



# **Findings on the factors that tend to exclude small business from government procurement**

Development Dialogue

April 2017

# Project: Reducing the Administrative Burden for Small Business

- Outputs:

- Research into impact of specific laws and procedures on SMEs
- Analysis of reform options, with assessment of costs, benefits and risks (SEIAS)
- Briefing notes to support engagement on reforms

- Areas of research:

- SME reporting and registration
- B-BBEE compliance
- State procurement procedures
- Construction industry

# Framework

## • Procurement

- 20% of points for tenders below R100 million and 10% for larger tenders are designated for **preferential procurement** – departments determine criteria (often BEE, not size or local production).
- National Treasury, together with the dti, has designated some strategic products for **local procurement**.
- Government departments are required to **pay suppliers within 30 days** of invoicing

## Construction (case study)

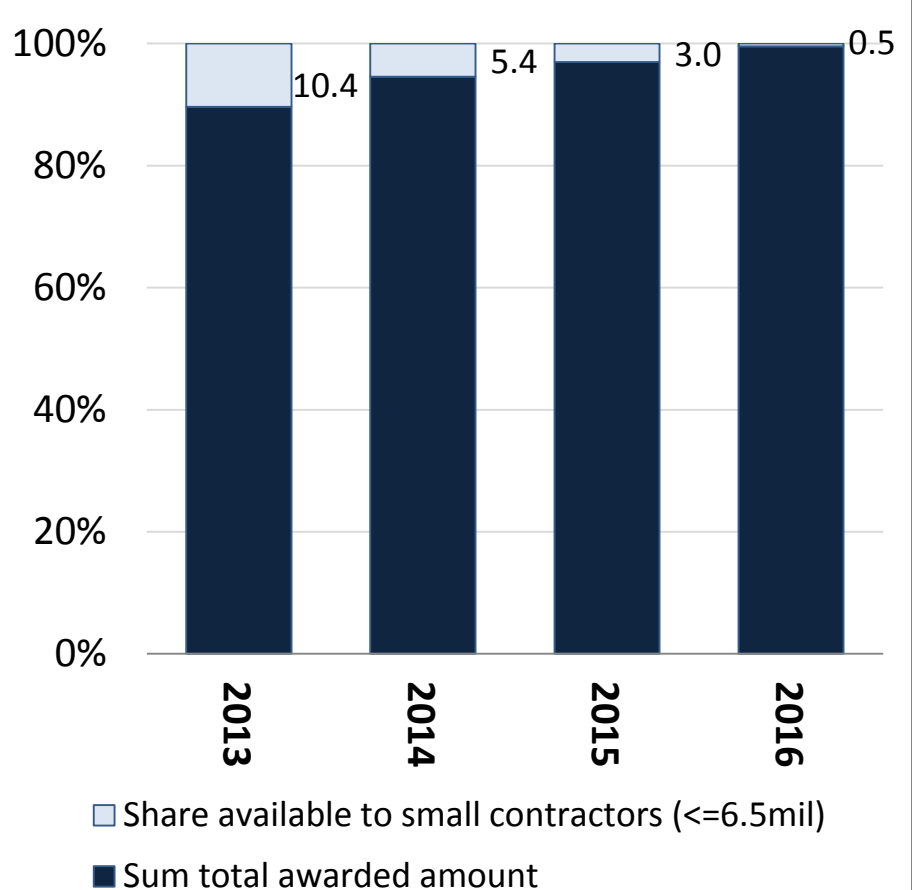
- CIDB – regulating institution:
  - Aim to get more diverse contractors - small contractors into state construction tenders
- Mechanisms:
  - Certification of contractors by size
    - Depends on capacity, including cash on hand as well as experience or track record
  - Some training and mentoring, but limited

# Emerging issues

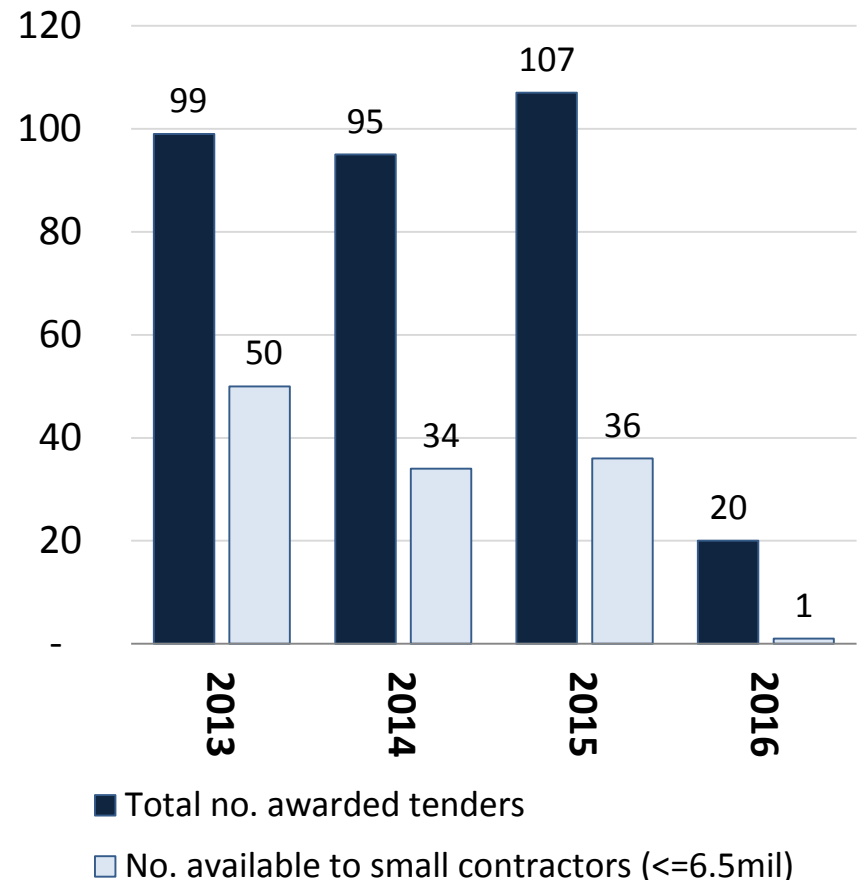
- Analysis of laws and of finalised tenders for Gauteng
- Consultations with stakeholders:
  - Regulating/government institutions
    - National Treasury
    - CIDB
  - SMEs
  - EPWP Vuk'uphile Learnership contractors
- **Tender size** – on average tenders are too large and make it hard for SMEs to bid.
- **Payment timing** – delays in payments affect business cash flows.
- **Subcontracting** – lack of regulation of contractual agreements opens up room for exploitation.
- **Up-front financing or payments** - SMEs cannot bid for tenders because cannot get any up-front financing or payment.

# Trends in tender size

## Construction tenders by awarded amount



## Construction tenders by numbers awarded



# Implications

- Tenders under R6,5 million: even if only look at levels 2 to 5 in GT, would be
  - 61 enterprises per tender
  - R50 000 per enterprise in value
- Ratios worse if include level 1

Grade	Tender value limit	CIDB RoC: Gauteng 2015/2016
1	200 000	35 863
2	650 000	1 014
3	2 000 000	306
4	4 000 000	537
5	6 500 000	339
6	13 000 000	457
7	40 000 000	318
8	130 000 000	167
9	>130 000 000	93
<b>Total</b>		<b>39 094</b>

Source: CIDB, Annual Report 2015/2016

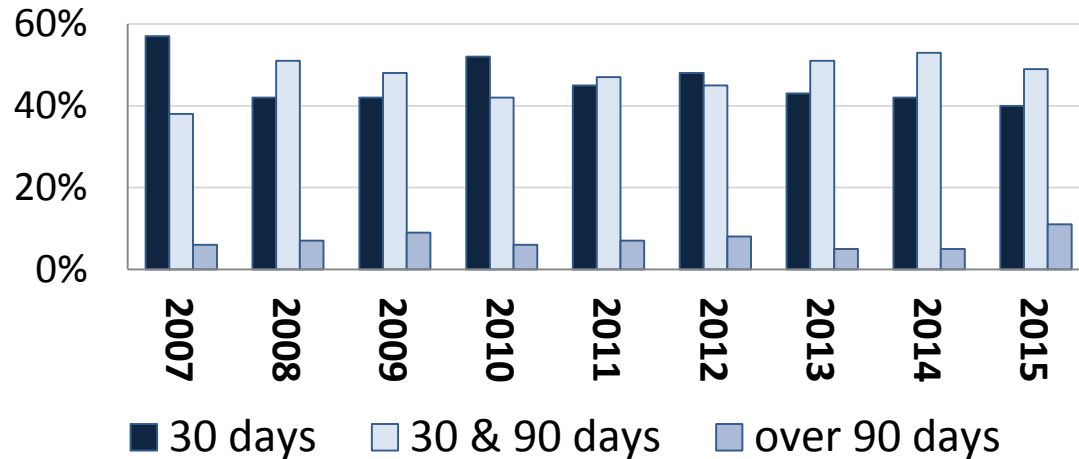


# Payment practices

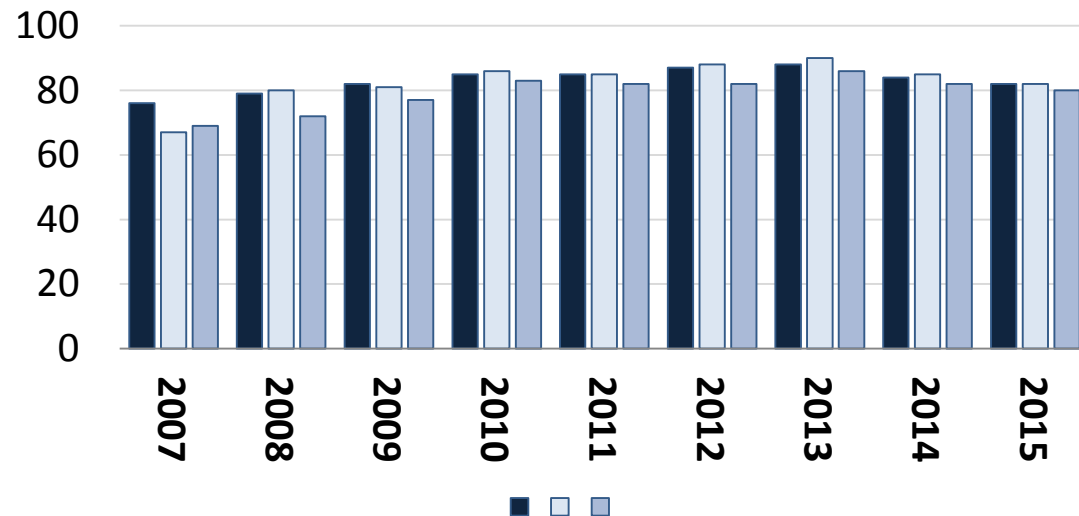
From 2007 to 2015:

- Decline in adherence to the 30-day payment timing - average payment timing is between 30 and 90 days.
- Improvement in client satisfaction with contractor performance, quality of work and resolution of defects.
- *What's are the reasons behind the payment delays?*

## Payment of contractors



## Client satisfaction



Source: CIDB, Construction Industry Indicators.

Downloaded in March 2017

# State of subcontracting

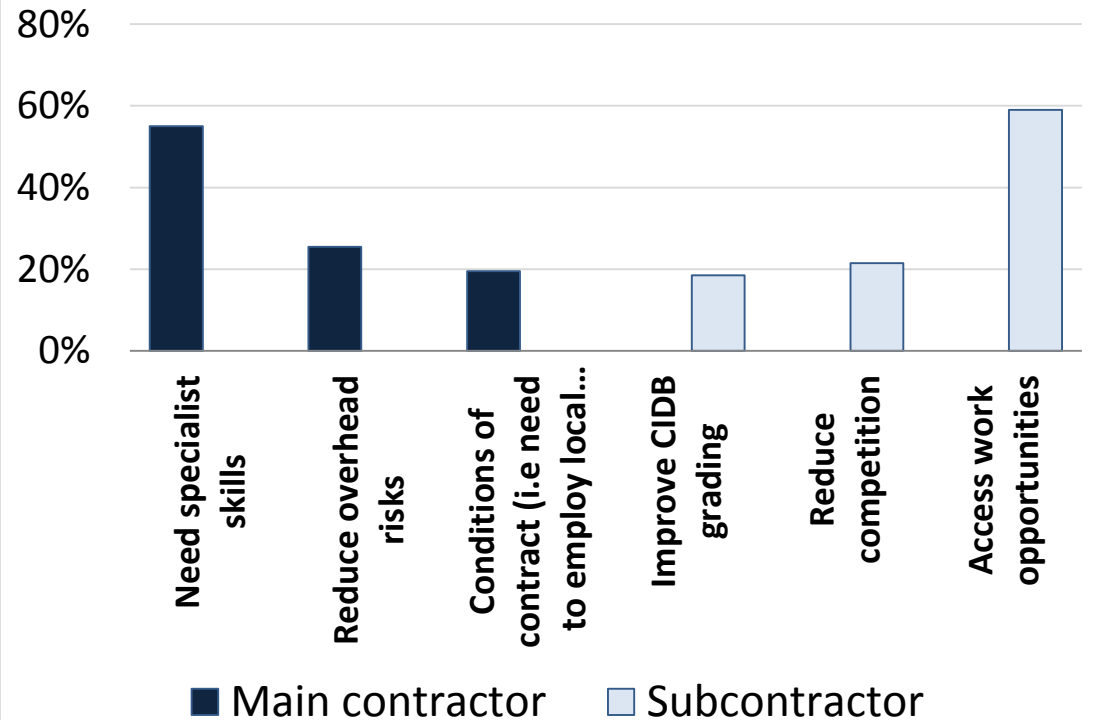
Subcontracting is very prevalent in the SA construction industry up to:

- 70% of building projects
- 30% of civil construction projects.

Dissatisfaction with subcontracting arises because of:

- late payments;
- under-payment;
- pressure to reduce prices; and
- lack of legislation or regulation.

## Reasons for entering into subcontracting



Source: CIDB, (2013)



# Up-front financing or payments

- Contracting virtually impossible for many SMEs because don't have cash flow to start projects even if have capacity to complete them
  - government permits NO upfront payments
  - cannot get loans or finance even if have contract.
- Challenge:
  - Up-front payments pose a real risk to government clients – failure to deliver.
  - For banks, lending on a contract has similar risks – failure to payback.
  - Cannot move up CIDB ladder to become eligible for larger contracts unless have significant cash on hand.

# Conclusions

- Current laws to encourage inclusion of SME contractors inadequate
- Incentives focus on bringing in (preferably empowered) small contractors within existing systems
- But systems in themselves militate against smaller contractors

- What could be done:
  - More research on tender size – is it driven by project requirements or habit?
  - On-going analysis of tender size and communication to contractors
  - Regulate subcontracting – at least have a complains hotline
  - Rotating fund for up-front payments
  - More accessible and fast dispute resolution on payments



**Enkosi!**