

Everite House, 7th Floor
20 De Korte St.
Braamfontein 2017
Johannesburg
South Africa

P.O. BOX 30762
Braamfontein 2017
Johannesburg
South Africa

Tel: (011) 339-7505
Fax: (011) 339-7731
e-mail: ntinga@worlded.co.za

UNEARTHING EMBEDDED SERVICES IN SOUTH AFRICA'S CONSTRUCTION SECTOR

The case of Materials Suppliers and MSEs

1. Introduction

World Education's Ntinga LINK project launched activities in January 2003 – after several months of market research and consultations with the donor and stakeholders on the choice of Construction as a sector of focus.

The broad goal of Ntinga LINK is to mainstream micro and very small businesses into the **Construction sector** via access to and use of value-adding, viable Business Linkage services. The main objectives are to:

- Stimulate the commercial provision of Business Linkage services in the sector- by assisting business service providers (BSPs) to develop and market such services
- Catalyse access to and use of such Linkage services by small as well as large firms
- Demonstrate economic benefits of BL services to all players in sector

The pre-project stage of selecting and investigating the Construction Sector as the target for intervention was critical to informing the initial design, analysis of BDS, and application and adaptation of strategies during LINK's implementation phase.

An in-depth sub-sector/market assessment¹ undertaken with a local research partner, confirmed growth trends in the sector, as well as the existence of large numbers of MSEs – most of them operating at the bottom of low-value end of the project scale.

The study influenced the geographic targeting of LINK programme activities, initiating work in two of the poorest and more rural provinces – KwaZulu-Natal and the Eastern Cape, where a high number and value of construction projects had been identified as being in the pipeline. The third target area was Gauteng Province, the economic and political hub of South Africa – much more urbanised, and with a high concentration of poor, township-based MSEs.

¹ . The Subject BDS Market Assessment incorporated elements of the GEMINI Sub-Sector Study approach with aspects of BDS Demand-Supply Assessment that have emerged under the Market Development Approach.

Just as important, the research highlighted that:

- Small firms exhibit severe capacity and performance constraints in acquiring as well as executing construction projects – which contributes to the concentration MSEs at the lower value end of the industry.
- Information and relationship marginalisation characterise the position of small firms.
- BDS availability and quality for MSEs is poor. BDS providers who work with MSEs themselves identified their own shortcomings – including limited technical skills; management experience; finances, for obtaining new work and/or for upgrading skills; and understanding of BEE.
- While sub-contracting and out-sourcing have always been part of the way the sector does business – and would offer opportunities even without the current push for affirmative procurement, the actual proportion of large firm-MSE links is limited and sporadic at best. The prevalence, frequency, and performance of such linkages is uneven and largely unsatisfactory to both sides, who hold very negative views and perceptions of each other.
- The policy push for BBEE (broad-based black economic empowerment or BEE, as it is commonly known) does and will, for the foreseeable future, influence MSE growth, development, outsourcing, and relationship issues – both positively and negatively. ²

Small Firm Constraints

- Inability to submit winning tenders, which are the primary vehicle for doing business in the sector.
- Lack of compliance – including legal, technical, and delivery documentation.
- Inability to negotiate appropriate payment and performance terms with clients
- Inadequate marketing and relationship-building skills – esp. with large firms
- Lack of access to finance – during pre-construction, which disqualifies MSEs from meeting guarantee and performance bond requirements; and during construction, which leads to cash-flow problems, incomplete work, and even liquidation
- Several lack of business and contract management skills
- Limited understanding project flows, and accessing and managing materials for maximum cost- and time-efficiency

As a result, small firms forego opportunities too big or risky; are not well known or marketed to key sector actors; have problems managing growth, when they do get large contracts; and often don't know where to turn for service solutions.

2. Mapping industry Relationships

2.1 MSEs at the Margins

The inescapable conclusion is that MSEs operate at the margins of the industry – with the value of their work being minimal in comparison to their numbers. This picture is summed up in the Sector Map (Fig. 1) below, which illustrates the range and relative strength of relationships among the key enterprise categories– large firms, medium firms (both of which are predominantly white/minority owned) and MSEs (which are predominantly PDI or black owned.)

² . See Section 5.3 for more information

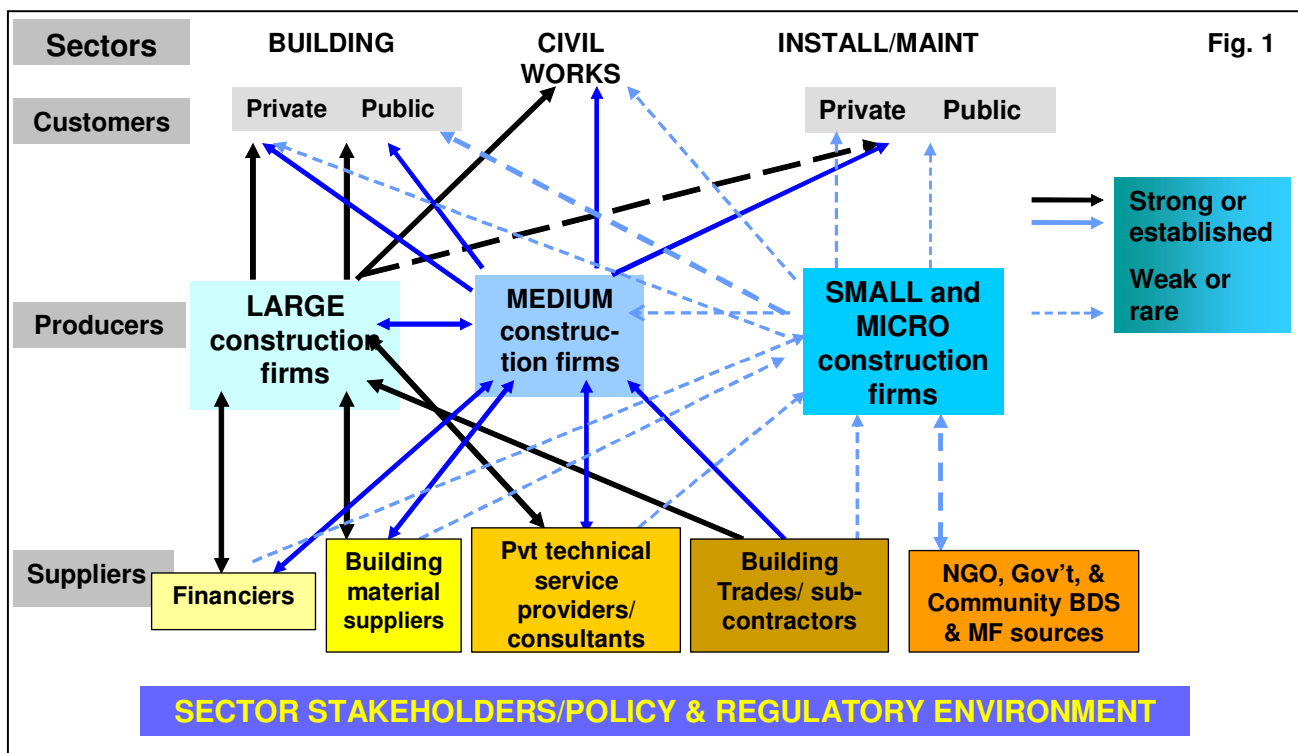


Fig. 1

Ntinga LINK's target group – the small, resource poor MSE – fares poorly in relating to or playing a significant role with most players. The **main relationship** of the MSE appears to be with non-profit (NGO) BDS providers and public sector customers and providers.

This fact influenced the initial programme outreach and activities of LINK, where considerable attention was paid to identifying and working with what the conventional 'generic' or cross-sector BSPs. In South Africa, there are several reasons for such the disjuncture in the types of relationships. In the main, the weakness or unattractiveness of relationships involving construction MSEs derives from to:

- **Historical factors** – differing business cultures, negative perceptions between small and large firms, and the deeply divisive legacy of apartheid.
- **Capacity constraints** – widely acknowledged and evidenced to be on the side of MSEs, who lack the experience and knowledge to perform consistently well or profitably in the market.
- **Market distortions** – due to which the large business sector has been able to establish favourable relationships at many levels, resulting in 'closed' markets and 'old boy clubs' that have successfully kept out new, perhaps more efficient and competitive entrants.³

LINK experience has shown that large entities (contractors, suppliers, and resource or opportunity holders) may also lack a key competence – that of appropriate systems, flexibility, and responsiveness to effectively interact with the dynamic and vast MSE market. However, this is rarely acknowledged or documented.

³. This is applicable to several other key sectors in South Africa – including manufacturing, large-scale agriculture, and mining, for example.

3. Evolving win-win relationship strategies

By establishing a broad picture of the multitude of relationships affecting small contractors and those that need to be strengthened, Ntinga LINK evolved a two-prong strategy to work on promoting sectoral linkages that is aimed at:

- Initially identifying and capitalising on relationship strengths that already exist.
- At the same time, identifying, analysing, and targeting those win-lose relationship categories that might be more amenable to intervention by parties concerned and allow for near-term realisation of benefits – notably finance and materials supply.

3.1 Identifying and strengthening Existing relationships

As Figures 1 and 2 showed, MSEs typically have the strongest relationships with:

- Cross sector or 'generic' Business Service Providers (BSPs) – typically an NGO or government/donor agency, whose function is to support the emergence of MSEs into the market. Most often this is done through provision of a broad range of information, awareness, training and mentoring services in areas of basic business planning and management.
- Public sector clients – those government departments that require construction services (often, lower-tech products such as low cost housing; refurbishments or additions; rural access roads, etc.) and have both the inclination and the mandate to undertake and enforce “affirmative” procurement that favours “emerging enterprises”⁴ via their tendering and quotation processes.

Therefore, Ntinga LINK instituted a programme of facilitation that would build the strengths of the BSPs that MSEs typically work with. The focus was on improving relevance, efficiency, and effectiveness of such services – through a targeted set of activities, including,:

Facilitating BSP introductions to and interaction with

- Corporates, para-statal
- Financiers
- Industry bodies
- Provincial infrastructure development authorities

Research and information dissemination on

- Industry trends
- Opportunities
- Finance

BSP Service development

- Enhancing BSP skills in costing, scheduling, tendering
- Developing & testing ULWAZI – a simplified costing tool
- Training in Joint Venture management

⁴ . A general term denoting mainly micro and small firms owned by PDIs (previously disadvantaged individuals – i.e. those formerly classified as Black, Indian, or Colored). See Glossary in Annex A for more details.

- Supporting development and use of ASANDE – a market oriented small contractor data-base & profiling system

BSP collaboration

- Helping 15 BSPs in KwaZulu-Natal and the Eastern Cape organize into provincial ‘forums’
- Providing collective and individual advice on linkage strategies
- Facilitating formulation of a BSP code of conduct to govern relationships and referrals among BSPs

At the same time, project personnel worked to establish informational and working relationships with key government departments – such as the local municipalities (in charge of local economic and infrastructure development), departments of Housing; Roads and Public Works, and Education (for schools). The aim in establishing these relationships was to ensure that BSPs, and their MSE clients, would become more aware of opportunities earlier on, and be able to engage with the clients to position themselves for accessing those opportunities, and also to be able to influence the process of tender issuance in terms of making the system more transparent, simpler to understand, and more consistently applied.

The interventions at BSP level were positively received, though engaging with the public sector bodies was impacted by bureaucratic and political issues. The more technically proficient and entrepreneurial BSPs were able to deliver services that benefited them and their MSE contractor clients.

In the most recent reporting period (January to June 2004), LINK Business Service Providers in KwaZulu-Natal and Eastern Cape provinces indicated that:

- They provided construction sector-related services to 3,975 firms during the period
- Of which 89% (3,532) were micro-enterprises, and
- Nearly 35% of the ME’s were women-owned.

The six reporting partners assisted approximately 100 micro-enterprises to tender for construction contracts worth nearly \$ 4 million, with 25 firms being awarded construction jobs to the value of approximately \$1.3 million. Two hundred construction jobs resulted from these tender awards.

4. Targeting relationships for improvement – the case of MSEs and Materials Suppliers

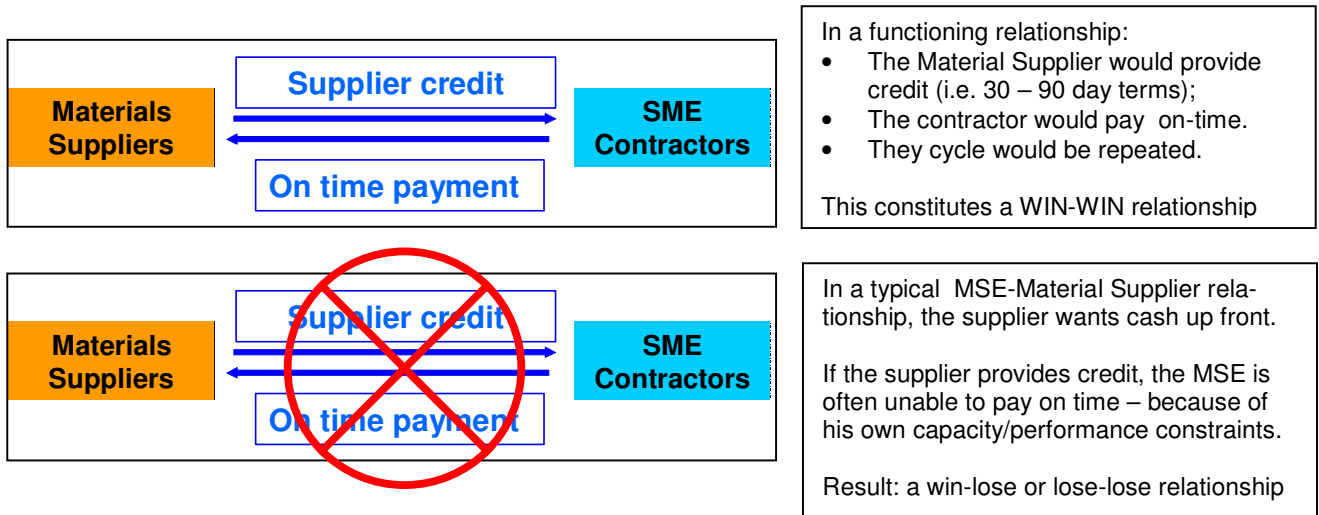
This has been a relatively recent strategy, pursued in the second year of the project and primarily in the third province, Gauteng, where LINK has deliberately downscaled work via the typical cross-sector BSP. By taking a broader definition of a Business Service Provider, LINK has focused on bringing in two key types of value-chain players into the program as “BSPs” – Materials Suppliers and Financiers.

The rest of this paper will focus on the emergence and promotion of relationships being developed between MSEs and Materials Suppliers – which includes the provision of “**embedded services**” along with supply of materials.

4.1 Identifying what constitutes a win-win relationship

The following set of diagrams illustrates how a normal working relationship between a contractor and a material supplier works – and where it breaks down between the MSE and supplier.

Fig. 3⁵



The suppliers' typical response to the break-down experience in Fig. 3, has been to avoid or abandon the MSE market altogether.

4.2 Evolution of Embedded Services

In recent years, however, due to both policy pressure, and the realisation among established firms of the market potential of the PDI (previously disadvantaged) majority in South Africa, materials suppliers like other chain stores and supermarkets have become more willing to deal with PDIs as consumers and buyers.

The **potential** of embedded BDS to develop and reinforce a “virtuous cycle” of WIN-WIN relationships – through enhancing MSE performance and payment -- is vast and exciting, given the prevailing context, MSE capacities, and policy and economic imperatives for sector growth.

The existence and provision of embedded services by suppliers has become apparent to LINK in its 2004 activities – as we have begun operations in Gauteng Province, where many of the national headquarters of major supplier firms are based.

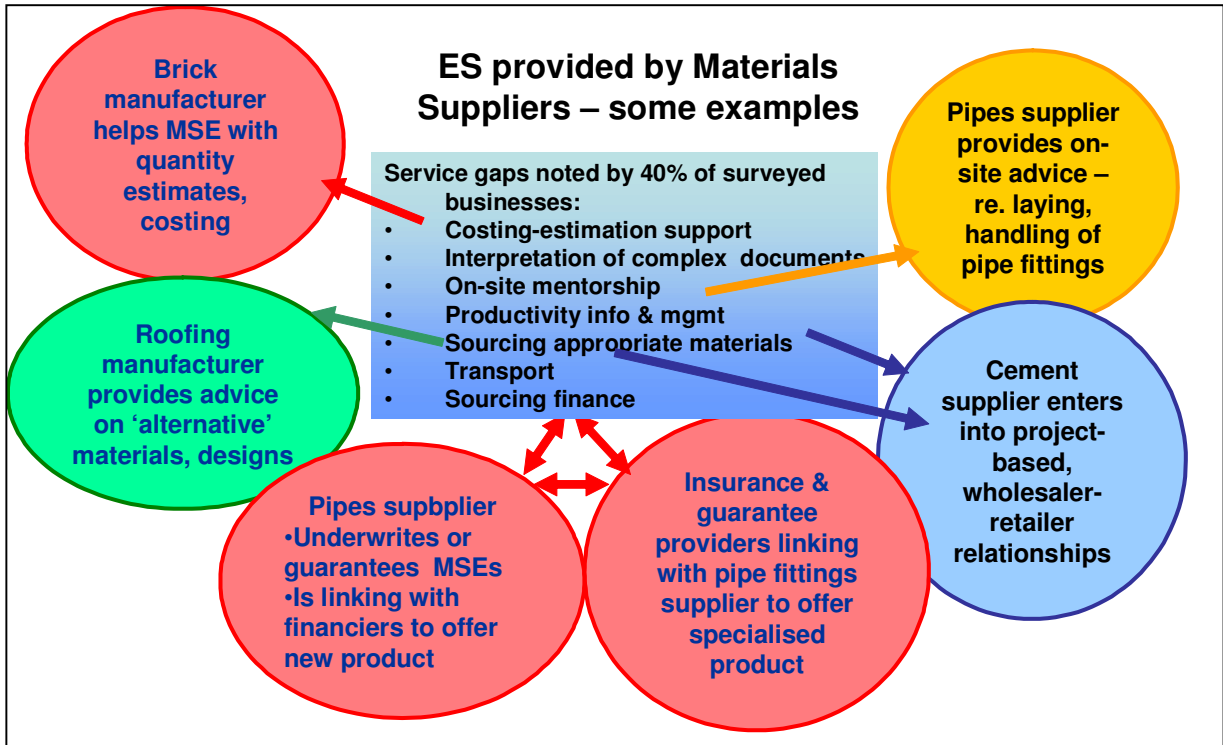
Some Materials suppliers provide the MSE contractor – both up front and during execution of the construction project - key costing, estimating, technical, and other advisory services that enable the MSE to make the right selection and appropriate use of the materials purchased – thus increasing his chances of delivery and repayment of a range of MSE creditors, including the supplier.

Figure 4 gives examples of specific types of embedded services that Materials Suppliers are providing. It is immediately obvious – from the type of service, as well as the response of the MSE – that such ES are much more relevant and of better quality than the advise and support

⁵ . Both diagrammes on this page adapted from a model developed and shared by Marshall Bear, Consultant, IGP Learning Network, USAID.

provided by the traditional or 'generic' BSP. In fact, it is directly addressing the service gaps identified in our research, and noted at right.

Fig. 4



Note: The newly designed joint service described in the two circles at bottom of figure is a direct result of Ntinga LINK's facilitation of networking among suppliers.

4.3 Facilitation of such ES

Having established that some suppliers were providing embedded services, LINK has seized the opportunity to promote this as a platform for win-win relationships.

The first step was to increase awareness, availability, and use of the existing services. This has been done through a set of buyer-supplier fora –dubbed the “Access to Resources for Small Contractors” seminar series.

Getting suppliers of materials, plant, and equipment (along with suppliers of finance, guarantees, and insurance) to share information about their core products as well as support (i.e. Embedded) services has unleashed a flood of interaction with MSE contractors, as well as spawning interactions between suppliers, who are now combining their core and support services to offer a new 'no-cost' package to the MSEs.

Use of Supplier Evaluations and written feedback (in addition to the normal event evaluation from all participants) has already highlighted the nature, volume of potential and actual business transactions.

Do these forums add value?

For the most recent event:

- Three suppliers contributed = \$ 1,000 to the costs
- The Pretoria municipality provided the use of its premises, paid for advertising, and refreshments;
- A major national contractor association and manager of one of the five largest construction firms asked to be on the programme
- 95% of attending contractors handed in very positive evaluations

4.4 Drivers, advantages, and limits to ES-based win-win relationships

a. Advantages

For the MSE there are definite advantages, and though the materials supplier incurs a cost in time and personnel resources, the benefits to the supplier apparently outweigh the costs, for the present, at least.

For the MSE, the advantages of obtaining embedded services from the supplier, rather than from a stand-alone or generic source are that the service is:

- Credible – because it comes from a known, established, experienced source
- ‘Close to’ and accessible to the small business
- Affordable – because separate payment is not required

For the Materials suppliers, the drivers or advantages of offering ES are that:

- It opens up access to new, larger markets via direct sales or franchise opportunities.
- It enables them to respond proactively and positively to current policy pressures and thus avert the threat of sanctions.
- It is also important to note that Materials Suppliers are able to offer ES effectively at present, because new risk-reduction mechanisms are coming into play (such as agreement to third-party payments and cessions, as well as the push for financial institutions to make working capital more readily available to MSEs.

b. Disadvantages and constraints

Given the relatively small number of suppliers currently offering ES, and the fact that they offer it on a limited basis, also carries some **disadvantages for MSEs**. Since the ES is supplier-driven, it is difficult for recipient MSE to shape service to exact needs, or demand quality and consistency. In addition, the pool of experience is relatively small because few suppliers offer ES, and familiarity between suppliers and MSEs may not stimulate further innovation

Obviously, even if they cannot clearly define the total actual or opportunity cost of providing specific ES, suppliers do make **cost and risk calculations** that place limits on the volume and depth of ES they are willing to offer MSEs.

The fact that *not more materials suppliers are offering such ES* can be traced to a combination of factors, including but not limited to:

- Lack of market knowledge or entrepreneurial flair
- Risk of non-payment, which still exists due to relatively high MSE failure rates – as the Construction industry is very demanding in terms of performance and delivery, in addition to operating on very slim margins
- There remains a potential for loss on materials – due to theft, lack of appropriate storage and management by the MSE.

Cost considerations are influenced by:

- Size, value of specific MSE order or contract
- Size, value of overall construction project (i.e. potential for new MSE customers)
- MSE client’s level of experience, need for assistance
- Potential to increase supplier’s visibility and exposure, thus improving future positioning

Risk factors include:

- Potential that the Materials Supplier may be overwhelmed by level of MSE need and demand for ES - and thus be diverted from its core business
- MSEs history of failure to complete projects, which is still relatively high despite the range of support available for this segment
- Systemic contractor payment processing delays, especially within public-sector commissioned construction works

4.5 Leveraging Policy

It has been noted above- and in more detail in Annex B, -- that Government Policy, popularly known as BEE (Black Economic Empowerment), is a key driver of embedded and other services in the Construction Industry. Given South Africa's history, and the moral, social, and political imperative of bringing the vastly disadvantaged majority into the economic mainstream, the far-reach scope and impact of BEE and related legislation cannot be underestimated.

Although some may view the effects of the policy as 'distortionary' to free market principles, there is no questions that economic transformation and a levelling of the playing field would take much longer without such a legislative "stick" and the correlative "carrots" in terms of public recognition and reward for affirmative procurement.

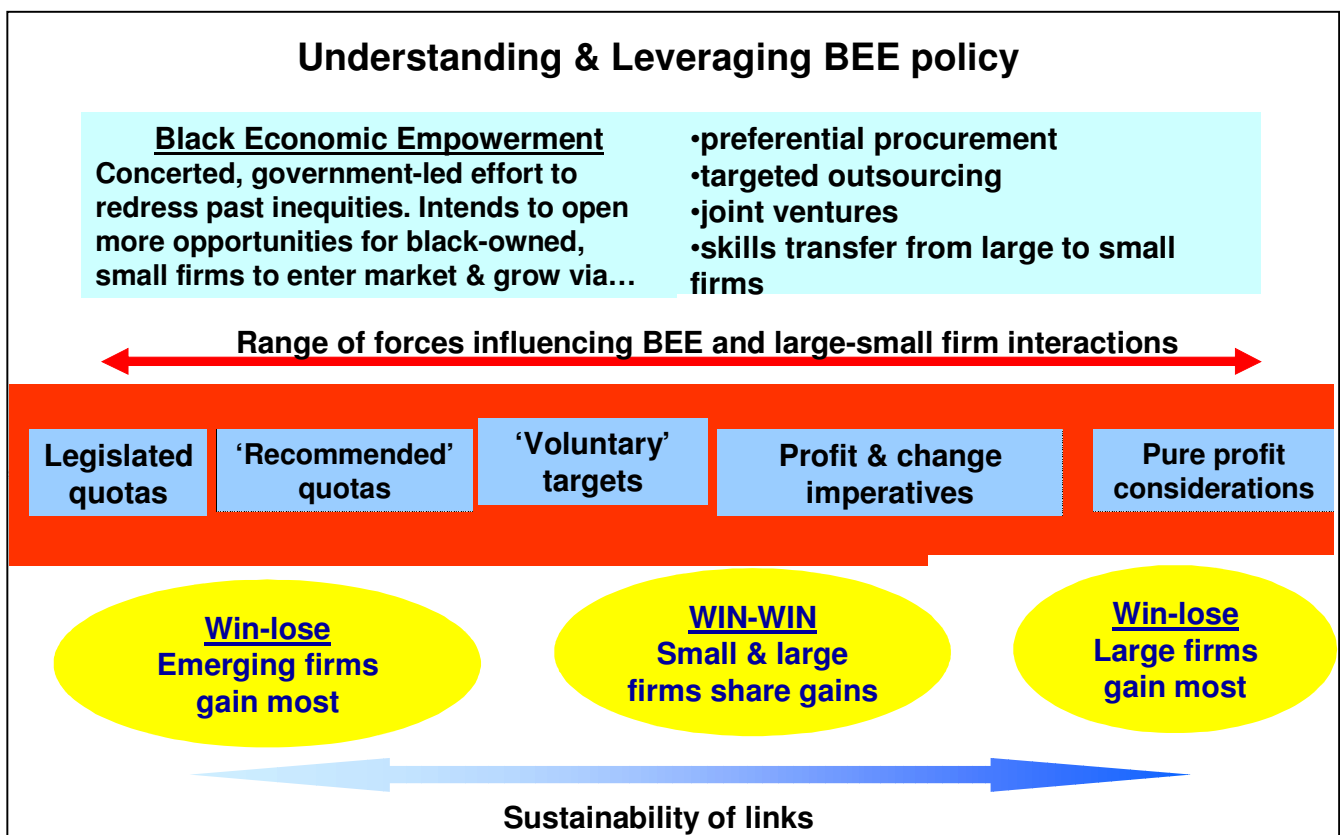


Fig. 5

Given the policy context – and its potential to support or work against market considerations, the programme facilitator sometimes confronts a fine line in staying true to the tenets of market development and commercial viability and sustainability of BDS that it facilitates.

From Ntinga LINK's point of view, the prevailing BEE policy offers opportunities to push the frontiers of service provision to a long-neglected group in South Africa. But there is a risk that both target MSEs as well as the intermediaries – commercial and non-commercial BDS and other service providers – will begin to formulate, design, and deliver services only to address legislative imperatives rather than basing them on good business sense or bottom line considerations. This may work effectively in the near term, but is likely to become unsustainable and ineffective soon thereafter.

4.5 Concluding observations - and looking ahead

Given all of the above, Ntinga LINK needs to be realistic in terms of assessing what it can do to further facilitate provision of relevant embedded services through the Material Supplier Channel – while also continuing efforts to unblock other key constraints to MSE access and performance, most notably finance and large contractor practices.

a. What is possible?

In the near term, LINK will continue to:

- ✓ Identify existing ES practices among suppliers, with the aim of documenting them and raising awareness among the MSE community as well as other suppliers and industry stakeholders of the existing and potential benefits of providing BDS in such a format.
- ✓ Increase access and use of existing ES via introductions and interaction between such suppliers and MSEs
- ✓ Spawn additional ES via interaction between such suppliers and those not yet offering ES, with some technical advice and assistance in forging temporary service partnerships.
- ✓ Programme research and documentation to inform our own interventions, and share more broadly within the industry
- ✓ Help publicise availability of specific suppliers' embedded services: This may be viewed in some quarters as favouring or pre-selecting a few suppliers to the detriment of the wider 'market.' However, the fact that MSEs need for such services is so high while their awareness of the availability is extremely low, impels us to consider this as a necessary immediate step in bridging the service gap.
- ✓ Facilitate development of new embedded services between suppliers, based on areas of specialisation and competitive advantage – especially on larger projects such as road

Currently, LINK staff are:

- Assisting suppliers and MSEs on crafting specific business deals – with the aim of better understanding and documenting the process, and establishing some “demonstration” examples.
- Facilitating supplier-to-supplier discussions on service collaboration, with the aim of action research.
- Conducting one-on-one research with those suppliers offering Embedded Services, to verify our anecdotal and experiential understanding of key drivers and constraints.

building and “heritage sights” that require use of a large proportion of local MSEs and labour.

- ✓ Help suppliers and MSE identify and publicise the pros, cons and returns on embedded services offered by specific suppliers

b. Limits to the role of a facilitator

At the same time, the LINK team recognises that there are limits to facilitating the increase and use of ES – both due to supplier cost/risk considerations (as noted earlier), as well as because of the highly competitive and cyclical nature of the industry and the established patterns of operations among the larger, more powerful commercial players.

Some of the constraints we see are:

- **Translating BDS jargon into supplier speak and vice versa** – so that Ntinga LINK can operate within the industry as a credible voice and resource, without abandoning its developmental goals and principles
- **Suppliers’ competition and confidentiality concerns** may limit spread of such services: Many suppliers are reluctant or unwilling to divulge to an outside party their full reasons and rewards for offering ES, for fear that such information may be made public – and used by competitors or attract unwarranted attention from other players.
- **Suppliers unable or unwilling to specify cost-benefit calculations:** Often, suppliers are unable to clearly articulate the specific factors that have led them to offer certain embedded services. This may be because the ES are still relatively ad hoc rather than integrated into the normal input supply procedures. Or, the ES may be provided only on an as needed basis to specific preferred MSEs with whom a relationship has been established. Almost more important is the fact that very often, in the current climate, the risk-return rationale may be political rather than financial. While this factor drives many a business deal in South Africa today, it is not something that most players would easily admit to.

Ntinga LINK is now at an exciting and critical phase of testing and implementing two different strategies and approaches, both with the same objective of increasing MSEs’ access to services and resources that will enable their entry and success in the mainstream construction sector. The outreach model being used in Gauteng will be replicated in several parts of the province, and will likely also be delivered in the existing provinces, as LINK moves to close out its direct involvement in KZN and EC by the end of the year.

*Armin Sethna
Ntinga LINK Programme
World Education SA
September 2004*

Annex A

Glossary

Acronym	Term	Usage, general meaning
ABE	Affirmable Business Enterprise (also PDI firm or “emerging” firm)	Generally, an ABE can be any firm with majority ‘black’ ownership or shareholding. In this report, it is largely used to refer to the smaller end of the spectrum – micro or small firms owned and run by “PDIs.”
Affirmative Procurement	Affirmative Procurement	Similar to BEE, as it refers to outsourcing or sub-contracting activities, which are usually issued under competitive bidding or tendering procedures
Apartheid	Apartheid	Political and legislative system that reigned for decades in South Africa, whereby the ruling white minority instituted a system of ‘separate’ development of the various race groups, leading to severe disenfranchisement and social, economic, and cultural dislocation of 90 percent of the population.
BEE	Black Economic Empowerment	A concerted effort, led by the public sector to redress past economic inequities and imbalances. General strategy is to promoting effective participation and benefits for greater numbers of PDIs, through increasing their access and participation in economic opportunities – via ownership, management, control and skilling. Very simply, BEE is predicated on “outsourcing” opportunities to PDIs at certain minimum or acceptable levels or percentages – usually 25 – 30% of a total contract value.
Black		Mainly individuals of African descent; but also, commonly used as a short-form, to include those who may be classified as “coloured” (mixed race) or Indian.
DRPW	Department of Roads & Public Works	A leader in BEE, affirmative procurement nationally – and particularly in the construction sector
Emerging firms		Interchangeable with PDI firm or ABE – again, usually referring to smaller, under-resourced black/PDI-owned businesses
PDI (also HDI)	Previously Disadvantaged Individual (Historically Disadvantaged Individual)	Term that refers to Africans (77% of the total population) Asians (2.5%), and Coloureds (8.7%), all of whom were officially discriminated against in varying levels until the formal abolition of apartheid in 1994. Women of all races are also considered to be PDIs.