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POTENTIAL MEASURES THAT CAN BE TAKEN TO USE PUBLIC PROCUREMENT TO STIMULATE THE SOCIAL ECONOMY IN SOUTH AFRICA – REVIEW OF LEGAL AND POLICY FRAMEWORK

black economic empowerment
local resources
service delivery
SMMEs
poverty alleviation
transfer
sustainability
co-operatives
job creation
social enterprises
growth opportunities
skills development
transformation
emerging contractors



dedt

DEPARTMENT :
Economic Development & Tourism
PROVINCE OF KWAZULU-NATAL

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Foreword

The South African government's New Growth Path (NGP), which identifies the social economy as having the potential to create 260,000 jobs in KwaZulu-Natal, specifically refers to the need to “encourage state procurement from, and service delivery through, organisations in the social economy”.

The International Labour Organization (ILO), in collaboration with other stakeholders, has embarked on a Public Procurement and Social Economy (PPSE) project that works both on the demand side (clarifying and influencing the interpretation of procurement regulations, and creating greater procurement opportunities) and the supply side (building the capacity of social economy enterprises to respond to these opportunities) of public procurement from the social economy.

Supply chain management in the public sector has evolved since the introduction of the Preferential Procurement Policy Framework Act, Act No. 5 of 2000 (PPPFA). New legal requirements in terms of the promotion of Black Economic Empowerment (BEE) through the promulgation of the Broad-Based Black Economic Empowerment Act, Act No. 53 of 2003 (BBBEEA) have been adopted to ensure that government assists the development of the local economy by investing funds into local businesses through its procurement activities.

However, the legal frameworks that govern public procurement are seen as barriers to advancing any public procurement strategies that target suppliers in the social economy.

The objectives of any targeted procurement policy must ensure that:

- The policy is simple so that it can be understood by everyone and is easy to apply;
- It meets all the legal requirements including provisions of the Constitution, PPPFA and BBBEEA to avoid or minimise any possible legal challenges; and
- It sets targets to be achieved so that performance can be measured through reliable monitoring mechanisms.

This report explores the potential to use public procurement to stimulate the social economy in South Africa. It seeks to analyse the implications of the legal frameworks and to recommend strategic sourcing interventions that can contribute to government's commitment to the following key priorities for procurement:

- Providing opportunities through black economic empowerment;
- Increasing use of local resources and emerging contractors;
- Promoting growth and ensuring sustainable small medium and micro enterprises (SMMEs);
- Contributing to socio-economic transformation;
- Creating opportunities for job creation and poverty alleviation;
- Commitment to skills development and transfer; and
- Fast-tracking service delivery.

More specifically, this report examines two aspects of the public procurement environment in KwaZulu-Natal. The first assesses whether there is sufficient stimulus for social enterprises to participate in public procurement opportunities in provincial departments and municipalities. The second looks at whether the legal environment is a barrier for social enterprises to engage in public procurement.



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1. Department of Trade and Industry
2. National Treasury
3. Statistics South Africa



KwaZulu-Natal Public Sector Institutions:

1. Legislature
2. Provincial Treasury
3. Department of Education
4. Department of Health
5. Department of Human Settlements
6. Department of Transport
7. Department of Agriculture
8. Department of Arts and Culture
9. Department of Economic Development and Tourism
10. Department of Social Development
11. Agri Business Development Agency
12. eThekweni Municipality
13. UMkhanyakude District Municipality



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Executive Summary

The International Labour Organization (ILO) has embarked on a project that explores the potential to use public procurement to stimulate the social economy in South Africa. It responds to the New Growth Path (NGP), which identifies the social economy as a sector with the potential to create 260,000 new jobs in KwaZulu-Natal, discussed in Chapters 1 and 2 of Part A of the report.

Chapter 3 of Part A reviews the research conducted to define a social enterprise. The definition that is applied by the ILO for organisations which “are businesses with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners” is applicable within the South African context. There is no specific reference to social enterprises in the PPPFA and BBBEEA. These enterprises are predominantly classified as SMMEs, co-operatives and emerging micro-enterprises. They normally operate in the community sector, personal services sector, agricultural sector and tourism sector.

The legal frameworks and relevant case law applicable to public procurement and social enterprises are evaluated in Chapters 1 to 4 of Part B of the report, with an emphasis on supply chain management practices in KwaZulu-Natal. The research conducted highlights that, while there are Constitutional imperatives to address poverty and unemployment through public procurement interventions, (the PPPFA, BBBEEA and the National Treasury’s Supply Chain Management (SCM) Practice Notes), these have very little impact on the expected outcomes and have created entry barriers for social enterprises in the public procurement arena. For example, Practice Note Number SCM 002 of 2006, which regulates the prohibition of set-asides, is considered to be the biggest barrier for social enterprises in public procurement.

Interestingly, the Construction Industry Development Board (CIDB) introduced Practice Note Number 29 in July 2012 to address the allocation of sustainable work opportunities to emerging contractors in its Contractor Development Programme (CDP). The legal opinion obtained by the board confirms that the interpretation of Practice Note Number SCM 002 of 2006 may only be applied, in its strictest form, in the absence of an approved policy framework that applies to specific development programmes. This provides an opportunity for the Department of Trade and Industry (the dti) to develop and implement a policy framework that governs the use of social enterprises in public procurement to advance government’s policy directive to reduce poverty and unemployment as articulated in the NGP.

While Practice Note Number SCM 008 of 2007 does provide an avenue for social enterprises to participate in public procurement through the compilation of a list of prospective suppliers per commodity or type of service, it is considered unfair for all suppliers to compete for goods and services irrespective of their size or classification.

For example, a community catering enterprise, classified as a social enterprise is expected to compete with a large established catering enterprise. It is recommended that prospective suppliers be further categorised based on size and capacity. Prospective suppliers then compete for public procurement within these categories. While the rotation of suppliers is considered fair in providing equity and transparency as envisaged by the Constitution, the disadvantage is that the sustainability of social enterprises may be affected as there may not be any guarantees for continuous contracts to be awarded over a given period.

The analysis of historical spend in KwaZulu-Natal in Chapter 4 of Part B shows that the status quo remains largely unchanged from 2005 to 2009 in that almost 75 percent of the number of suppliers in KwaZulu-Natal were small to survivalist, but only about 25 percent of the province’s procurement spend was paid to these entities. These statistics confirm that the Preferential Procurement Objectives introduced as a targeted procurement strategy to:

- Develop SMMEs and bring more sustainable opportunities to micro and survivalist enterprises;
- Transform the second economy; and
- Dramatically narrow the gap between the first and second economies, has not been achieved.

Furthermore, the historical spend analysis indicates that the suppliers in the small category received R60,310 on average for one year, while suppliers in the medium to large category received R583,949 on average for

one year, and suppliers in the large established category received R9,816,259 on average for one year, for goods and services rendered.

While past performance appears to have had minimal impact on government's policy priorities, government institutions remain committed to supporting social enterprises in public procurement in KwaZulu-Natal. The results of the survey conducted, outlined in Chapter 4 of Part B, identified catering/school nutrition, recycling, construction, education/skills development, weed killing, community services, food security, waste management, childcare/crèches, agriculture, arts and culture, healthcare, road maintenance, hospital laundry services, crime prevention, security, transportation and distribution, and garden services as possible goods and services that may be acquired from social enterprises.

Part D of this report proposes the following recommendations to provide an enabling environment to allow public procurement to stimulate the social economy:

1. Policy Frameworks

The dti should develop and implement a policy framework to advance sustainable work opportunities for social enterprises as part of a local economic development programme.

National Treasury should conduct a thorough review of the SCM legal and policy frameworks to incorporate an exemption for social enterprises from:

- Submitting tax clearance certificates;
- Submitting BBBEE certificates as an emerging micro enterprise (EME);
- Prohibiting set-asides for procurement that has a social impact; and
- Competitive bidding processes for procurement that has a social impact.

A separate SCM policy framework should be developed for social enterprises that simplifies the procurement process and incorporates a step-by-step procedure manual that ensures transparency in inviting quotations through appropriate advertising media, evaluation and awarding of quotations/bids to social enterprises.

2. Market Research

A thorough spend analysis should be conducted to establish spending patterns by provincial and local government in the commodities/services that KwaZulu-Natal provincial departments identified as opportunities for public procurement to stimulate the social economy.

3. Database of Social Enterprises

A formal registration process should be embarked on to pre-approve and register social enterprises on a provincial supplier database. The database should allow for public sector institutions to access social enterprises by type of enterprise, size of enterprise, type of commodity or service offered, and geographical area. The social enterprise supplier database should provide for categories of suppliers that can compete within a category but not across categories. For example, community caterers can compete with each other but should not compete with large, established caterers whether white or black. The number of people being catered for could be used as a criterion for categorisation.

4. Recommended Sourcing Strategy

KwaZulu-Natal Provincial Treasury should identify commodities/services that can be offered by social enterprises on transversal contracts and engage with departments and municipalities to participate on them in terms of Regulation 16A6.5 and 16A6.6 of the Treasury Regulations, 2005. A pilot exercise should be conducted to test this sourcing strategy.

5. Training

Training should be provided by KwaZulu-Natal Provincial Treasury to all SCM practitioners in KwaZulu-Natal to ensure compliance with this policy and procedure framework and to obtain a commitment to acquire goods and/or services from social enterprises.

Training should be provided by KwaZulu-Natal Department of Economic Development to all social enterprises on business related issues.

6. Monitoring and Evaluation

Targets for procurement spend should be set for each participating institution per commodity/service to ensure sustainability of the social enterprises is achieved.

Targets for job creation should be set for social enterprises to measure the impact of public procurement on the social economy.

A reporting tool should be designed for social enterprises and institutions to report on actual achievements monthly or quarterly.

In conclusion, Phoebe Bolton, writing in the Journal of Public Procurement, 2006, Volume 6, issue 3, 193-217, reasons: "The use of government procurement as an instrument of policy is not without controversy. On the whole, however, particularly in the South African context, procurement as a policy tool can be said to be justified. Even though there are time and cost premiums attached to the use of procurement as an empowerment tool these are, to a large extent, outweighed by the fact that it is not only the owners of affirmative businesses that benefit but also their workforce. This, in turn, leads to job creation and economic development. Affirmative procurement also does not amount to infringement of the right to equality in section 9 of the Constitution."

Abbreviations

BBBEEA	Broad-Based Black Economic Empowerment Act, Act No. 53 of 2003
BBBEE	Broad Based Black Economic Empowerment
BEE	Black Economic Empowerment
CDP	Contractor Development Programme
CIDB	Construction Industry Development Board
Constitution	Constitution of the Republic of South Africa, Act No. 108 of 1996
the dti	Department of Trade and Industry
EME	Emerging Micro Enterprise
HDI	Historically Disadvantaged Individual
ILO	International Labour Organization
MFMA	Municipal Finance Management Act, Act No. 56 of 2003
NGO	Non-governmental Organisation
NGP	New Growth Path
PAYE	Pay-As-You-Earn
PFMA	Public Finance Management Act (No. 1 of 1999)
PPPFA	Preferential Procurement Policy Framework Act, Act No. 5 of 2000
PPSE	Public Procurement and Social Economy
QSE	Qualifying Small Enterprise
RDP	Reconstruction and Development Plan
SARS	South African Revenue Service
SASSA	South African Social Security Agency
SBD	Standard Bidding Document
SCM	Supply Chain Management
SMME	Small, Medium and Micro Enterprise
R	Rand (South African currency)
VAT	Value-Added Tax



PART A: **INTRODUCTION**



Chapter 1:

Purpose of this Research

This research aims to improve the understanding of the South African legal and policy context of the social economy and thereby increase legal and policy effectiveness in promoting the sector. First the term “social economy” is defined. Then, the range of legal and policy responses to the social economy is reviewed. The interface between the legal prescripts, policy and social economy is examined with particular reference to provincial departments and municipalities in KwaZulu-Natal to identify potential measures to use public procurement to stimulate the social economy.

The following research questions are addressed in this report:

TABLE 1: RESEARCH QUESTIONS

RESEARCH QUESTION	SECTION IN THIS REPORT
Which policies, laws and regulations need to be taken into account when considering the scope of using public procurement to stimulate the social economy in South Africa?	Part B: Chapters 1, 2 and 3
What are the implications of the policies, laws and regulations identified?	
What examples in South Africa illustrate the use of public procurement to stimulate the social economy, and to what extent are these consistent with the policies, laws and regulations identified?	Part B: Chapter 4
Which of the interventions identified would be consistent with the policies, laws and regulations identified?	
Which types of interventions aimed at using public procurement to stimulate the social economy are theoretically possible?	
Of the interventions that are both possible and consistent with the policies, laws and regulations identified, which are most likely to be easily implemented and effective in stimulating the social economy in South Africa?	

Chapter 2:

The New Growth Path

Given the high levels of unemployment and poverty in South Africa, the government has developed the New Growth Path (NGP), which sets out a vision to create five million new jobs by 2020 through increasing the economy's labour-absorbing capacity and decreasing its carbon-emission intensity. The NGP, released in 2010, complements the National Development Plan 2030. It targets specific sections of the population such as women, black South Africans, workers, the rural population and young people. Thus, the provincial commitments to job creation are well set out in provincial growth and development strategies. In response, KwaZulu-Natal has developed a number of strategies to grow the economy and contribute to the national vision of creating five million jobs by 2020.

The Premier of KwaZulu-Natal, Dr Zweli Mkhize, further stated in his 2012 State of the Province address: "The effort to grow the economy of our province will, for the foreseeable future, be a result of the combined investment of national departments and parastatals, provincial and local government and the private sector. The majority of job opportunities will be created by the private sector, particularly the small business sector. The submission I wish to table will cover the breadth of these efforts that result from government having created an enabling environment in which the investments are encouraged by the boldness of government spending decisions that unlock opportunities for sustained growth. The total pipeline investment going to all the districts in KwaZulu-Natal ranges between R3 billion to R8 billion for each district, except Uthukela, Uthungulu and eThekweni with more than R20 billion because of special projects in those areas."

According to Mike Mabuyakhulu, MEC for the Department of Economic Development in KwaZulu-Natal, "economic growth in KwaZulu-Natal remains subdued as a result of factors such as the Euro debt crisis, low global consumer confidence and slow domestic investment. The province posted a growth rate of 3.3% in the fourth quarter of 2011 following a growth rate of 2.3% (revised from 2.0%) in the third quarter. The provincial growth rate is slightly above the national growth rate of 3.2%. The average quarterly growth rate for KwaZulu-Natal in 2011 was 2.8% which is too low to sustain the extent of job creation which the province aims to pursue. He quoted that the unemployment rate grew from 19.3% in the fourth quarter to 20.5% in the first quarter. In order to meet the New Growth Path's job creation targets, the province needs to consistently achieve growth rates in excess of 6%."

The National Treasury document on "confronting youth unemployment: policy options for South Africa" also articulates the New Growth Path call for creative and effective strategies to create new jobs. The political will to decrease the inequalities in socio-economic opportunities for all citizens in KwaZulu-Natal, and indeed the rest of South Africa, is strong. With government being the biggest buyer of goods and services in the country, how can public procurement be used to ensure transformation in the social economy?

Chapter 3:

The Social Economy: A third sector in economies

There is no single definition of the social economy. A regional ILO conference in October 2009 on the social economy as a response to the economic crisis in Africa defined it as “a concept designating enterprises and organisations, in particular co-operatives, mutual benefit societies, associations, foundations and social enterprises, which have the specific feature of producing goods, services and knowledge while pursuing both economic and social aims and fostering solidarity” (ILO, 2009).

The New Growth Path states that “the social economy includes a myriad of not-for-profit institutions that provide goods and services, including co-ops, non-governmental organisations (NGOs) and stokvels [informal saving clubs].” For the purposes of the PPSE project, it should be assumed that the social economy includes all social purpose enterprises, including all co-operatives that adhere to the co-operative principles, non-profit organisations that provide goods and/or services and that earn a substantial portion of their income, and other social enterprises that apply at least 50 percent of profits for their social purpose.

The social economy spans economic activity in the community, voluntary and social enterprise sectors. The social economy usually develops because of a need to find new and innovative solutions to economic, social and environmental issues and to satisfy the needs of members and users that have been ignored or inadequately fulfilled by the private or public sectors.

According to Wikipedia, Economies may be considered to have three sectors:

1. The business private sector, which is privately owned and profit motivated;
2. The public sector, which is owned by the state on behalf of the people of the state; and
3. The social economy that embraces a wide range of community, voluntary and not-for-profit activities.

The third sector can be broken down into three sub-sectors, the community sector, the voluntary sector and the social enterprise sector:

The community sector includes those organisations active on a local or community level, usually small, modestly funded and largely dependent on voluntary, rather than paid, effort. Examples include neighbourhood watch, small community associations, civic societies, and small support groups.

The voluntary sector: The UK’s National Council for Voluntary Organisations describes the voluntary sector as including those organisations that are formal (they have a constitution), independent of government and self-governing, not-for-profit and operate with a meaningful degree of volunteer involvement. Examples include housing associations, large charities, large community associations and national campaign organisations.

Social enterprise sector: According to the UK government’s definition, the social enterprise sector includes organisations which “are businesses with primarily social objectives whose surpluses are principally reinvested

for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners. Examples include co-operatives, building societies, development trusts and credit unions”.

While these definitions are applied by the ILO and UK Government, they are applicable in the South African context. The PPPFA and BBBEEA do not specifically reference social enterprises. However, these enterprises are predominantly classified as SMMEs, co-operatives and EMEs. They normally operate in the community sector, personal services sector, agricultural sector and tourism sector.

By using solutions to achieve not-for-profit aims, it is generally believed that the social economy has a distinct and valuable role to play in helping to create a strong, sustainable, prosperous, and inclusive society.

PART B: **RESEARCH
CONDUCTED**



Chapter 1:

Legal Prescripts

This section looks at which policies, laws and regulations need to be taken into account when considering the scope of using public procurement to stimulate the social economy in South Africa and to investigate their implications.

CONSTITUTIONAL PROVISIONS

Public procurement is governed by section 217(1) of the Constitution of the Republic of South Africa, Act No. 108 of 1996 (“the Constitution”), which prescribes the manner in which organs of state should procure goods and services. In particular, the Constitution prescribes that organs of state must do so in accordance with a system that is fair, equitable, transparent, competitive and cost-effective. In essence, all organs of state when engaging in procurement must conform to the said constitutional prescripts.

Subsection 217(2) indicates that Section 217(1) does not prevent the organs of state or institutions referred to in that subsection from implementing a procurement policy providing for:

- Categories of preference in the allocation of contracts; and
- The protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination.

Section 217(3) of the Constitution further confers an obligation for national legislation to prescribe a framework that provides for preferential procurement to address the social and economic imbalances of the past.

The five criteria (fair, equitable, transparent, competitive and cost effective) are set for the public procurement system as a whole, as well as for each individual procurement decisions. Both the promulgation of legislation and the awarding of a tender that clash with these five criteria would be unconstitutional, and therefore legally invalid.

This legality is tested at two levels: the regulatory level and the procurement process level. The level of actual procurement processes comprises decisions by end-users, bid committees and procurement officials to buy a good or service from a specific supplier. These are administrative actions as contemplated in the Promotion of Administrative Justice Act, No. 3 of 2000.

It is necessary to know what the five principles mean to determine possible synergies and conflicts between them.

Fairness, is a basic concept not only in public procurement, but in all government actions.

Bolton (2007:46) explains the dictionary meanings of the word: “Most relevant to the government procurement context are arguably the following: free from discrimination, just and appropriate in the circumstances, impartial, in conformity with rules or standards, treating people equally, unbiased, uncorrupted, and unprejudiced.” This

may be read with the following description from a World Bank Manual on Procurement (2001: xx). “Good procurement is impartial, consistent, and therefore reliable. It offers all interested contractors, suppliers and consultants a level playing field on which to compete and thereby directly expands the purchaser’s options and opportunities.” According to Pauw and Wolvaardt (2009:73) “fairness relates to getting what you deserve: procedural justice and just allocation. Procedural justice itself also has two parts, namely the fairness of the steps in the procedure and secondly the absence of partiality, bias or prejudice”.

Equity is applied when equal treatment on a numerical basis is allocated. In South Africa, certain groups were placed at a disadvantage by apartheid, and are now declared as designated groups.

Transparency is necessary for the open society that the Constitution purports to establish (Bolton 2007:53). In World Bank guidelines, transparency of tenders requires advertising, pre-disclosure, public bid opening, accessibility of policies and regulations, use of standard bidding and contract documents, appeal mechanisms, debriefing and publication of awards. Reliable and open information about government procurement contributes to better service delivery and promotes commercially viable enterprises.

Competitiveness requires that a sufficient number of suppliers should be afforded the opportunity to bid for goods and/or services on offer. Competitiveness means that contracts are awarded on merit on level playing fields.

Cost-effectiveness increases the public benefits derived from the spending of public money. Pauw *et al* (2009:76) understand the term to be a synonym for efficiency. Increased efficiency means doing more with the same resources. Cost-effectiveness is particularly relevant where resources are limited.

In terms of Section 217 of the Constitution, fairness, equity and transparency can be characterised as affirmative action, while free-market thinking is specifically represented by transparency, competitiveness and cost-efficiency. However, Section 217 (2) and (3) specifically provide for introducing preferential procurement policies to advance the social economy.

The promulgation of the following Acts and Regulations are an attempt to address this issue and the imbalances of the past.

- Preferential Procurement Policy Framework Act, No. 5 of 2000 (PPPFA);
- Preferential Procurement Regulations, 2001;
- Broad Based Black Economic Empowerment Act, No. 53 of 2003 (BBBEEA); and
- Preferential Procurement Regulations, 2011.

PPPFA AND BBBEE PROVISIONS

The Preferential Procurement Policy Framework Act, 2000 (Act 5 of 2000) (PPPFA) and its accompanying Regulations were promulgated to prescribe a framework for a preferential procurement system to give effect to section 217(3) of the Constitution.

The PPPFA and its 2001 Regulations provided for the implementation of a preference point system in allocating contracts for categories of service providers and the promotion of goals, including socio-economic goals, to advance the interest of people disadvantaged by unfair discrimination on the basis of race, gender or disability and implementing the programmes of the Reconstruction and Development Programme (RDP).

Bids or proposals with a value equal to or above R30,000 are to be evaluated on the basis of price as well as the achievement of specified preferential procurement goals. The Act and its Regulations provided for the following preference points system:

- Bids/quotations with an estimated value equal to or above R30,000 and up to R500,000 will use the 80/20 preferential point system.
- Bids/proposals with an estimated value above R500,000 will use the 90/10 preferential point system.

Section 17(3) of the Act draws attention to the awarding of preference points in favour of Historically Disadvantaged Individuals (HDIs). The 20/10 points would be allocated to specific goals being:

1. The promotion of South African-owned enterprises;
2. The promotion of export-orientated production to create jobs;
3. The promotion of SMMEs;
4. The creation of new jobs or the intensification of labour absorption;
5. The promotion of enterprises located in a specific province for work to be done or services to be rendered in that province;
6. The promotion of enterprises located in a specific region for work to be done or services to be rendered in that region;
7. The promotion of enterprises located in a specific municipality for work to be done or services to be rendered in that municipality;
8. The promotion of enterprises located in rural areas;
9. The empowerment of the workforce by standardising the level of skill and knowledge of workers;
10. The development of human resources, including by assisting in tertiary and other advanced training programmes, in line with the key indicators such as percentage of wage bill spent on education and training and improvement of management skills; and
11. The uplifting of communities through, but not limited to, housing, transport, schools, infrastructure donations, and charitable organisations.

The Act defines BEE as “an integrated and coherent socio-economic process that directly contributes to the economic transformation of South Africa and brings about significant increases in the numbers of black people that manage, own and control the country’s economy, as well as significant decreases in the income inequalities”. The BBBEEA defines “black people” as a generic term, which means blacks, coloureds and Indians.

The BBBEEA allows the Minister of Trade and Industry to issue codes of practice that could include “qualification criteria for preferential purposes for procurement and other economic activities”. Where BEE should at all times be included as a priority, at least until certain prescribed targets have been achieved, allowance should also be made for pursuing other policy priorities through the PPPFA (such as job creation and SMME development).

The codes issued in terms of the BBBEEA have nine subsections:

- Code 000: Framework for Measuring Broad-Based Black Economic Empowerment.
- Code 100: Measurement of the Ownership Element of Broad-Based Black Economic Empowerment.
- Code 200: Measurement of the Management Control Element of Broad-Based Black Economic Empowerment.
- Code 300: Measurement of the Employment Element of Broad-Based Black Economic Empowerment.
- Code 400: Measurement of the Skills Development Element of Broad-Based Black Economic Empowerment.
- Code 500: Measurement of the Preferential Procurement Element of Broad-Based Black Economic Empowerment.
- Code 600: Measurement of the Enterprise Development Element of Broad-Based Black Economic Empowerment.
- Code 700: Measurement of the Socio-Economic Development Element of Broad-Based Black Economic Empowerment.
- Code 800: Measurement of Qualifying Small Enterprises of Broad-Based Black Economic Empowerment.

Broad-based black economic empowerment is measured using seven pillars, each with a relative weighting. Unlike narrow based empowerment, ownership and management account for only 30 percent of the total contribution.

- Direct Empowerment:
 - Equity Ownership – 20 percent
 - Management – 10 percent;

- Indirect Empowerment:
 - Employment Equity – 15 percent
 - Skills Development – 15 percent
 - Preferential Procurement – 20 percent
 - Enterprise Development – 15 percent
 - Socio-economic Development – 5 percent;
- In terms of the Codes of Good Practice for Black Economic Empowerment all enterprises in South Africa are divided into one of three categories: Generic Enterprises – turnover greater than R35 million;
- Qualifying Small Enterprises (QSEs) – turnover between R5 million and R35 million; and
- Exempted Micro Enterprises (EMEs) – turnover less than R5 million.

Each of these categories has different sets of measurement criteria.

Generic Enterprises are those enterprises that have a turnover of greater than R35 million. It is estimated that only four percent of South African enterprises fall into this category. **Generic enterprises** must apply all seven pillars of BBBEE to calculate their score as per the Generic Scorecard. Generic Enterprises must apply Code 000-700 of the Act and apply stringent reporting techniques.

Qualifying Small Enterprises are enterprises with a turnover between R5 million and R35 million. These enterprises apply code 800 to calculate their scorecards. Code 800 is a simplified version of Code 000-700 and includes less stringent scorecards for each element. QSEs can choose the best four of their seven elements, with each element accounting for 25 percent of their scorecard out of 100.

While code 800 is a simplified version of the other seven pillars, it has been ruled by the dti that any issues not specifically discussed in Code 800 should be applied as per Code 100-700.

Exempted Micro Enterprises are enterprises with a turnover of less than R5 million. EMEs do not need to be rated, but they need to be able to provide reasonable evidence that they are EMEs. EMEs automatically qualify as 100 percent contributors towards preferential procurement.

If they are greater than 50 percent black owned, EMEs qualify as 110 percent contributors towards preferential procurement. Most social enterprises will qualify as EMEs.

These requirements played a large part in the amendments to the PPPFA Regulations, 2001. Revised Regulations that accompany the PPPFA were issued in June 2011, and became effective on 7 December 2011. These regulations provide for preference points to be allocated against a BBBEE score that is issued by an Accredited Verification Agency in line with the provisions of the BBBEEA.

Bids or proposals with a value equal to or above R30,000 are to be evaluated on the basis of price as well as the achievement of specified preferential procurement goals. The Act and its Regulations provide for the following preference points system:

- Bids/quotations with an estimated value equal to or above R30,000 and up to R1 million will use the 80/20 preferential point system.
- Bids/proposals with an estimated value above R1 million will use the 90/10 preferential point system.

The government procurement system attempts to strike a balance in quantitative terms between equity, cost-effectiveness and competitiveness. This is achieved by a prescribed set of formulae (South Africa 2000a, 2001). The price formulae resulting from the Preferential Procurement Policy Framework Act, No. 5 of 2000 either has the parameters of 90 and 10, or 80 and 20. For smaller contracts, the targeted procurement impact is stronger (25 percent) than for bigger contracts (11 percent).

The 20 and 10 points must be allocated as follows (Generic Score Card):

TABLE 2: GENERIC SCORECARD

BBBEE STATUS LEVEL OF CONTRIBUTOR	NUMBER OF POINTS (90/10 SYSTEM)	NUMBER OF POINTS (80/20 SYSTEM)
1	10	20
2	9	18
3	8	16
4	5	12
5	4	8
6	3	6
7	2	4
8	1	2
Non-Contributor	0	0

The following sensitivity analysis demonstrates that while preference points do give their recipients an advantage for procurement, price is a major determinant in both the 80/20 and 90/10 preference points system.

The 80/20 Preference Points System

Four quotations have been submitted and are evaluated against the 80/20 principle. The price quoted by the supplier in Quote 1 is R700,000, in Quote 2 is R800,000, in Quote 3 is R900,000 and in Quote 4 is R999,000. To demonstrate the effect of the preference points in relation to the price quoted by a supplier, four different scenarios have been created. In each scenario only one supplier is a level 1 BBBEE compliant supplier and the other three are non-compliant suppliers.

However, the price quoted by the compliant supplier ranges from the lowest price to the highest price (see Table 3).

TABLE 3: 80/20 PREFERENCE POINTS SENSITIVITY ANALYSIS

SCENARIO 1				
80/20	Quote 1	Quote 2	Quote 3	Quote 4
Price	R700,000	R800,000	R900,000	R999,000
Preference Points	20	0	0	0
SCENARIO 2				
80/20	Quote 1	Quote 2	Quote 3	Quote 4
Price	R700,000	R800,000	R900,000	R999,000
Preference Points	0	20	0	0
SCENARIO 3				
80/20	Quote 1	Quote 2	Quote 3	Quote 4
Price	R700,000	R800,000	R900,000	R999,000
Preference Points	0	0	20	0
SCENARIO 4				
80/20	Quote 1	Quote 2	Quote 3	Quote 4
Price	R700,000	R800,000	R900,000	R999,000
Preference Points	0	0	0	20

Figure 1 details the results of the calculation for each scenario:

Scenario 1

Bidder	Q1	Q2	Q3	Q4
Score for price	700,000	800,000	900,000	999,000
Total points for price	80.00	68.57	57.14	45.83
Points scored for BBBEE				
Level 1	20	20.00		
Level 2	18			
Level 3	16			
Level 4	12			
Level 5	8			
Level 6	6			
Level 7	4			
Level 8	2			
Non-contributor	0	0.00	0.00	0.00
Total points for BBBEE	20.00	0.00	0.00	0.00
Total points scores	100.00	68.57	57.14	45.83
Ranking	1	2	3	4

Scenario 2

Bidder	Q1	Q2	Q3	Q4
Score for price	700,000	800,000	900,000	999,000
Total points for price	80.00	68.57	57.14	45.83
Points scored for BBBEE				
Level 1	20	20.00		
Level 2	18			
Level 3	16			
Level 4	12			
Level 5	8			
Level 6	6			
Level 7	4			
Level 8	2			
Non-contributor	0	0.00	0.00	0.00
Total points for BBBEE	0.00	20.00	0.00	0.00
Total points scores	80.00	88.57	57.14	45.83
Ranking	2	1	3	4

Scenario 3

Bidder	Q1	Q2	Q3	Q4
Score for price	700,000	800,000	900,000	999,000
Total points for price	80.00	68.57	57.14	45.83
Points scored for BBBEE				
Level 1	20		20.00	
Level 2	18			
Level 3	16			
Level 4	12			
Level 5	8			
Level 6	6			
Level 7	4			
Level 8	2			
Non-contributor	0	0.00	0.00	0.00
Total points for BBBEE	0.00	0.00	20.00	0.00
Total points scores	80.00	68.57	77.14	45.83
Ranking	1	3	2	4

Scenario 4

Bidder	Q1	Q2	Q3	Q4
Score for price	700,000	800,000	900,000	999,000
Total points for price	80.00	68.57	57.14	45.83
Points scored for BBBEE				
Level 1	20			20.00
Level 2	18			
Level 3	16			
Level 4	12			
Level 5	8			
Level 6	6			
Level 7	4			
Level 8	2			
Non-contributor	0	0.00	0.00	0.00
Total points for BBBEE	0.00	0.00	0.00	20.00
Total points scores	80.00	68.57	57.14	65.83
Ranking	1	2	4	3

FIGURE 1: 80/20 PREFERENCE POINTS SENSITIVITY ANALYSIS

In Scenario 1 the supplier with the highest preference points and lowest price is ranked first. In Scenario 2, the supplier with the highest preference points is ranked second even though his price is not the lowest. In Scenario 3, the supplier with the highest preference points improves his position from third to second place, although his price is the second highest. Similarly, in Scenario 4, the supplier with the highest preference points improves from fourth to third position. Consequently, based on this analysis it is evident that the principles inherent in the Preferential Procurement Policy Framework Act, which seeks to provide BBBEE Compliant suppliers with an advantage, holds true only if a competitive price is offered.

90/10 Preference Points System

Four bids have been submitted and are evaluated against the 90/10 principle. The price quoted in Bid 1 is R1.5 million, in Bid 2 is R1.6 million, in Bid 3 is R1.7 million and in Bid 4 is R1.8 million. To demonstrate the effect of the preference points in relation to the price quoted by a supplier, four different scenarios have been created. In each scenario only one supplier is a level 1 BBBEE compliant supplier and the other three are non-compliant suppliers.

However, the price quoted by the compliant supplier ranges from the lowest price to the highest price (see Table 4).

TABLE 4: 90/10 PREFERENCE POINTS SENSITIVITY ANALYSIS

SCENARIO 1				
90/10	Bid 1	Bid 2	Bid 3	Bid 4
Price	R1,500,000	R1,600,000	R1,700,000	R1,800,000
Preference Points	10	0	0	0
SCENARIO 2				
90/10	Bid 1	Bid 2	Bid 3	Bid 4
Price	R1,500,000	R1,600,000	R 1,700,000	R1,800,000
Preference Points	0	10	0	0
SCENARIO 3				
90/10	Bid 1	Bid 2	Bid 3	Bid 4
Price	R1,500,000	R1,600,000	R1,700,000	R1,800,000
Preference Points	0	0	10	0
SCENARIO 4				
90/10	Bid 1	Bid 2	Bid 3	Bid 4
Price	R1,500,000	R1,600,000	R1,700,000	R1,800,000
Preference Points	0	0	0	10

Figure 2 details the results of the calculation for each scenario.

Scenario 1

Bidder	B1	B2	B3	B4
Score for price	1,500,000	1,600,000	1,700,000	1,800,000
Total points for price	90.00	84.00	78.00	72.00
Points scored for BBBEE				
Level 1	20	10.00		
Level 2	18			
Level 3	16			
Level 4	12			
Level 5	8			
Level 6	6			
Level 7	4			
Level 8	2			
Non-contributor	0	0.00	0.00	0.00
Total points for BBBEE	10.00	0.00	0.00	0.00
Total points scores	100.00	84.00	78.00	72.00
Ranking	1	2	3	4

Scenario 2

Bidder	B1	B2	B3	B4
Score for price	1,500,000	1,600,000	1,700,000	1,800,000
Total points for price	90.00	84.00	78.00	72.00
Points scored for BBBEE				
Level 1	20		10.00	
Level 2	18			
Level 3	16			
Level 4	12			
Level 5	8			
Level 6	6			
Level 7	4			
Level 8	2			
Non-contributor	0	0.00	0.00	0.00
Total points for BBBEE	0.00	10.00	0.00	0.00
Total points scores	90.00	94.00	78.00	72.00
Ranking	2	1	3	4

Scenario 3

Bidder	B1	B2	B3	B4
Score for price	1,500,000	1,600,000	1,700,000	1,800,000
Total points for price	90.00	84.00	78.00	72.00
Points scored for BBBEE				
Level 1	20		10.00	
Level 2	18			
Level 3	16			
Level 4	12			
Level 5	8			
Level 6	6			
Level 7	4			
Level 8	2			
Non-contributor	0	0.00	0.00	0.00
Total points for BBBEE	0.00	0.00	10.00	0.00
Total points scores	90.00	84.00	88.00	72.00
Ranking	1	3	2	4

Scenario 4

Bidder	B1	B2	B3	B4
Score for price	1,500,000	1,600,000	1,700,000	1,800,000
Total points for price	90.00	84.00	78.00	72.00
Points scored for BBBEE				
Level 1	20			10.00
Level 2	18			
Level 3	16			
Level 4	12			
Level 5	8			
Level 6	6			
Level 7	4			
Level 8	2			
Non-contributor	0	0.00	0.00	0.00
Total points for BBBEE	0.00	0.00	0.00	10.00
Total points scores	90.00	84.00	78.00	82.00
Ranking	1	2	4	3

FIGURE 2: 90/10 PREFERENCE POINTS SENSITIVITY ANALYSIS

In Scenario 1 the supplier with the highest preference points and lowest price is ranked first. In Scenario 2, the supplier with the highest preference points is ranked second even though his price is not the lowest. In Scenario 3, the supplier with the highest preference points improves his position from third to second place, although his price is the second highest. Similarly, in Scenario 4, the supplier with the highest preference points improves from fourth to third position. Consequently, based on this analysis it is evident that the principles inherent in the Preferential Procurement Policy Framework Act, which seeks to provide BBBEE Compliant suppliers with an advantage, holds true only if a competitive price is offered.

To achieve the objective of this study, it is necessary to take a closer look at various court judgments, with special emphasis on those provisions that have come under the scrutiny of the courts. This will assist in ascertaining the courts' view on whether or not procurement legislation is consistent with the Constitution, PPPFA and BBEEA.

Chapter 2:

Case Law

The issue of public procurement has not escaped the scrutiny of the courts in recent years. There have been various court pronouncements on the issue. A search for relevant court judgments established that the key issues of ring-fencing and set-asides have not been tested in the courts as yet. Ring-fencing and set-asides refer to instances where public sector institutions provide a specific amount in the budget for targeted procurement strategies, for example, R10 million may be provided for targeting only co-operatives in catering contracts. The South African Federation of Civil Engineering Contractors has brought an application before the court to prevent the KwaZulu-Natal Department of Transport from excluding its members from the department's Database of Emerging Contractors, specifically for the Vukuzakhe Emerging Contractors Development Programme. This case had not been finalised at the time of this report being compiled.

The analysis of the cases that follow are mainly relevant to the legislative and administrative actions of government institutions.

In keeping with the demands of the Constitution 217(1), the Municipal Finance Management Act (MFMA), No. 56 of 2003, enacted section 117 which reads:

"No councillor of any municipality may be a member of a municipal bid committee or any other committee evaluating or approving tenders, quotations, contracts, or other bids, nor attend any such meeting as an observer."

It is submitted that in keeping with fairness and transparency, the legislators enacted S117 of the MFMA to prohibit politicians from interfering in the adjudication, recommendation or acceptance of tenders by a municipality. This is done to maintain the impartiality and integrity of the process. In *Thabo Mogudi Security Services CC v Randfontein Local Municipality and Another [2010] 4 ALL SA 314 (GSJ)* the court held that the municipal manager's action to scrap the bidding process and commence afresh was in keeping with provisions of S117 of the MFMA when there was evidence of interference by councillors during the bidding process.

Recently, the Pietermaritzburg High Court in *Sizabonke Civics cc t/a Pilcon Projects v Zululand District Municipality and Others 2011 (4) SA 406* was confronted with a question where Judge Gorvan J had to adjudicate, among other things, that Regulations 8(2) to 8(7) of the Preferential Procurement Regulations, 2001 were inconsistent with section 2(1) (b) of the Preferential Procurement Policy Framework Act, No 5 of 2000 and are invalid.

Regulations 8(2) to 8(7):

- (2) The total combined points allowed for functionality and price may, in respect of tenders with an estimated Rand value equal to, or below, R500,000, not exceed 80 points.
- (3) The total combined points allowed for functionality and price may, in respect of tenders with an estimated Rand value above R500,000, not exceed 90 points.

- (4) When evaluating the tenders contemplated in this item, the points for functionality must be calculated for each individual tenderer.
- (5) The conditions of tender may stipulate that a tenderer must score a specified minimum number of points for functionality to qualify for further adjudication.
- (6) The points for price, in respect of a tender which has scored the specified number of points contemplated in sub-regulation (5) must, subject to the application of the evaluation system for functionality and price contemplated in this regulation, be established separately and be calculated in accordance with the provisions of regulations 3 and 4.
- (7) Preferences for being an HDI and/or subcontracting with an HDI and/or achieving specified goals must be calculated separately and must be added to the points scored for functionality and price.

Section 2(1)(b):

- I. for contracts with a Rand value above a prescribed amount a maximum of 10 points may be allocated for specific goals as contemplated in paragraph (d) provided that the lowest acceptable tender scores 90 points for price;
- II. for contracts with a Rand value equal to or below a prescribed amount a maximum of 20 points may be allocated for specific goals as contemplated in paragraph (d) provided that the lowest acceptable tender scores 80 points for price.

Section 2(1) (d):

The specific goals may include:

- I. contracting with persons, or categories of persons, historically disadvantaged by unfair discrimination on the basis of race, gender or disability;
- II. implementing the programmes of the Reconstruction and Development Programme as published in Government Gazette No. 16085 dated 23 November 1994.

It was submitted on behalf of the third respondent, Zululand District Municipality, that they would apply the invalid regulations in future tendering processes and this would likely to give rise to further litigation or, at the very least, uncertainty. However, the court mentioned that there was evidence in the papers that the officials in KwaZulu-Natal Provincial Treasury had sought to address the conflict between the Act and the impugned regulations. Also interesting was the court's pronouncement that legislative administrative actions were reviewable under the Promotion of Administration of Justice Act, No. 3 of 2000.

Thereafter, the eThekweni Municipality, notwithstanding knowledge of an illegality in *Sizabonke Civils* proceeded with a tender process and awarded a contract. This was evident in *Sanyathi Civil Engineering (Pty) Ltd and Another v eThekweni Municipality and Others; Group Five Construction (Pty) Ltd v eThekweni Municipality and Others [2012] 1 A SA 200 (KZP)*. In case, the court observed that when exercising its contractual rights in a tender process, an authority exercises public power; it does not exercise its contractual powers only and jettison its administrative justice rights and public duties under the Constitution and legislation. The court made an order setting aside the award of the contract to Esorfranki-Cycad, with eThekweni paying the applicant's costs. The court also issued additional directions with a view to the council of eThekweni conducting or commissioning an investigation into the conduct of officials involved in the awarding of the tender and recovering the costs incurred by eThekweni from those officials found guilty of misconduct or acting unlawfully.

The Constitutional Court, in *Viking Pony Africa Pumps (Pty) Ltd t/a Tricom Africa v Hidro-Tech Systems (Pty) Ltd and City of Cape Town*, adopted a strong view against the City of Cape Town (City) for what the Court termed "dereliction of duty" for its failure to act on the complaint that one of the respondents made fraudulent misrepresentations in its tender documents to the City about its profile of historically disadvantaged individuals.

In *The Chief Executive Officer of the South African Social Security Agency N.O. v Cash Paymaster Services (Pty) Ltd (90/10) [2011] ZASA 13 (11 March 2011)* the Supreme Court of Appeal was called to rule whether

or not non-compliance with the Public Finance Management Act, No. 1 of 1999 (PFMA) and the Treasury Regulations was fatal. In this case it was common cause that SASSA did not follow a competitive bidding process when it contracted with South African Post Office Ltd to render banking or payment services without having followed a procurement process which complies with S217 of the Constitution, the PFMA and the Treasury Regulations and the question that arose was whether it was obliged to do so. The court, having considered all the facts, held that the agreement was entered into in terms of the Intergovernmental Relations Framework Act, No. 13 of 2005 and that the object of the agreement was to provide for collaboration between two government entities by working together and to integrate their services. The intention, too, was to improve grant enrolment and payment services on a cost-effective basis. Hence, the court found non-compliance not fatal. The court placed the importance of controlling public funds above other principles as provided for in S217 of the Constitution.

In *Moseme Road Construction CC and Others v King Civil Engineering Contractors (Pty) Ltd and Another (385/2009) [2010] ZASCA 13* the Appeal Court considered the PPPFA and the Construction Industry Development Board Act, No. 38 of 2000. King had launched an application for an urgent interim interdict in which it asked that the court should award the contract to it since it tendered the lowest price, had scored the highest points, and was recommended during the bid evaluation process. Moseme sought, by way of counter-application, an order that the contract was to remain extant in spite of the review. The court ruled that not every error in the administration of tenders was necessarily subject to a court's sanction, and therefore that King was not entitled to any relief, despite the imperfect administrative process. In deciding the matter, the court ruled that a declaration of invalidity of the tender award could not be considered in isolation, but that the court had to consider the possible consequence of such a decision, and in so doing, strike a balance between the interests of both parties involved, also taking into consideration the consequences for the public at large.

Chapter 3:

Supply Chain Management Practice Notes

The previous chapters looked at the impact of the Constitution, PPPFA, BBEEA, and their accompanying Regulations, 2001 and 2011 on public procurement. This chapter investigates the relevant Supply Chain Management (SCM) Practice Notes issued by National Treasury to guide the implementation of public procurement in the public sector.

NATIONAL TREASURY PRACTICE NOTES AND INSTRUCTION NOTES

The Supply Chain Management Regulatory Framework was promulgated on 18 November 2003. This applies to all national and provincial departments and trading entities, constitutional institutions and public entities. This National Regulatory Framework was encapsulated and replaced by Treasury Regulations 16A on 30 May 2005.

Table 5 lists the SCM Practice Notes and Instruction Notes issued by National Treasury to guide the uniform implementation of SCM. However, many of these policy guidelines have not been reviewed or updated since 2003. This study only looks at the relevant practice notes.

TABLE 5: NATIONAL TREASURY SCM PRACTICE AND INSTRUCTION NOTES

PRACTICE/ INSTRUCTION NOTE NO.	PRACTICE/INSTRUCTION NOTE TITLE
2003	
SCM 001 of 2003	• General Conditions of Contract and Standardised Bidding Documents
SCM 002 of 2003	• Threshold Values for the invitation of price and competitive bids
SCM 003 of 2003	• Appointment of Consultants
SCM 004 of 2003	• Code of Conduct for Supply Chain Management Practitioners
2004	
SCM 001 of 2004	• Tax Clearance Certificate • Contact Details of South African Revenue Service (SARS) Official dealing with Tax Clearance Certificates
SCM 003 of 2004	• Checklist and Questionnaires
SCM 004 of 2004	• Strategic Sourcing of Motor Vehicles – Request for Estimates
SCM 005 of 2004	• Training of Supply Chain Management Officials

PRACTICE/ INSTRUCTION NOTE NO.	PRACTICE/INSTRUCTION NOTE TITLE
2005	
SCM 001 of 2005	Standard Bidding Document (SBD)
SCM 002 of 2005	Threshold Values for Procurement of Goods and Services by means of petty cash, verbal/written price quotations and competitive bids
SCM 003 of 2005	- Projects/Services funded by grants in accordance with Technical Assistance Agreements - Appointment of Transaction Advisors to assist with Public Private Partnerships
2006	
SCM 001 of 2006	- Tax Clearance Certificate and revised application form - Tax Certificate for price quotation up to R200,000 - Threshold for obtaining tax certificate
SCM 002 of 2006	- Prohibition of set-asides and the use of price estimates as a benchmark - Measurables attached to specific goals for which Preference Points are awarded.
SCM 003 of 2006	Tax Clearance Certificate for price quotations and competitive bids
SCM 004 of 2006	Standard bidding document: Declaration of the bidder's past Supply Chain Management practice (SBD 8)
SCM 005 of 2006	- Restriction of suppliers - Augmentation of General Conditions of Contract
2007	
SCM 006 of 2007	Procurement of goods and services by means other than through the invitation of competitive bids
SCM 008 of 2007	Threshold Value for Procurement of Goods, Works and Services by means of petty cash, verbal/written price quotations and competitive bids
SCM 009 of 2007	- National Industrial Participation Programme - Standard Bidding Documents (SBD 5) - Augmentation of General Conditions of Contract
2008	
SCM 004 of 2008	Irregular Expenditure
SCM 011 of 2008	Unsolicited Proposals
2009	
SCM 5 of 2009–2010	Procurement through the State Information Technology Agency (SITA) and accountability of Accounting Officers/Authorities
2010	
Practice Note 7 of 2009–2010	Supply Chain Management Declaration of interest; Amendment augmentation to standard bidding documents (SBD 4)
Practice Note dated 21 July 2010	Prohibition of restrictive Practices: Certificate of independent Bid Determination: Bidding Document (SBD 9)
Instruction Note: 3 September 2010	The amended guidelines in respect of bids that include functionality as a criteria for evaluation
Instruction Note: 31 May 2011	Enhancing compliance monitoring and improving transparency and accountability in supply chain management

Practice Note Number SCM 001 of 2006: Tax Clearance Certificates

This Practice Note requires that institutions must obtain a Tax Clearance Certificate from a vendor for any item purchased for a value exceeding R30,000. To comply with this provision, every enterprise wishing to do business with the public sector must ensure that their tax affairs are in order and that they are fully compliant with income tax, value-added tax (VAT), pay-as-you-earn (PAYE), skills development levy and Unemployment Insurance Fund requirements.

These requirements are considered to be extremely costly and onerous for SMMEs and social enterprises.

Practice Note Number SCM 002 of 2006: 1. Prohibition of Set-Asides

National Treasury issued this Practice Note in response to several complaints by potential bidders that institutions were setting aside specific items and budgets with specific conditions that excluded certain categories of bidders from bidding for government contracts. Despite Sections 217 (2) and (3) of the Constitution, which allow for preference to be provided for the protection or advancement of persons or categories of persons disadvantaged by unfair discrimination, both the Constitution and PPPFA must do so without prohibiting any category of bidders from bidding for government contracts.

The levelling of the procurement playing field was addressed by introducing the Preference Points system, which provides for 20 or 10 points to be allocated to potential bidders as a measure to provide for such protection or advancement of HDIs.

Practice Note Number SCM 008 of 2007: Threshold Values for the Procurement of Goods, Works and Services by means of Petty Cash, Verbal/Written Price Quotations or Competitive Bids

This Practice Note serves to remind institutions to apply the following thresholds, without splitting the goods, works or services into parts or items of lesser value merely to avoid this requirement. It also emphasises the application of the PPPFA for all procurement equal to or above R30,000 (VAT included). It further recommends the compilation of an annual list of prospective suppliers per commodity or type of service, which must be updated quarterly and must promote BEE through the participation of black-owned enterprises, black-empowered enterprises, black women-owned enterprises and enterprises owned by HDIs.

TABLE 6: THRESHOLD LIMITS FOR PROCUREMENT

PROCUREMENT LIMITS	REQUIRED PROCEDURE
R0 to R2,000 (VAT included)	• May procure requirements without inviting competitive bids or price quotations by means of petty cash. • Institutions must apply their own internal procedures to ensure sound financial management of funds.
R2,001 to R10,000 (VAT included).	• At least three verbal or written quotations must be obtained from, where applicable, a list of prospective suppliers.
R10,001 to R500,000 (VAT included)	• As many written quotations must be obtained from, where applicable, a list of prospective suppliers.
R500,001 to an unlimited monetary value	• Publicly inviting bids in news media and provincial government gazette.

Institutions should be encouraged to use a list of prospective suppliers that are appointed through a competitive bidding process in the advertisement of quotations up to R500,000. However, no guidance is provided on the categorisation of suppliers, which suggests that large established enterprises will compete with SMMEs and social enterprises with the same procurement requirements.

The second issue that arises is the medium used by institutions to advertise competitive bids. News media and Government gazettes are not considered appropriate to attract SMMEs or social enterprises as they do not have access to these either due to cost or availability in rural or remote areas.

The third issue is the rotation of suppliers on the list of prospective suppliers, which will not provide for sustainability of SMMEs and social enterprises in that continued and sustainable support from government institutions is not guaranteed.

CONSTRUCTION INDUSTRY DEVELOPMENT BOARD PRACTICE NOTE NO. 29 JULY 2012

This Practice Note deals with the allocation of sustainable work opportunities to the Contractor Development Programme (CDP) and attempts to clarify the perceptions around “set-asides” and “ring-fencing” as interpreted in the National Treasury Practice Note No. 2 of 2006.

According to legal opinion sought by the CIDB, it was confirmed that government institutions can:

- Identify projects, which by their nature have the ability to assist in the development of a contractor;
- Allocate a portion of their budget for these developmental projects for the exclusive expenditure only to contractors within their predetermined development programmes – this portion of the budget must be reasonable in relation to the standard required from government; and
- Award individual projects to contractors enrolled in the CDP through a competitive bidding process.

The process for contractors to enter the programme must be through open competition and must follow the registration process for inclusion on the Register of Contractors, and is evaluated on contracting and financial capacity. Contractors are subjected to a developmental programme, which must be attained in three years.

This approach and methodology should not be restricted to the construction industry only. If government had a social enterprise development framework that provided for the development of social enterprises and a database or register of social enterprises, the same process may be applied to allocating budgets for identified goods and/or services that may be acquired from social enterprises.

The next chapter explores public procurement trends in KwaZulu-Natal with an emphasis on using social enterprises.

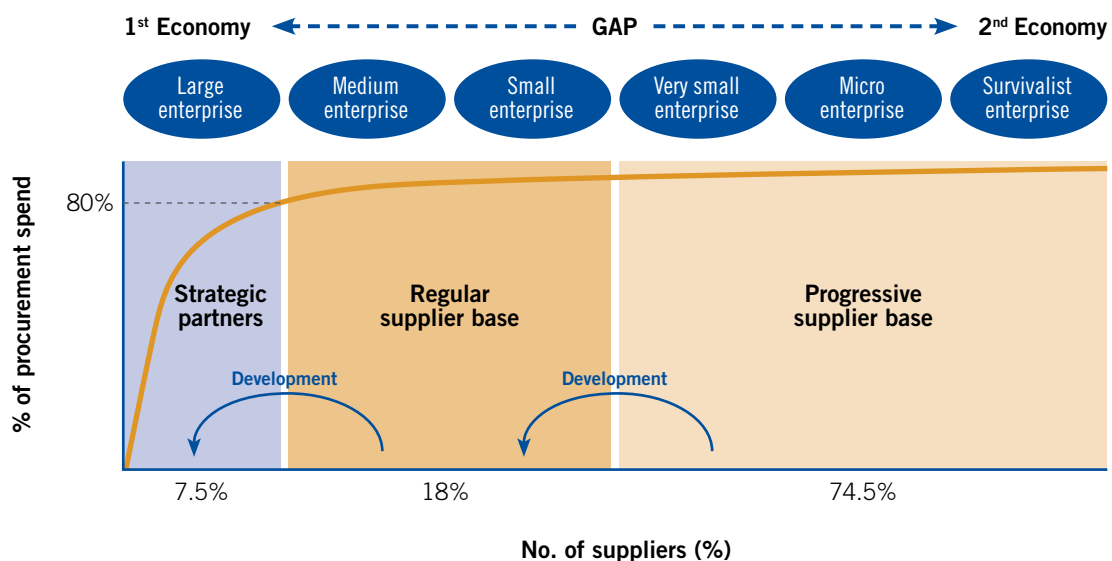
Chapter 4:

Public Procurement in KwaZulu-Natal

This chapter explores the public procurement environment in KwaZulu-Natal. It identifies existing interventions applied in supply chain management to stimulate the social economy; perceived barriers to stimulating the social economy through public procurement; and recommends strategies that may be considered in the future. To achieve this, the past spending patterns in KwaZulu-Natal were analysed and a survey of SCM managers was conducted to solicit their perceptions.

HISTORICAL SPEND ANALYSIS IN KWAZULU-NATAL

In 2005, the KwaZulu-Natal Provincial Treasury implemented supply chain management in all departments and municipalities in KwaZulu-Natal. A spend analysis was conducted to assess trends in public procurement to inform the development of Preferential Procurement Objectives. Figure 3 shows the results of the analysis in 2005 for provincial departments only.



Source KwaZulu-Natal Treasury 2005

FIGURE 3: PERCENTAGE PROCUREMENT SPEND PER SUPPLIER BAND IN 2005

The status quo in 2005 was that although 74.5 percent of the number of suppliers in KwaZulu-Natal were small to survivalist, only 20 percent of the province's procurement spend was paid to these entities. The introduction of Preferential Procurement Objectives as a targeted procurement strategy was to:

- Develop SMMEs and bring more sustainable opportunities to micro and survivalist enterprises;
- Transform the second economy; and
- Dramatically narrow the gap between the first and second economies.

More recent data for procurement spend by supplier band was not readily available.

The SCM Unit within the KwaZulu-Natal Provincial Treasury published, in the Budget Statements of 2008–2009, an analysis of the expenditure within the KwaZulu-Natal Provincial Government. This analysis was done to determine the impact of provincial spending on provincial priorities of broad-based black economic empowerment, unemployment and poverty eradication. The information that is presented is on actual spend over the 2005–2006, 2006–2007 and 2007–2008 fiscal years.

TABLE 7: NUMBER OF SUPPLIERS PER % BUDGET THRESHOLD

THRESHOLD CATEGORY	5% OF TOTAL BUDGET	15% OF TOTAL BUDGET	80% OF TOTAL BUDGET	TOTAL
Number of Suppliers per Budget % Threshold Category 2005/2006	14,553	4,251	1,500	20,304
% of Total Suppliers per Budget % Threshold Category 2005/2006	72%	21%	7%	100%
Number of Suppliers per Budget % Threshold Category 2006/2007	15,272	4,316	1,322	20,910
% of Total Suppliers per Budget % Threshold Category 2006/2007	73%	21%	6%	100%
Number of Suppliers per Budget % Threshold Category 2007/2008	11,251	3,486	1,106	15,843
% of Total Suppliers per Budget % Threshold Category 2007/2008	71%	22%	7%	100%

Source KwaZulu-Natal Treasury 2007

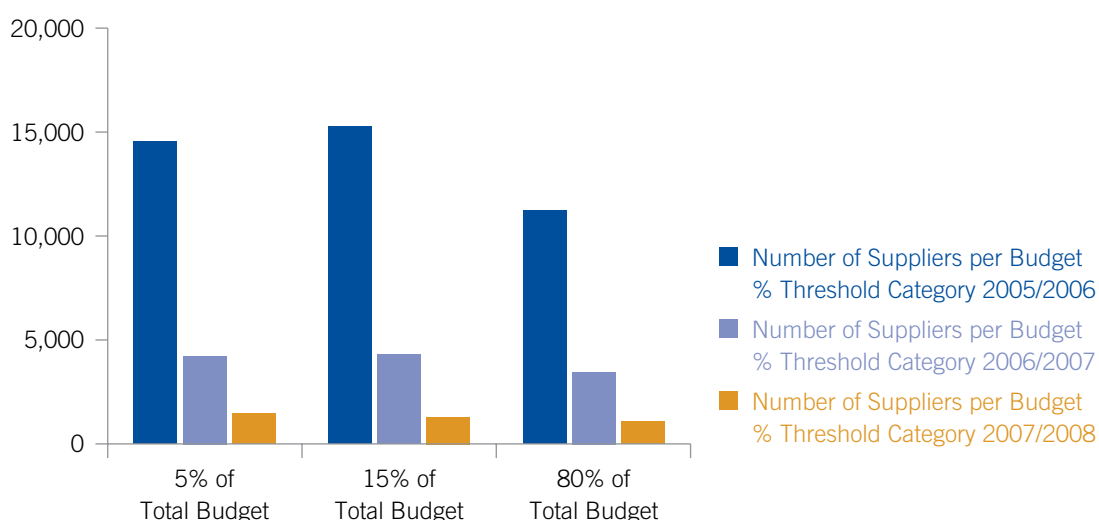


FIGURE 4: NUMBER OF SUPPLIERS PER % BUDGET THRESHOLD

Table 7 and Figure 4 show that 93 percent of the total number of suppliers shared 20 percent of the province's procurement spend and seven percent of the total number of suppliers shared 80 percent of the province's procurement spend over the three-year period. Data is not available to demonstrate what percentage of these suppliers were small to survivalist.

TABLE 8: VALUE OF SCM SPEND PER % BUDGET THRESHOLD

THRESHOLD CATEGORY	5% OF TOTAL BUDGET	15% OF TOTAL BUDGET	80% OF TOTAL BUDGET	TOTAL
Value of Budget Spent per Budget % Threshold Category 2007/2008	678,549,000	2,035,647,000	10,856,783,000	13,570,979,000
Number of Suppliers per Budget % Threshold Category 2007/2008	11,251	3,486	1,106	15,843
% of Total Suppliers per Budget % Threshold Category 2007/2008	71%	22%	7%	100%
Average Amount Spent per Supplier in each Budget % Threshold Category 2007/2008	60,310	583,949	9,816,259	856,591

Source KwaZulu-Natal Treasury 2007

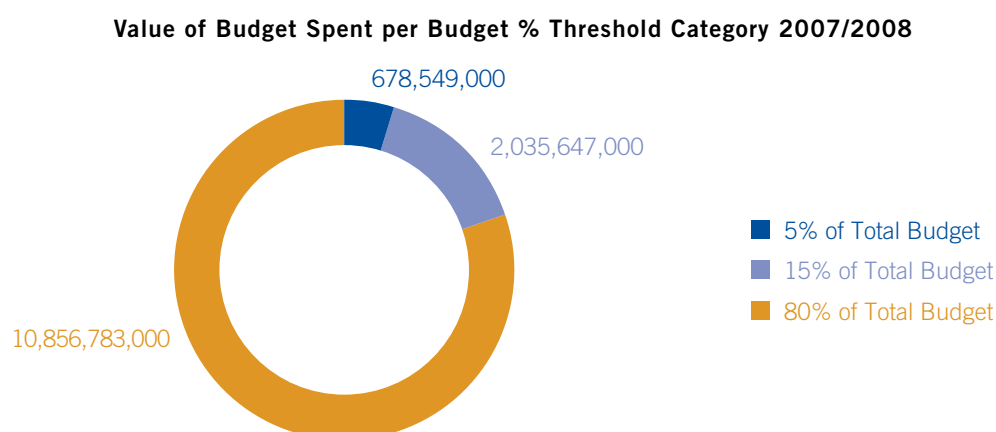


FIGURE 5: VALUE OF SCM SPEND PER % BUDGET THRESHOLD

Table 8 and Figure 5 indicate that the suppliers in the five percent Budget Threshold Category receive R60,310 on average for one year, while suppliers in the 15 percent category receive R583,949 on average for one year, and suppliers in the 80 percent category receive R9,816,259 on average for one year, for goods and services rendered.

The Province of KwaZulu-Natal Budget Statements for the 2008–2009 fiscal year further note that “the statistics illustrated here highlight the ineffectiveness of government procurement processes to make a visible impact on combating poverty and opening up economic opportunities to the previously disadvantaged groups and thus reducing unemployment”.

This statement would imply that large established enterprises are still dominant in securing government contracts whilst small, medium and micro enterprises continue to lag behind. Hence, the picture has not changed from 2005 to 2008.

These findings led the KwaZulu-Natal Provincial Government to make a commitment, in an extract from the Province of KwaZulu-Natal Budget Statements 2008–2009 (pp. 13–14), to “embark on an aggressive plan of action”, which aims to do the following:

- The KwaZulu-Natal Provincial government will “facilitate and guarantee” the award of nearly 12 percent of procurement spend to small enterprises and co-operatives as per identified sectors. In monetary terms this constitutes an injection of almost R1.2 billion into the local economy. The identified sectors are agriculture, forestry and fishing; catering, accommodation and other trade; clothing, textile, leather and footwear; community, social and personal services; construction; finance and business services; retail, motor trade and repair services; transport, storage and communications; and wholesale trade, commercial agent and allied services. However, this commitment is not permissible as it would be considered a “set-aside”, which is not permissible in terms of SCM Practice Note No. SCM 002 of 2006.
- Fast-track the implementation of BEE codes of good practice by establishing a separate charter that specifically regulates the KwaZulu-Natal economy.
- The KwaZulu-Natal scorecard will be applicable to all procurement above R100,000 and the province will conduct business with service providers demonstrating a minimum of level 6 (60 percent) BEE compliance. However, this also is not permissible under the 2011 Preferential Procurement Regulations. Under the 2011 Regulations, all suppliers must be allowed to compete, regardless of their exact BEE rating. Even suppliers that are not BEE compliant are entitled to participate in government procurement processes. Only suppliers which are BEE rated are, however, entitled to preference points and their precise points are determined with reference to the level of their BEE rating.
- The province will aim to identify suitable accreditation agencies for the accreditation of provincial suppliers.

The overall caveat is that a phased-in approach will be adopted for the charter, in that specific targets will be determined for a ten-year span.

SURVEY CONDUCTED

This section analyses responses to a questionnaire circulated to 20 public sector institutions in KwaZulu-Natal, in an attempt to obtain data that will address the following research questions:

- What existing examples are there in South Africa of the use of public procurement to stimulate the social economy, and to what extent are these consistent with the policies, laws and regulations identified above?
- Which of the interventions identified would be consistent with the policies, laws and regulations identified?
- Which types of interventions aimed at using public procurement to stimulate the social economy are theoretically possible?
- Of the interventions that are both possible and consistent with the policies, laws and regulations identified, which are most likely to be easily implemented and effective in stimulating the social economy in South Africa?

Respondents were asked the following questions:

1. What do you understand about the social economy and social enterprises, please give examples?
2. Do you think public procurement can be a stimulus for employment creation in the social economy? How?
3. Have you supported social enterprises through your SCM processes in the past financial year?
Yes/No _____
If Yes, what is the value of spend on Social Enterprises in the past financial year?
If No, are there any strategies that you are considering?
4. Do you have a database of Social Enterprises that supply products/services in your area?
Yes/No _____
5. Would you consider awarding contracts to Social Enterprises in the following areas? If so, please circle those you would choose.
 - (i) Recycling
 - (ii) Waste Management

- (iii) Municipal Services
- (iv) Health Care
- (v) Hospital Laundry Services
- (vi) Childcare/Crèches
- (vii) Agriculture
- (viii) Arts and Culture
- (ix) Construction
- (x) Community Services
- (xi) Food Security
- (xii) Crime Prevention
- (xiii) Education/skills development
- (xiv) School Nutrition
- (xv) Catering
- (xvi) Road Maintenance
- (xvii) Weed killing

6. What, in your opinion, are the barriers to using public procurement to stimulate the social economy, for example SCM Legal Prescripts? Please be specific as to which Act, Regulation or Practice Note.
7. What methods do you use to advertise procurement opportunities in your institution? How can you encourage more Social Enterprises to participate in tenders issued by the government?
8. List any other economic sectors that are linked to public procurement which may have business opportunities for new social enterprises in your institution.

A total of 20 departments and municipalities were contacted by email, facsimile and telephone and requested to complete the survey by 10 August 2012. This date was extended to 27 August 2012 as only five completed questionnaires were received by the due date. Fifty percent of the targeted population responded, and only provincial departments are representative of the respondents. No municipalities responded to the survey.

TABLE 9: TARGETED POPULATION

TOTAL POPULATION	TOTAL
Did respond	10
Did not respond	10
Targeted population	20

Please refer to **Annexure I** for the detailed results of the survey.

ANALYSIS OF THE SURVEY RESULTS

Question 1

The respondents were requested to demonstrate their understanding of the social economy and social economy enterprises. All respondents demonstrated a good understanding of the two concepts and the following are some extracts from their responses:

1. The social economy in this context would be a reference to a broad based participation in the government procurement process inclusive of previously disadvantaged individuals, more especially referring to a stimulus of current participation by the latter individuals. It is also a reference to public procurement processes that are compatible with economic embellishment of potential participants/suppliers from disadvantaged

backgrounds and is also an envisaged approach to public procurement that seeks to enrich households and communities who otherwise would have no mechanisms to become economically active.

2. The social economy includes non-profit institutions that provide goods and services, including co-ops, NGOs, stokvels and creates jobs.
3. Social economy is that part of the economy that is not public or private. Social economy enterprises consist of different organisations and businesses with the aim of improving the lives of the local people. They are not for profit-making and they also include voluntary activities.
4. The social economy sector is neither governmental nor business and its main rationale is the promotion of the wellbeing of a particular community or society.
5. The social economic enterprise is a social enterprise that is established by the social group or trustees whose objectives are in the main social but operate as an enterprise where its monetary or financial gains are distributed towards the objective for which it was established. A typical example is community-based agriculture where a community will produce the agricultural product for subsistence, sell the surplus to the market and plough back the revenue generated in farming. The main feature of these enterprises are that their continued existence is through self-sustaining.
6. The concept of social economy goes back to the 19th century when various new types of organisations and enterprises were formed collectively by groups of people in response to problems they were facing due to deep transformation of the economic system: co-operative societies, friendly (mutual benefit) societies, and other forms of undertakings which aimed at organising production, consumption, access to credit, access to health care and other services on a more equitable and democratic basis. Today, the social economy covers enterprises of the co-operative movements, mutual benefit and insurance societies, foundations and all other types of non-profit organisations. Indeed, social economy organisations differ from the private for-profit sector as their primary goal is to serve members' needs or a broader public interest instead of maximising and distributing profits to shareholders or members. They are also clearly distinct from the public sector although non-profit organisations may receive public subsidies to fulfil their mission: they are self-governed private organisations with the rule "one member, one vote" in their general assembly.

Question 2

TABLE 10: PUBLIC PROCUREMENT STIMULATION ON EMPLOYMENT IN THE SOCIAL ECONOMY

Q NO.	DESCRIPTION	NO. OF RESPONDENTS	
		YES	NO
2	Do you think public procurement can be a stimulus for employment creation in the social economy? How?	9	1

Does Public Procurement stimulate employment in the Social Economy?

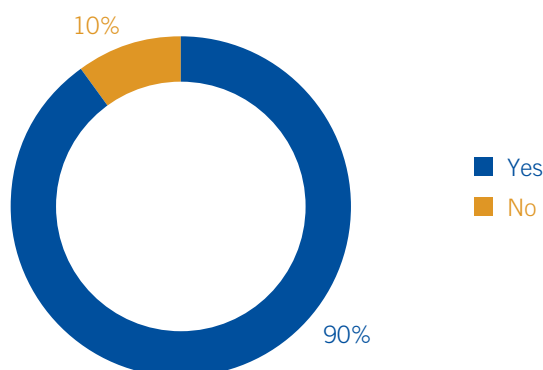


FIGURE 6: PUBLIC PROCUREMENT STIMULATION ON EMPLOYMENT IN THE SOCIAL ECONOMY

Ninety percent of respondents thought that public procurement CAN stimulate the employment level in the social economy. The respondents felt that jobs could be created for cooks, caterers, transport and delivery contractors, construction workers and drivers, among others.

The economy is affected by government spending, which increases demand for products and this demand essentially increases the need to employ people. The various sectors in the economy should be thoroughly analysed before a social enterprise can successfully and sustainably provide employment in the sector. The ultimate goal is to create permanent employment as opposed to temporary employment. This is not always the case with social enterprises as they may not always receive work from public institutions, which results in more temporary employment.

Some social enterprises lack expertise due to a number of factors. Hence, support programmes should be established to assist them in becoming self sustaining and to grow.

Question 3

TABLE 11: HAVE SOCIAL ENTERPRISES BEEN SUPPORTED IN THE SCM PROCESS

Q NO.	DESCRIPTION	NO. OF RESPONDENTS	
		YES	NO
3	Have you supported social enterprises through your SCM processes in the past financial year? If Yes, what is the value of spend on social enterprises in the past financial year? If No, are there any strategies that you are considering?	8	2

Have Social Enterprises been supported through the SCM Process? – 2011/2012

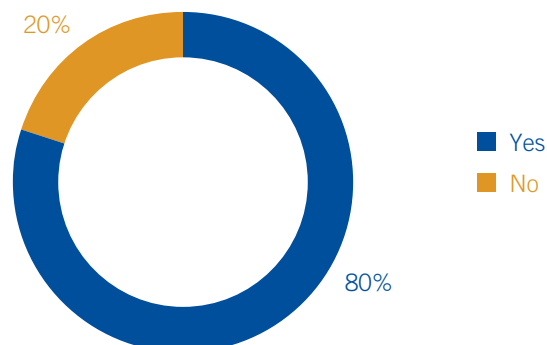


FIGURE 7: HAVE SOCIAL ENTERPRISES BEEN SUPPORTED IN THE SCM PROCESS

Social enterprises are supported in the SCM processes by 80 percent of the respondents of the survey. The value of expenditure at which the respondents have supported social enterprises may not be accurately determined, but it was thought that an average level of 60 percent of overall expenditure may be spent on procurement of goods/services from social enterprises. This statement is not supported by the spend analysis conducted in the previous section of this report, neither could the departments provide actual expenditure to support their statements.

The other 20 percent think that the public procurement framework does not support strategies designed to support social enterprise procurement. It is thought that the two procurement methods differ and could be aligned with a provincial policy to support the procurement from social enterprises.

Question 4

TABLE 12: IS THERE A DATABASE OF SOCIAL ENTERPRISES THAT SUPPLY THE AREA

Q NO.	DESCRIPTION	NO. OF RESPONDENTS	
		YES	NO
4	Do you have a database of social enterprises that supply products/ services in your area?	6	4

Is there a Database of Social Enterprises that supply the area?

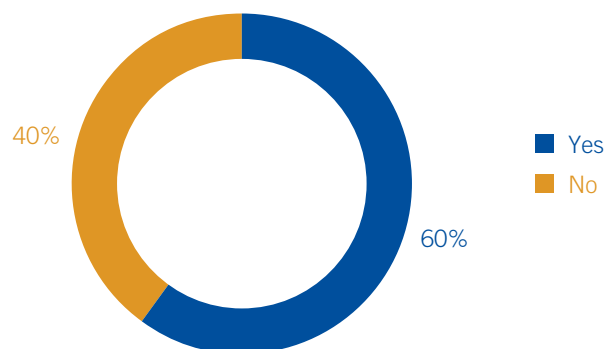


FIGURE 8: IS THERE A DATABASE OF SOCIAL ENTERPRISES THAT SUPPLY THE AREA

The results show that 60 percent of the respondents have a database of the social enterprises. Of the 60 percent, only 20 percent of respondents confirmed that they have a database of co-operatives, which help in the search for specific services but they are not sure as to how up-to-date the information is. Ten percent of the respondents said the database is not specific to social enterprises; the other 30 percent did not specify the nature of their database. Those without a database of social enterprises, either have no database; rely on the KwaZulu-Natal Provincial Treasury database; or have databases which are specific to their development programmes.

Question 5

TABLE 13: CONTRACTS AWARDED IN SPECIFIC AREAS

Q NO.	DESCRIPTION	NO. OF RESPONDENTS
		YES
5	Would you consider awarding contracts to social enterprises in the following areas?	
	Recycling	7
	Waste management	3
	Municipal services	0
	Health care	2
	Hospital laundry services	1
	Childcare/crèches	2
	Agriculture	2
	Arts and culture	2
	Construction	6

Q NO.	DESCRIPTION	NO. OF RESPONDENTS
		YES
	Community services	3
	Food security	3
	Crime prevention	1
	Education/skills development	4
	School nutrition	2
	Catering	7
	Road maintenance	1
	Weed killing	4

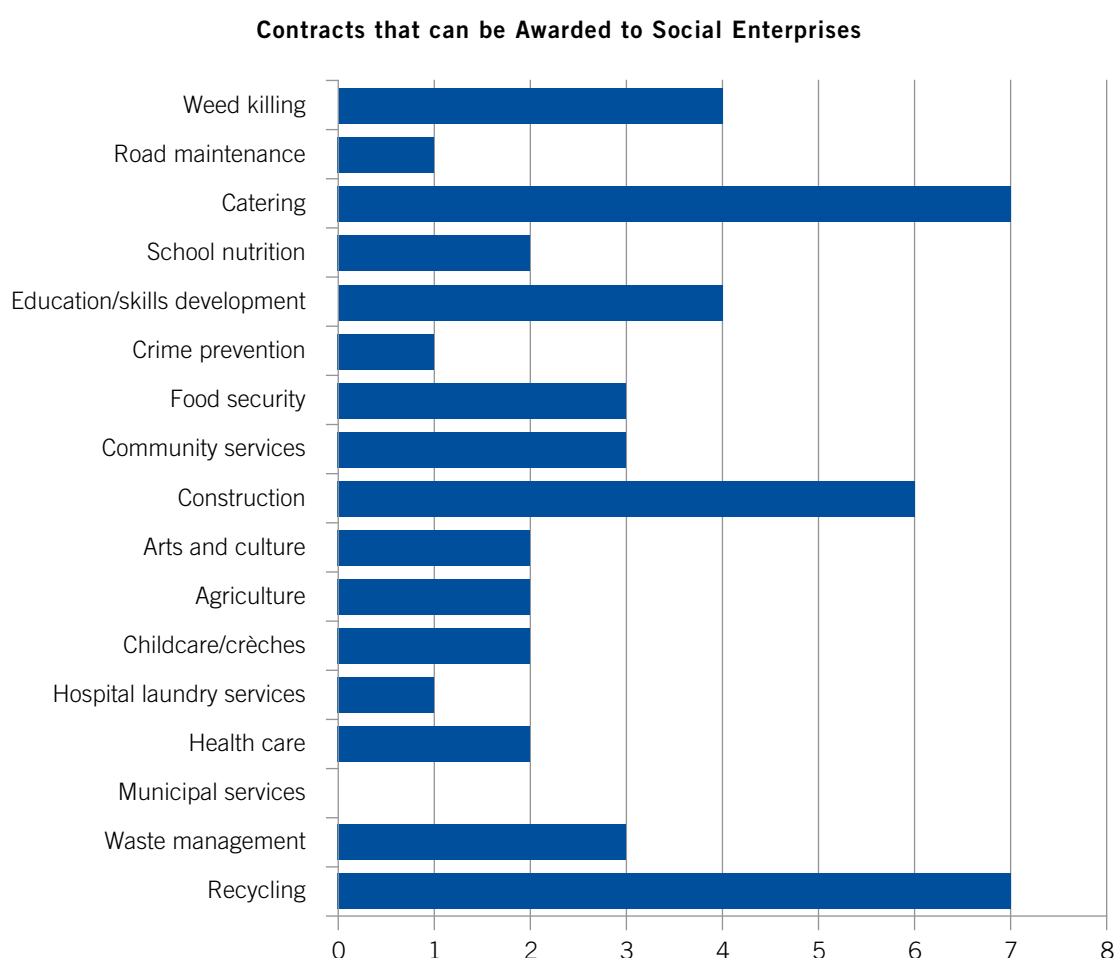


FIGURE 9: CONTRACTS THAT CAN BE AWARDED TO SOCIAL ENTERPRISES

A previous baseline study conducted by the ILO (ILO, 2010) identified specific goods and services that may be procured from social enterprises. Respondents were requested to identify which items they would consider awarding to social enterprises. The results of the survey confirm that 70 percent of respondents would award contracts to social enterprises for catering and recycling, 60 percent for construction, 40 percent for weed killing and education/skills development, and 30 percent for food security, community services and waste management.

Question 6

TABLE 14: BARRIERS TO PUBLIC PROCUREMENT THAT STIMULATES SOCIAL ECONOMY

Q NO.	DESCRIPTION	NO. OF RESPONDENTS
6	What in your opinion are the barriers to using public procurement to stimulate the social economy, for example SCM Legal Prescripts? Please be specific as to which Act, Regulation or Practice Note.	
	Preferential Procurement Policy Framework Act (PPPFA)	3
	Insufficient literature	1
	Prevention of set-asides	3
	Statutory requirements in relation to nature of work	2
	Authentic database with rotation of suppliers	2
	Support enabling quality service	1
	Trade unions	1
	Politics	1
	SCM Legislation	1
	Change of administration	1

Barriers to Public Procurement that Stimulates Social Economy

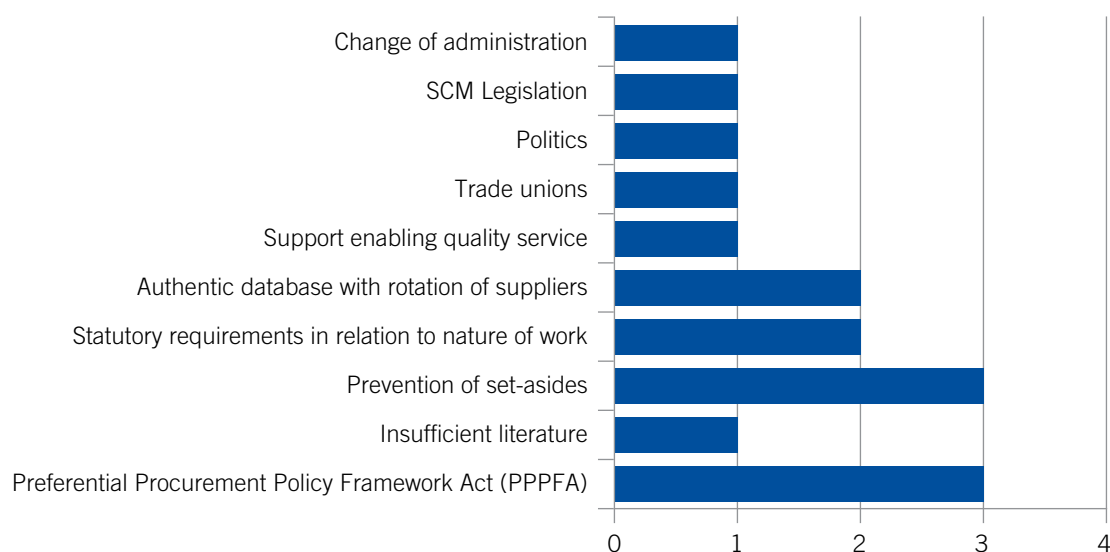


FIGURE 10: BARRIERS TO PUBLIC PROCUREMENT THAT STIMULATES SOCIAL ECONOMY

Thirty percent of respondents felt that the PPPFA and the Practice Note on set-asides were the biggest barriers in the legal frameworks to advancing the support for social enterprises in public procurement. Twenty percent of the respondents felt that statutory requirements and the database with rotation of suppliers are the barriers to public procurement acting as a stimulus for social enterprises. These perceptions have been tested in the chapter in this report that deals with the review of the legal prescripts.

Question 7

TABLE 15: METHODS USED TO ADVERTISE PROCUREMENT OPPORTUNITIES

Q NO.	DESCRIPTION	NO. OF RESPONDENTS
7	What methods do you use to advertise procurement opportunities in your institution? How can you encourage more Social Enterprises to participate in tenders issued by the government?	
	Newspapers	9
	Government Gazette	2
	State Tender Bulletin	4
	Notice Boards	2
	Government Intranet/Website	4
	Quotations Process	3

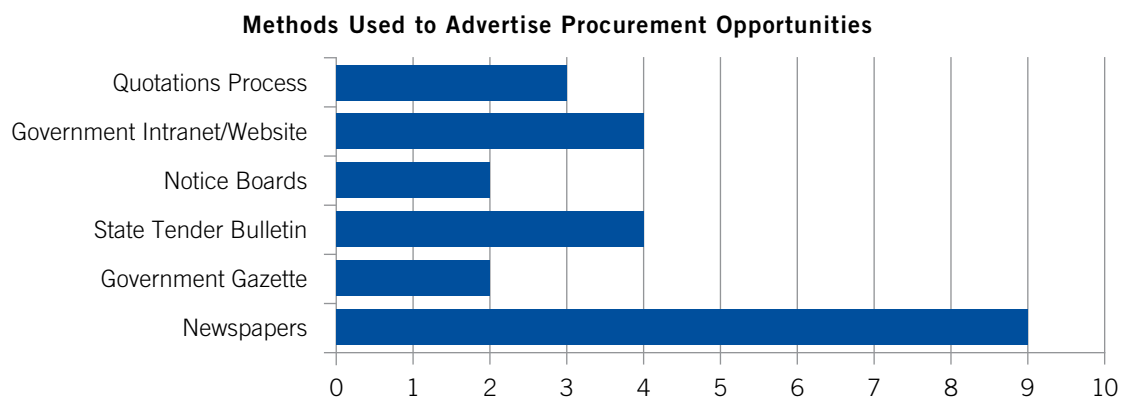


FIGURE 11: METHODS USED TO ADVERTISE PROCUREMENT OPPORTUNITIES

While newspapers are the most prevalent form of media used to advertise tenders, other methods used were government websites, state tender bulletins, notice boards and the Government Gazette, while some responded to the SCM quotations process in which suppliers were selected from an existing database and invited to quote.

Question 8

TABLE 16: OTHER BUSINESS OPPORTUNITIES FOR SOCIAL ENTERPRISES

Q NO.	DESCRIPTION	NO. OF RESPONDENTS
		YES
8	List any other economic sectors that are linked to public procurement which may have business opportunities for new Social Enterprises in your Institution.	
	Transportation and distribution	3
	Printing	1
	Entertainment	1
	Repairs and maintenance	1
	Garden services	1
	Raw material	1
	Manufacturing	1
	Security	3
	Cleaning	3

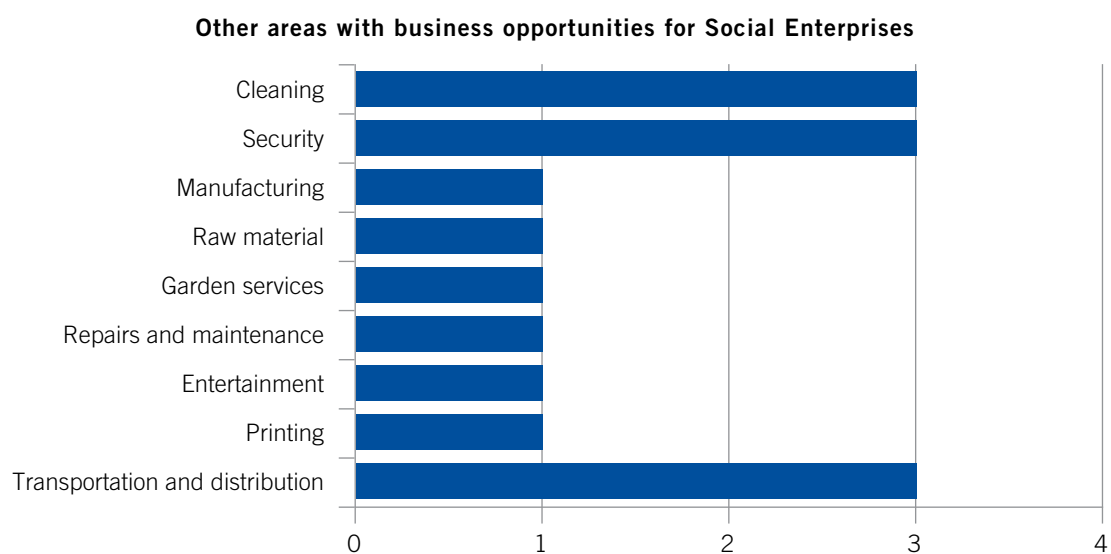


FIGURE 12: OTHER BUSINESS OPPORTUNITIES FOR SOCIAL ENTERPRISES

It was also reported that cleaning, security, and transportation and distribution could provide additional opportunities for social enterprises in public procurement.

PART C:

**RESEARCH
FINDINGS**



Chapter 1:

Barriers/Conflicts in the Legal and Policy Frameworks

The research conducted is analysed in this section in an attempt to answer the two research questions:

Which policies, laws and regulations need to be taken into account when considering the scope to use public procurement to stimulate the social economy in South Africa?

The research confirmed that the following laws, regulations and policies are most relevant:

1. The Constitution of the Republic of South Africa, Act No. 108 of 1996;
2. Preferential Procurement Policy Framework Act, No. 5 of 2000 (PPPFA);
3. Preferential Procurement Regulations, 2001;
4. Broad Based Black Economic Empowerment Act, No. 53 of 2003 (BBBEE);
5. Preferential Procurement Regulations, 2011;
6. Treasury Regulations 16A;
7. National Treasury Practice Note Number SCM 001 of 2006: Tax Clearance Certificates;
8. National Treasury Practice Note Number SCM 002 of 2006: 1. Prohibition of Set-Asides; and
9. National Treasury Practice Note Number SCM 008 of 2007: Threshold Values for the Procurement of Goods, Works and Services by means of Petty Cash, Verbal/Written Price Quotations or Competitive Bids;
10. National Treasury Practice Note Number 29: Allocating Sustainable Work Opportunities to Contractor Development.

However, this study has highlighted the need to review the Treasury Regulations and SCM Practice Notes to incorporate the lessons learned from the implementation of supply chain management and court judgments since 2003.

It must also be noted that, while there are Constitutional imperatives to address poverty and unemployment through public procurement interventions, there are no SCM Practice Notes that address any measures that can be implemented to use public procurement to stimulate the social economy in South Africa.

What are the implications of the policies, laws and regulations identified?

The Constitution has clearly articulated the legislators' intention to address discrimination that created large imbalances in the past. With specific reference to public procurement, section 217(1), prescribes that all organs of state must procure goods in accordance with a system that is fair, equitable, transparent, competitive

and cost-effective. Any tender awarded contrary to these five principles would be considered unconstitutional, and therefore, would be legally invalid. The research also suggests two levels at which such legality would be tested, namely at a regulatory level and at a process level.

Fairness, equity and transparency may be characterised as affirmative action, while free-market thinking is represented by competitiveness and cost-effectiveness. The Constitution seeks to make provision for all enterprises, namely big, established, small, micro and even social enterprises. Government also has an obligation to address key challenges of poverty and unemployment and as the country's largest buyer, it is expected to transform both the social and economic landscape through innovative public procurement practices. Hence, section 217(2) makes provision for institutions to implement a procurement policy that allows for categories of preference in the allocation of contracts and the protection or advancement of persons or categories of persons that were disadvantaged by unfair discrimination. Section 217(3) further confers an obligation for national legislation to prescribe a framework for preferential procurement, which resulted in the promulgation of the PPPFA in 2000.

While these Acts have attempted to address these issues, they have also created entry barriers for social enterprises in the public procurement arena. The 20 points for bids and quotations below R1 million and the 10 points for bids above R1 million, provided in the Preference Points System in terms of the PPPFA, only provide a 25 percent and 11 percent advantage respectively. It has also been in the sensitivity analysis that the higher the price offered by a BBBEE compliant supplier, the lower this advantage becomes.

Therefore, the principles, inherent in the PPPFA and BBBEEA, hold true only if a competitive price is offered.

This begs the question, "How can a BBBEE compliant supplier compete fairly on price with an established large supplier who is not BBBEE compliant?" It is also logical that large established enterprises can offer lower prices than social enterprises as they have the infrastructure and capacity to take advantage of quicker delivery of higher volumes. Social enterprises are concerned primarily with social or environmental objectives and are not profit motivated. They are vehicles that may be used for poverty alleviation and addressing unemployment. Consequently, government should incorporate a cost premium for "affirmative procurement" by adjusting the formula for price points to consider the value proposition that social enterprises will help to create towards a self-sustaining and more inclusive society.

Furthermore, social enterprises are not exempt from submitting BBBEE certificates for public procurement. This certificate must be issued by an accredited verification agency, and the cost is unaffordable for social enterprises. However, if the social enterprise falls under the definition of an exempt micro enterprise, whose annual turnover is less than the prescribed threshold, a certificate from an approved accounting officer will be acceptable. But, this certificate also comes at a cost. This creates another barrier for social enterprises to participate in public procurement.

Tax clearance certificates, as required by Practice Note Number SCM 001 of 2006, have also been identified as a barrier for social enterprises in public procurement for items exceeding R30,000.

SARS provides a tax exemption for social enterprises but allows voluntary registration for VAT and compulsory registration for PAYE. It is considered unusual that social enterprises would have employees earning above the income tax threshold, and as they are exempt from income tax, it would be appropriate for this exemption to be extended for the purposes of public procurement by allowing a waiver of the submission of tax clearance certificates for social enterprises.

Practice Note Number SCM 002 of 2006, which regulates the prohibition of set-asides, is considered to be the biggest barrier for social enterprises in public procurement. This has been confirmed by the KwaZulu-Natal provincial departments in the survey conducted. Sections 217 (2) and (3) of the Constitution allow for preference to be provided for the protection or advancement of persons or categories of persons disadvantaged by unfair discrimination. However, the PPPFA and BBBEEA do not exempt social enterprises from competing on price, albeit they are not profit motivated. Therefore, there is a conflict between the Constitutional provisions and PPPFA and BBBEEA provisions as well as Practice Note Number SCM 002 of 2006. This has also been confirmed in a legal opinion received from CIDB, which introduced Practice Note Number 29 to address the allocation of sustainable work opportunities to emerging contractors in its Contractor Development Programme.

Practice Note Number SCM 008 of 2007 does provide an avenue for social enterprises to participate in public procurement through the compilation of a list of prospective suppliers per commodity or type of service.

However, it is considered unfair for all suppliers to compete for goods and services irrespective of their size or classification. For example, a community catering enterprise, classified as a social enterprise, is expected to compete with a large established catering enterprise. It is recommended that prospective suppliers be further categorised based on size and capacity, as well as profit-generating enterprises and non-profit enterprises. Prospective suppliers then compete for public procurement within these categories. While the rotation of suppliers is considered fair in providing equity and transparency as envisaged by the Constitution, the disadvantage is that the sustainability of social enterprises may be affected as there may not be any guarantees for contracts to be awarded regularly over a given period.

Chapter 2:

Existing Public Procurement Strategies

The research detailed in Part B of this report is analysed in this section in an attempt to answer the following research questions:

What existing examples are there in South Africa of the use of public procurement to stimulate the social economy, and to what extent are these consistent with the policies, laws and regulations identified above?

This study was limited to KwaZulu-Natal. The research showed that information available relating to social enterprises in the province is limited and conflicting. KwaZulu-Natal also selected no municipalities to respond to the research questionnaire circulated. Based on the responses to the survey conducted, some provincial departments confirmed that they did have a database of social enterprises. However, the only type of enterprise was co-operatives and concern was raised on the accuracy and completeness of these databases.

The Department of Education did record contracts of about R1.8 billion in the 2011–2012 financial year that were awarded to social enterprises in the National School Nutrition Programme, Learner Teacher Support Material initiative and infrastructure projects. It was also confirmed that there is a database of co-operatives, cooks and food handlers. However, this programme is managed outside of the SCM Unit and is dealt with as a poverty alleviation programme and therefore does not comply with SCM legal prescripts.

The Department of Transport has databases for contractors that are part of the Zibambele and Vukuzakhe development programmes. These are designed as poverty alleviation programmes and therefore, do not comply with the SCM legal prescripts.

Since budgets are allocated to goods and/or services within all the programmes mentioned above, they are required to be procured in terms of SCM legal prescripts. Therefore, it is considered that the use of public procurement to stimulate the social economy for these items is not consistent with the SCM policies, laws and regulations.

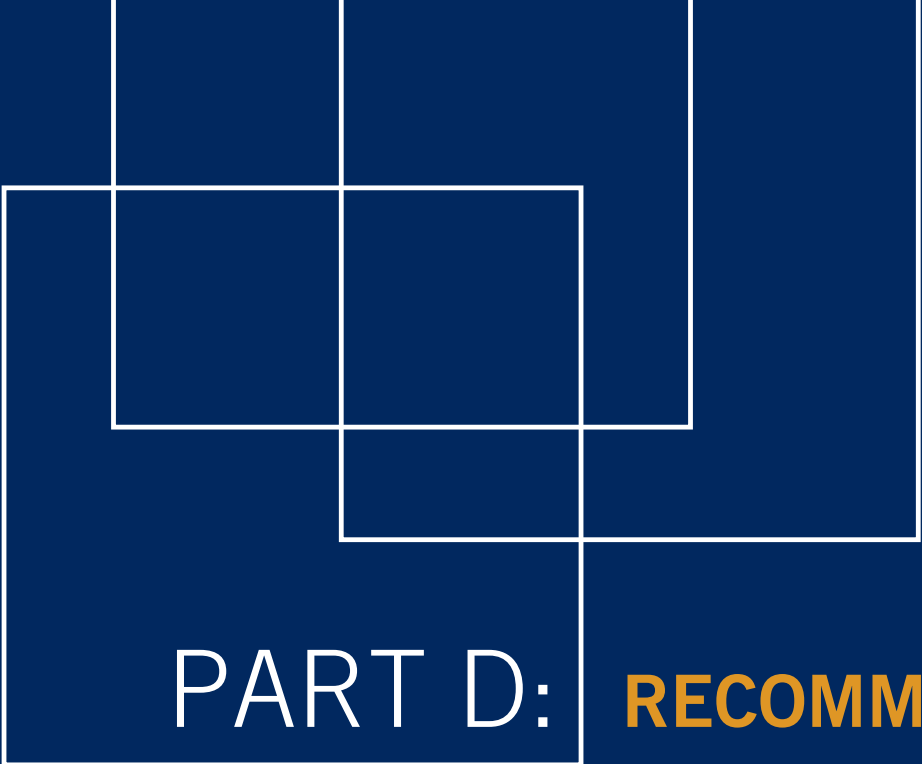
Which of the interventions identified above would be consistent with the policies, laws and regulations identified?

None of the interventions identified above would be consistent with the SCM legal prescripts as they would be considered to be set-asides. Furthermore, as the values of contracts awarded would be in excess of R500,000, competitive bidding processes would have to be followed in every instance, which would require the application of the PPPFA and the BBEEA and the successful awards of contracts to social enterprises would depend on the price offered.

Which types of interventions aimed at using public procurement to stimulate the social economy are theoretically possible?

Of the interventions that are both possible and consistent with the policies, laws and regulations identified above, which are most likely to be easily implemented and effective in stimulating the social economy in South Africa?

Based on the findings, unless a specific policy framework is introduced to regulate supply chain management practices for social enterprises and the practice note on set-asides is withdrawn, none of the existing interventions will pass the two tests for legality, namely the regulatory level and the procurement process level.



PART D: **RECOMMENDATIONS**



The following recommendations are proposed to provide an enabling environment to allow public procurement to stimulate the social economy:

1. Policy Frameworks

- The Department of Trade and Industry should develop and implement a policy framework to advance sustainable work opportunities for social enterprises as part of a local economic development programme.
- National Treasury should conduct a thorough review of the SCM legal and policy frameworks to incorporate an exemption for social enterprises from:
 - Submitting tax clearance certificates;
 - Submitting BBBEE certificates as an EME;
 - Prohibiting set-asides for procurement that has a social impact; and
 - Competitive bidding processes for procurement that has a social impact.
- A separate SCM policy framework should be developed for social enterprises that simplifies the procurement process and incorporates:
 - A step-by-step procedure manual that ensures transparency in inviting quotations through appropriate advertising media, evaluation and awarding of quotations/bids to social enterprises.

2. Market Research

- A thorough spend analysis should be conducted to establish spending patterns by provincial and local government in the commodities/services that KwaZulu-Natal provincial departments identified as opportunities for public procurement to stimulate the social economy, namely:
 - Catering/school nutrition
 - Recycling
 - Construction
 - Education/skills development
 - Weed killing
 - Community services
 - Food security
 - Waste management
 - Childcare/crèches
 - Agriculture
 - Arts and culture
 - Health care
 - Road maintenance
 - Hospital laundry services
 - Crime prevention
 - Security
 - Transportation and distribution
 - Garden services

3. Database

- A formal registration process should be embarked on to pre-approve and register Social Enterprises on a Provincial Supplier Database. The database should allow for Public Sector Institutions to access Social Enterprises by type of enterprise, size of enterprise, type of commodity or service offered, and geographical area. The Social Enterprise Supplier Database should provide for categories of suppliers that can compete within a category but not across categories. For example, Community Caterers can compete with each other but should not compete with large established caterers whether white or black. One could use the number of people being catered for as a criteria for categorisation.

4. Recommended Sourcing Strategy

- KwaZulu-Natal Provincial Treasury should identify commodities/services that can be offered by social enterprises on transversal contracts and engage with departments and municipalities to participate on them in terms of Regulation 16A6.5 and 16A6.6 of the Treasury Regulations, 2005.
- A pilot exercise should be conducted to test this sourcing strategy.

5. Training

- Training should be provided by KwaZulu-Natal Provincial Treasury to all SCM practitioners in KwaZulu-Natal to ensure compliance with this policy and procedure framework and to obtain a commitment to acquire goods and/or services from social enterprises.
- Training should be provided by the KwaZulu-Natal Department of Economic Development to all social enterprises on business-related issues.

6. Monitoring and Evaluation

- Targets for procurement spend should be set for each participating institution per commodity/service to ensure sustainability of the social enterprises is achieved.
- Targets for job creation should be set for social enterprises to measure the impact of public procurement on the social economy.
- A reporting tool should be designed for social enterprises and institutions to report on actual achievements monthly or quarterly.

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