



LINKING SMMES TO PUBLIC SECTOR
PROCUREMENT: ***PROVINCIAL
GOVERNMENT GOODS AND SERVICES BUDGET***

Q2 ECONOMIC INTELLIGENCE REPORT
RESEARCH & DEVELOPMENT

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BACKGROUND

The phenomenon of localization, to the extent that it firstly supports resuscitation of the manufacturing sector and secondly supports development of the SMME sector, has become fundamental for the South African government. The Preferential Procurement Policy Framework Act is aimed at stimulating local procurement through public-sector procurement whilst the Local Procurement Accord negotiates committing both the private and public sectors to targets in respect of the localisation of procurement. By definition local content means that when a foreign company **makes products in a country**, the materials, parts, services or works etcetera must be made in that **country** rather than imported.

The nationally driven strategic infrastructure present investment opportunities to the SMME sector. The same is true regarding renewable energy projects, particularly for the Northern Cape Province. Six of the eighteen Strategic Integrated Projects (SIPs), intended to strengthen the delivery of basic services and to transform SA economic landscape whilst simultaneously creating significant numbers of new jobs are located in the Northern Cape. The Renewable Energy Independent Power Producer Procurement Programme (REIPPPP) which was designed to start and stimulate the renewable energy industry in South Africa, similarly has forty of the seventy six REIPPPP projects in the Bid Windows 1-4 located in the Northern Cape.

The important thing to note though is that localisation is used only in the context of the country with irrefutable deterring implications for development agendas of provinces. It is therefore a challenging provincial reality that these investment opportunities are confined to localisation in the national context to the detriment of province. Simply stated, localisation should ideally translate into provincialisation as far as the Northern Cape SMME development agenda is concerned. However the legislative framework guiding localisation hampers such efforts.

The Northern Cape Provincial Growth and Development Strategy cites the SMME sector as one of the strategic priority sectors for provincial growth and development. Whilst the realms of localisation frustrate provincial efforts towards growth and development of Northern Cape SMME sector, the strategic importance of public sector procurement, is often misjudged and undervalued, hence it is important for those making provincial government purchasing decisions to understand the economic value of their decisions. Provincial government as a limb of public sector procurement represents an important vehicle through which the objectives of provincialisation can be addressed and achieved.

Government is the country's largest buyer of goods and services. Thence provincial governments should drive their localisation (provincial context) efforts through provincial budgets. Meaningful participation of SMMEs within government supply chains can be attained by giving special consideration to goods and services that can be procured in huge quantities, which do not demand high or proficiency skills, technology or capital input. This is the best leverage for provincial government to promote localisation in the context of provinces.

In the 2014/15 financial year Northern Cape provincial departments spent R 445 million¹ on the fifteen most commonly purchased goods and services. In the outer years, the goods and services budget for these fifteen most commonly purchased items is projected at R348 million in 2016/17 and R369 million in 2017/18². Thus provincial government goods and services procurement budgets and plans are a great force for giving expression to government's policies and strategies in support of small business development. The development of a more SMME-friendly approach to provincial government procurement means SMMEs can maximize their potential for job creation, growth and innovation.

POLICY PERSPECTIVE

An important milestone was achieved in 1995 when government released its White Paper on the National Strategy for the Development and Promotion of small business in South Africa. The white paper emphasised the need for government to facilitate access to information and advice for small business and to boost procurement from small enterprises.

The policy environment for the promotion of small businesses was further strengthened by the NGP which clearly stipulates the goal of creating 5 million jobs by 2030, in order for this goal to be reached Social Partners must work together to strengthen local industry, support Small, Medium and Micro Enterprises [SMMEs] and encourage entrepreneurs. In his State of the Nation Address [2015], President Jacob Zuma also directed strong attention to unlocking the potential of SMMEs, Co-operatives as well as township and rural enterprises through a 30% target for designated categories of state procurement

In addition to the policies, strategies and initiatives which focus on various aspects of small business development a number of legislative frameworks for government supply chain management, have been put in place. Key legislation influencing public sector procurement includes the Public Finance Management Act 1 [PFMA] of 1999 which is the overarching framework for supply chain management in national and provincial government. The Act defines the principles of a procurement system as being fair, equitable, transparent, competitive and cost effective while the supply

¹ Amount only relates to the 15 most procured goods and services with SMME opportunities, and therefore excludes such items as operating leases, property payments and so on.

² Cost containment measures at play reason for the decrease.

chain management functions of local government are covered by The Municipal Finance Management Act 56 [MFMA] of 2003.

The Preferential Procurement Act [PPA] which was enacted in 2000, is premised on the recognition that government, as the largest buyer of goods and services in the economy, has the responsibility to leverage its purchasing power in support of the economic policy objectives of broad-based black economic empowerment, small enterprise development, and labour-intensive construction. Necessarily, the creation of new jobs or the intensification of labour absorption through the promotion of SMME's is advocated for in the Preferential Procurement Policy Framework Act 5 [PPFA] of 2000

Support of SMMEs for employment creation and economic development which was initially highlighted in the New Growth Path [NGP] has most recently been emphasized in the National Development Plan [NDP]. NDP as the roadmap of the country asserts that public and private procurement will be an essential stimulator of demand for small and expanding firms.

PURPOSE

The intention of this report is to analyse expenditure patterns of provincial departments' goods and services in order to identify opportunities to expand the presence of SMMEs through linkages to provincial government goods and services procurement. The analysis will point out where opportunities lie for local SMMEs through identification of fifteen [15] drivers of provincial goods and services' budget, that is the commonly purchased goods and services. The outer year budgets of provincial departments will also be analysed so that SMMEs are supported within these projected procurement budgets in relation to the most procured goods and services

The fifteen most procured goods and services should be targeted and prioritised based on the value of opportunity they represent such as employment and income generation potential as well as their alignment to sectors earmarked for stimulation of growth at the provincial government sphere.

METHODOLOGY

The expenditure analysis for Departments is drawn from the pre-audit IYM report in respect of the 2014/15 financial year, sourced from the Northern Cape Provincial Treasury and is representative of all the provincial departments, namely: Health, Transport, Safety & Liaison, Social Development, Agriculture, Sports, Arts & Culture, Economic Development & Tourism, Education, Environment & Nature Conservation, Co-operative Governance Human Settlements & Traditional Affairs, Provincial Treasury, Office of the Premier and Legislature.

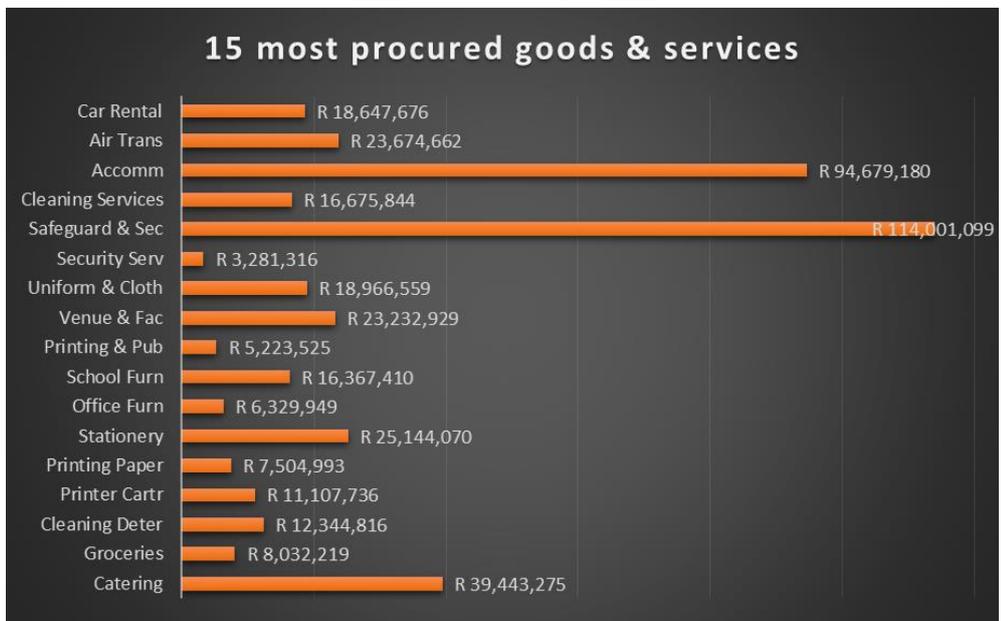
Policies, research reports and other documents relating to public sector procurement and small business development were reviewed and analysed. In addition legislative frameworks concerning government supply chain management, guidelines and practice notes released by National Treasury were also reviewed.

LIMITATIONS

It should also be noted that IYM data taken into account for the analysis of expenditure at provincial level is pre-audit.

FIFTEEN (15) MOST COMMONLY PURCHASED GOODS AND SERVICES ITEMS IN THE PROVINCE

According to the figure below, major cost drivers of government goods and services expenditure in the province are safeguard and security services at R 114 million, accommodation at R 95 million, stationery at R25 million, air transport and venue and facilities at R24 million each, furniture at R22 million (office furniture is modest at R6 million) and car rental and uniform and clothing at R19 million each. Security services can be said to be the least procured of the fifteen items, as it recorded expenditure amount of R3 million.



Source: Provincial Treasury 14/15 Pre-Audit IYM Report

Given the substantial amount spent on safeguarding and security services, this item of goods and services is worth noting. Safeguarding and security services entails the maintenance of safety and security in government buildings, through the control of access by security guards. It is due to the labour absorption capacity that expenditure on safeguarding and security services is said to worth noting. The three departments that were drivers of this expenditure item are Health (R62 million), Education (R20 million) and Social Development (R15 million). Together, the three departments accounted for 85% of the safeguarding and security expenditure.

Expenditure on accommodation and transport was also quite significant as it amounted to R138 million. Health is the biggest driver of expenditure on accommodation as it spent R36 million, over half the total provincial expenditure on the item. The substantial amounts spent on transport can partly be attributed to the vastness of the province and thence high costs associated with travelling.

Education was the major driver of expenditure in furniture (R22 million spent), specifically because it is the sole procurer of school furniture as an item. School furniture accounted for 73% (R16 million) of the total provincial expenditure on furniture. The rest of the funds were spent on procurement of office furniture (R6 million).

Stationery, printing paper and printer cartridges, considered as tools of trade, were commonly purchased across all departments. All together expenditure on these items amounted to R 38 million in the 2014/15 financial year.

Although expenditure is most likely to decrease in catering (as an item mostly targeted in cost containment), it must be noted that catering services were procured at R38 million. The major drivers of this expenditure were departments of Education (R11 million) and Health (R10 million), which together accounted for 61% of provincial catering expenditure.

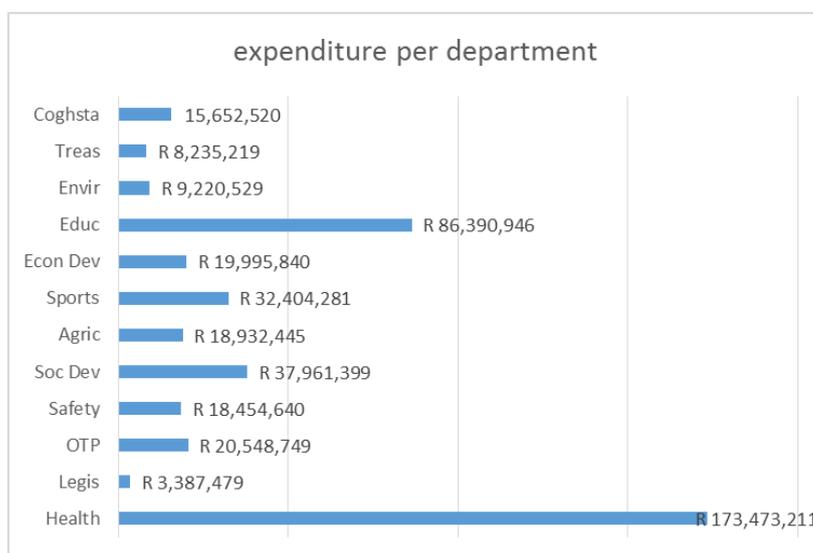
The three departments driving an expenditure amount of R19 million on the uniform and clothing item are Health (R9 million), Sports, Arts and Culture (R5 million) and Safety and Liaison (R2 million).

Given the volume and weight of provincial government expenditure, specifically on goods and service, it is of vital importance to improve the extent to which SMMEs have access to procurement opportunities. Whilst it is encouraged that SMMEs access these supply opportunities, this must be done price competitively. In other words, government should put in place measures to ensure SMMEs do not outsize profit margins to products supplied. Demand for locally sourced goods and services would not only support local industries but also promote competitiveness, innovation and distribution of wealth.

Comment [S1]: It must be noted that it is encouraged for SMMEs to access these supply opportunities. However, this must be done price competitively with no outsize profit margins added to such products e.g. loaf of bread costing R30 or R50 in terms of the Schools Nutrition/Feeding Programmes.

DISTRIBUTION OF EXPENDITURE ON THE 15 MOST PROCURED GOODS AND SERVICES ITEMS BY DEPARTMENT

The table below shows the distribution of expenditure on most commonly procured goods & services per department. Expenditure in the province is mainly driven by four [4] departments. Health: R 173 million; Education: R 86 million; Social Development: R 38 million and Sports, Arts & Culture: R 32 million. Collectively, these four departments account for 74.3% of provincial spending on the most procured goods and services items as listed in figure 1 above.



Source: Provincial Treasury 14/15 Pre-Audit IYM Report

The department of Health's share of expenditure is the highest compared to other departments. The second biggest contributor to provincial expenditure is Education at R 86 390 946.

EXPENDITURE ON THE 15 MOST PROCURED GOODS AND SERVICES ITEMS CLUSTERED PER SECTOR

In the main the fifteen most procured goods and services in the province fall within broad sectors, services, tourism and manufacturing. Bulk of procurement (almost half) is driven by items in the services, followed by tourism and lastly

manufacturing sectors. Table below, gives a breakdown of the procured items according to subsectors within the three mentioned broad sectors.

The Standard Industrial Classification was used to classify most commonly bought goods & services according to their various sectors and sub-sectors. This list excludes items like groceries, venues and facilities as the purpose of this report is to identify opportunities for SMMEs.

Commodity	Amount	Sector	Sub- Sector
Safeguard & Security	R114 001 099	Security & Investigation Activities	Private security activities
Accommodation	R94 679 180	Tourism	Short term accommodation activity
Catering	R 39 443 275	Event catering & other food services	Event catering
Uniform & Clothing	R 18 966 559	Manufacture of wearing apparel	Manufacture of wearing apparel except for fur apparel
Cleaning Detergents	R 12 344 816	Manufacture of other chemical products	Manufacture of soap, detergents
Air transport + Car rental	R 42 322 338	Travel Agency, Tour Operator, Reservation Services	Travel agency activities
Office Furniture	R 22 697 359	Manufacture of furniture	Manufacture of furniture
Stationery, Cartridge, Paper	R 43 756 799	Wholesale of household goods	Wholesale trade in books & stationery

Total

Source: Standard Industrial Classification

SERVICES

Current expenditure in the services sector is driven by Security & Investigation Activities, Catering, buying and selling furniture, wholesale in books and services. Ideally, to be able to deliver on the mandate of job creation, DEDaT should note the need to reengineer the procurement conditions of such items as furniture and stationery from buying, selling and distribution. There is an opportunity for local production of these and therefore SMMEs need to be supported to promote manufacturing in the province.

TOURISM

In the tourism sector the largest share of expenditure is mainly concentrated in the hospitality sub-sector, which includes accommodation services, travel agency, tour operator, food and beverages, meetings and event services. Given the volume of expenditure there is scope for SMMEs operating in the above-mentioned sub-sectors to grab opportunities which will ultimately diversify the local tourism sector and its related industries.

MANUFACTURING

The manufacturing sector is a prominent and valuable industry and can contribute immensely to economic growth and job creation, hence it was targeted as one of the six potential growth sectors in both the New Growth Path [NGP] and the NCPGDS. Provincial departments currently procure uniforms and cleaning detergents which fall into clothing and textile and chemical industries.

The substantial expenditure on uniform has positive implications for SMMEs in the clothing sector as it represents an opportunity to manufacture apparel and garments for health practitioners and officials in the police force to name but a few, thereby boosting employment generation potential. The soaps, perfumes, cosmetics, detergents, polishes & waxes sub-sector sector is a major contributor to technology and wealth-creation and also happens to be the largest and most important in the chemicals sector. Opportunities for SMMEs exist in the manufacturing of soap, other cleaning chemicals, polishes and waxes

What is key for Trade and Sector is to note the current provincial procurement conditions around furniture and stationery, cartridges and paper. These are currently traded on buying, selling and distribution. This presents opportunities for expansion in local manufacturing. Expenditure in furniture amounted to R 22 million in the past financial year which is quite substantial in SMME development. Given that the manufacturing is growing at a much slower pace in comparison to other sectors, considerations of such would be valuable.

INDICATIVE ALLOCATIONS OF THE 15 MOST PROCURED GOODS AND SERVICES

The table below shows the indicative budget allocations for the fifteen most procured goods and services by provincial departments, in respect of the 2 outer years of the 15/16 MTEF. Analysis of the indicative allocations indicated that provincial government expenditure will still be driven by these fifteen goods and services items as in the past financial year.

This is to show the opportunities for SMME development towards localization objectives in respect of these most procured items.

The decrease in the budgets can be mostly linked to the cost containment measures surrounding government budgets. The total goods and services budget for the 16/17 financial year are estimated at R349 million and R369 million in 17/18. The amount will increase by 6% between the two outer years.

Department	16/17	17/18	Year On Year % Change
Vote 1: OTP	R 48 048	R 50 464	5.3
Vote 2: Legislature	R 35 748	R 37 550	5
Vote 3: Safety	R 173 511	R 182 195	5
Vote 4: Education	R 343 438	R 352 643	2.6
Vote 5: Roads	R 975 353	R 1045 098	7.2
Vote 6: Econ Dev	R 82 080	R 86 183	5
Vote 8: Treasury	R 47 186	R 48 919	3.7
Vote 9: Coghsta	R 50 711	R 51 566	1.7
Vote10: Health	R 1339 779	R 1419 727	6
Vote11: Soc Dev	R 160 602	R 169 114	5.3
Vote12: Agric	R 192 658	R 210 283	9.2
Vote13: Environ	R 37 028	R 39 034	5.4
TOTAL	R 348 6142	R 369 2776	

Source: Northern Cape Provincial Treasury

Agriculture, Roads and Health made considerable provision for the payment of goods and services by making percentage increases of 9.2%, 7.2% and 6% respectively. The least growth was recorded by Education at 2.6% followed by Coghsta at 1.7%.

CONCLUSION & RECOMMENDATIONS

DEDaT is currently postured on four specific strategic pillars in this strategic cycle, namely manufacturing, job creation, rural development and localization. As far as localization is concerned, there tends to be a clash between national and provincial interventions, stemming from the legislated definition of local content. Outside of the investment opportunities within national projects, provincial government is the biggest driver of expenditure. Meaningful participation of SMMEs within government supply chains is the best vehicle towards localization in the context of the province (what is broadly called provincialisation). Whilst acknowledging one of the biggest challenges that SMMEs face when doing business with government, that is, late payment for goods and services rendered, it is comforting to note the regulatory evolution within the sector towards thirty day turnaround time for payment.

This report discussed the most commonly purchased goods and services, value of expenditure, major departments driving this expenditure and projected expenditure in the outer years. The broad sectors within which these items fall were also listed. Using provincial contracting as the best leverage, these sectors present opportunities for DEDaT to properly direct SMME development within the province in order to attain economic growth and job creation. Capitalising on these identified opportunities and driving departments should be done in full consideration of the prevalent capacity within the SMME sector, capacity gaps and training needs. Most importantly stringent controls should be in place to ensure pricing of supplied products is competitive with no outsized profit margins. It is thus recommended that Programme 2 and 3 note the contents of this report:

- In terms of the manufacturing sector, value chain opportunities for SMMEs are found in the manufacturing and supply of corporate clothing, manufacturing of furniture principally for use in schools and offices as well as the manufacturing of cleaning detergents. Substantial amounts spent on stationery, printing paper and cartridges also represent an opportunity for local SMMEs to produce these locally and thus benefit from provincial government procurement.

- In terms of tourism, opportunities exist to enhance the provincial tourism economy and its related industries by giving attention to the following activities and services: tour operators, events, Conference facilities, and accommodation and transport services.
- In terms of the services opportunities exist for SMMEs to generate income and possibly create jobs particularly given that the skill requirements of this sector are not extreme or intense.

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