope Businesses help change the public perception about such enterprises and realize social values**

Besides economic contributions, SMG's procurement policy to increase the purchase of goods and services from the Hope Businesses has positive social effects. It serves as a model to other local governments and agencies. It also makes general public and government officials to become more favorably disposed to the Hope Businesses as well as their products. According to statistics, 45.4 percent of the Hope Businesses surveyed believed that SMG's policy would bring desirable changes to the procurement systems of other authorities. It greatly outnumbered those who responded otherwise (17.3 percent). To the question about whether they think the policy helps change the negative perception of some government officials and individuals about the Hope Businesses, 45.1 percent answered yes, up by 6.9

percent point from 2013.

Furthermore, the policy is reported to have played an important role in realizing social values. It encouraged the Hope Businesses to take part in converting temporary workers into the regular, employing disabled individuals, and other various kinds of social activities. According to the survey, 52.6 percent of the respondents were either already pursuing social missions or planning to. Given that, procuring more goods and services from the Hope Businesses may serve as a vehicle to stabilize and expand the employment of the vulnerable in society.



[Figure 4] Social Effect of SMG's Procurement Policy to Increase the Purchase of Goods and Services from the Hope Businesses

**Companies certified by SMG as socially responsible businesses have the success rate of 62.5 percent in the city's procurement bid. However, not many businesses are aware of it**

SMG gives extra credits to organizations that have been certified as socially responsible businesses when they enter the bid. The government has introduced such preferential treatment in 2014. Any enterprise can seek to be certified if they participate in: cultivating respectful and cooperative culture between labor and management; creating family-friendly working environment; addressing consumer complaints; promoting fair competition; and/or pursuing shared growth. Given

extra points, certified socially responsible businesses have a higher success rate in the procurement bid by SMG as well as its affiliated organizations and autonomous district governments. According to the study, 62.5 percent of government procurement transactions were made with certified socially responsible businesses. Meanwhile, 47.2 percent of enterprises got certified on the ground that they hired new employees (and so contributed to job creation). The rest were certified, for they hired disabled people (16.7 percent), converted non-regular workers into the regular (11.1 percent), and created new jobs for the handicapped (11.1 percent).

Without knowing that certified socially responsible businesses can enjoy such preferential treatment, some companies did not seek to be certified. In the survey, 41 percent of the companies responded that they intend to get certified. Given that, the positive effect of extending special treatment to certified socially responsible businesses is likely to spread. In the meantime, the large majority of respondents neither advocated nor opposed the idea of giving more extra points or introducing new evaluation criteria. They mentioned that the current scheme already gives enough extra credits.

**The awareness of SMG’s procurement policy is low, with 67.7 percent of the Hope Businesses “unaware of such policy that gives benefits in contracts with government agencies”**

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In the survey, 67.7 percent of the Hope Businesses responded that they do not know about SMG’s procurement policy. This clearly illustrates that there needs a systematic approach to inform and promote the policy. This study has also discovered that some Hope Businesses had no transaction with SMG largely because they were not properly informed about the government’s procurement orders. According to the 2013 study, 41.3 percent of the Hope Businesses could not participate in the government contracts, for not having prepared goods on the order list. This, however, has dropped by 31.4 percent point to 9.9 percent in 2015. Unfortunately, a lack of information on the bid still remains as a dire problem. In

2013, 26.6 percent of the Hope Businesses picked it as the main reason why they failed to identify contract opportunities. The number has increased to 31.4 percent in 2015. Meanwhile, the Hope Businesses reported that they would welcome some improvements in the current procurement scheme. In detail, they requested the government to: expand private contracts, which would help their sales grow; give them more extra credits and if necessary, implement new criteria to facilitate the policy; and widen the range of products applicable to the restricted bidding process when social enterprises enter the contracts made public online.

### 3. Conclusions & Policy Recommendations

For the purpose of this research, SMG's procurement policy to increase the purchase of goods and services from the Hope Businesses has been examined. As explained earlier, the policy has yielded progress on both economic and social fronts. Based on the findings, we have drawn the following conclusions and policy recommendations.

**Overall, SMG's procurement policy regarding the purchase of goods and services from the Hope Businesses has achieved desired outcomes in both economic and social terms**

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SMG has been relying on its procurement policy to increase the purchase of goods and services from the Hope Businesses as their main tool to support such enterprises. And it has made some progress on both economic and social fronts. First, the Hope Businesses have enjoyed growth in their sales and profitability, which has made them hire more workers. Meanwhile, the policy has facilitated the realization of social values. Yet its contribution to improving other public institutions' procurement systems is reported to be less significant. The same is also true of its effect on fixing the misapprehension of the Hope Businesses held by some government officials and individuals in general.

[Table 2] Economic Effect of SMG's Procurement Policy to Increase the Purchase of Goods and Services from the Hope Businesses

(Unit : %)

Category		Contribute to sales growth	Contribute to profitability improvement	Contribute to employment expansion
Total		10.5	54.3	48.7
Types of business	Social businesses	49.8	55.7	55.0
	Rehabilitation organizations	-176.8	66.7	61.9
	Manufacturing facilities operated by the severely handicapped	51.3	46.6	38.4
	Co-operatives	122.6	54.5	45.5
	Community interest companies	-796.5	50.0	12.5
	Others	34.8	37.5	25.0

[Note: Each category (from left to right) is measured in the contribution rate of increase in transactions on the sales figures; the proportion of business respondents that believed the policy has contributed to the improvement of profitability; the proportion of business respondents that believed the policy has contributed to the expansion of employment, respectively.]

[Table 3] Social Effect of the SMG's Procurement Policy to Increase the Purchase of Goods and Services from the Hope Businesses

(Unit : %)

Category		Contribute to the improvement of other authorities' procurement systems	Contribute to the improvement of the general public and government officials' attitudes towards the Hope Businesses	Contribute to the realization of social values
Total		45.4(3.35)	45.1(3.36)	52.5(3.55)
Types of business	Social businesses	45.5(3.35)	45.2(3.36)	52.9(3.58)
	Rehabilitation organizations	50.0(3.50)	58.3(3.62)	51.7(3.55)
	Manufacturing facilities operated by the severely handicapped	44.6(3.40)	43.4(3.37)	52.4(3.52)
	Co-operatives	38.1(3.05)	47.6(3.38)	52.4(3.40)
	Community interest companies	43.8(3.06)	25.0(2.94)	50.0(3.50)
	Others	42.1(3.29)	36.8(3.26)	42.1(3.39)

[Note: Each category is measured in the proportion of business respondents that answered positively to the questions about the policy's social contribution. Figures in the parenthesis represent the score (on a five-point scale) given by business respondents.]

**Improve the policy's efficacy by adopting the following five suggestions, which include establishing the Center for Procurement Policy**

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In this study, we attempted to identify the Hope Businesses' demand for procurement policy and problems embodied in SMG's current scheme. Several issues have been addressed. Among them, the following two problems are reported particularly serious: One is the low awareness of the government's policy among the Hope Businesses; Another is a lack of information on the city's procurement bid. This research proposes herewith five solutions to such problems.

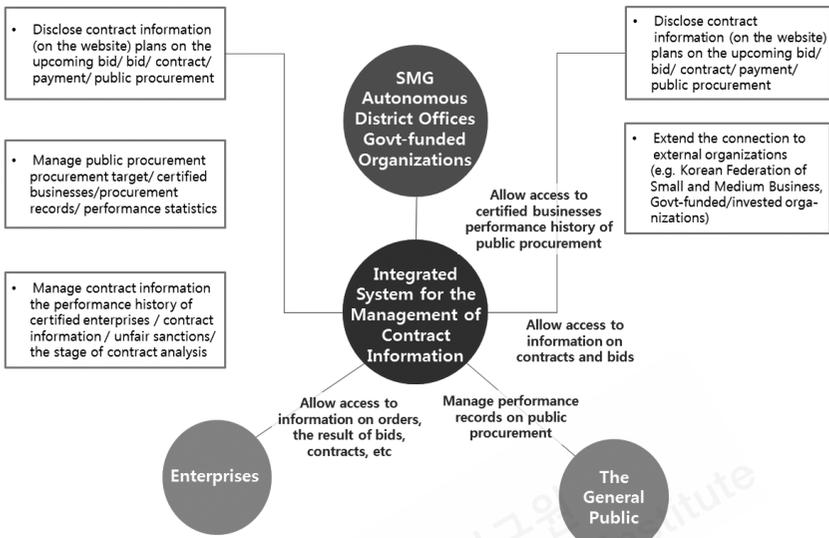
First, set up the Center for Procurement Policy to provide one-stop service for the Hope Businesses. At the moment, there is no organization in charge of dealing with complaints and problems reported by the Hope Businesses regarding the current procurement system. The Center for Procurement Policy should take the responsibility in bridging buyers and sellers. Its task should include the following: handling every procurement order and bid made by SMG, affiliated organizations, and autonomous district governments; overseeing business transaction between the two parties; and settling disputes if they arise. It would be cost effective to combine existing organizations or offices responsible for public procurement into one center than creating a whole new one.

Alternatively, the SMG can expand the role and work scope of the current Seoul Social Enterprise Promotion Agency to make it provide consultation services regarding the city's procurement policy. The agency then should be renamed, say, the Center for Procurement Policy. With the center at the heart of public procurement business, the SMG, autonomous district governments, and organizations funded or invested by the government ought to arrange workshops or set up an online platform where they can communicate with the Hope Businesses: Buyers can provide sellers with information about, for example, the expected quality of products or the types of goods and services in demand. On the other hand, sellers may propose suggestions (about the preferential treatment, for instance) or report problems they have spotted in the current procurement system. Whether it is an event or venue,

they all should be served as a channel, through which suppliers and demanders can share opinions and seek solutions together.

Second, implement more effective strategies to better inform the Hope Businesses about the city's public procurement bids. Over the past several years, the SMG has been exemplary to other local governments in vigorously taking policy efforts to support the socially and economically disadvantaged businesses. Unfortunately, the study shows that too few enterprises are aware of such policy. Not only that, some Hope Businesses missed out on the chance to work with government agencies. They mostly blamed lack of information on the procurement bid. If the SMG fails to find a way to raise the Hope Businesses' awareness of its procurement policy and provide them with sufficient information about the bids, it will end up undermining its policy effort to support the Hope Businesses.

Therefore, SMG must devise a strategy to provide sufficient information regarding its procurement plan to the Hope Businesses. On top of it, the government should seek a way to promote the merits of its procurement system. All of these can be accomplished if the SMG installs an integrated system to facilitate the management of procurement contracts online. After implementing it, SMG and its affiliated organizations as well as autonomous district governments must disclose the list of products that they intend to purchase, their plans and details about upcoming bid, and other relevant information. Hope Businesses, in turn, should give buyers access to, for instance, the list of their products, records on the procurement transactions they had in the past, and contact information. In this way, the system can serve as a bridge between suppliers and demanders. To facilitate such a function, the SMG, its affiliated organizations, autonomous district governments, and the Hope Businesses must all be granted access to the system.



[Figure 5] Strategies to Open and Promote the Procurement Bid on the Integrated System for the Management of Contract Information

Third, focus on the enrichment, not the expansion, of existing preferential treatment scheme for certified social businesses. It has not been long since the SMG has first introduced the scheme. Therefore, the SMG should concentrate on improving it rather than expanding it prematurely. Nearly a half of the Hope Businesses surveyed opposed the idea of giving more additional credits to certified socially responsible businesses as well as implementing new evaluation criteria. In particular, 58 percent of certified socially responsible businesses objected to the two aforesaid ideas. Besides, if the SMG introduces new evaluation requirements, they are likely to be filled with qualitative indicators. Needless to say, it is difficult to set up a clear, objective standard for qualitative criteria.

However, the SMG should consider the idea of giving more additional credits to a business for having employed new workers. It can work as a solution to the decreased rate of employment in Seoul. Besides, a large number of certified socially responsible businesses have been demanding for extra points for their social

contributions made by hiring new employees. By the objective evaluation criteria, certified socially responsible businesses can receive only up to two extra points for having employed new workers for the business of current year. Though the rule on additional credits stipulated in the contracts was amended in 2012, this part remained unchanged. Thus, there is a room for improvement.

Fourth, expand the range of products restricted for a bid among social enterprises. The large majority of Hope Businesses prefer to enter the private contract in pursuit of sales growth. Abiding by the law, the SMG procures goods and services from the Hope Businesses whenever the private contracts can be made. However, expanding the private contracts is challenging in practice. It is likely to trigger accusation that the government gives too many privileges to particular companies. As an alternative, the SMG may look for other ways to encourage competition among social enterprises in the procurement bid. For this, the SMG should expand the range of items applicable to the restricted bidding process. This is to be done by first collecting opinions from affiliated organizations, autonomous district governments, and public government agencies that procure commodities from the Hope Businesses more frequently than SMG.

Last but not least, SMG should design and implement a program that promotes shared growth of medium-sized enterprises and the Hope Businesses. In other words, it should establish a system in which medium-sized enterprises and Hope Businesses share responsibilities to supplement the capability of the Hope Businesses in preparing and submitting bids on their own. This places the right to “sell” in the hands of medium-sized enterprises. The Hope Businesses, on the other hand, will have the ownership. The Mentor-Protege Program adopted by the US Department of Energy and Small Business Administration (SBA) is a model example that the SMG can consider. It supports socially and economically disadvantaged companies in their journey to success. Under the program, both the mentor (the supporter) and the protege (the recipient of support) can achieve synergy.