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Preferential Procurement is Set to Reinforce BBBEE Codes

Legislation is like a rowboat. The boat is provided for you to get to the other side, but you have to row it in the right direction in order to get there. This is the thinking behind the new regulations on Preferential Procurement that come into effect on 7 December 2011. For the supplier, the rowboat is the means to securing a contract; for government the rowboat will facilitate the equitable spread of economic empowerment.

The loopholes that have allowed the prevalence of fronting and the enrichment of individuals at the expense of wider capacity building and skills transfer have been a worrying factor for the architects of Black Economic Empowerment (BEE). Many are asking the question: after 17 years of BEE, where are the black industrialists?

President Zuma asked this question at the Black Business Summit in September 2011. "The economy must produce authentic black entrepreneurs, who own factories and manufacture textiles, furniture, metal products or whatever the market requires," he said.

The answer to this concern may well be provided by the new Preferential Procurement regulations which aim at closing the door to fronting and black intermediaries that act as order mail boxes. The intention is to encourage black suppliers to develop their own capacity to deliver while recognising companies that engage in real transformation. Both the weighting of procurement points and the new restraints on outsourcing should result in a more equitable outcome.

Evaluation of points

Come December, tenders must first be evaluated on functionality, with scores allocated for each candidate's capacity to meet the terms of reference. These may include criteria stipulated by National Treasury or the relevant government body to meet certain transformational objectives.

Applicants who meet the minimum criteria for functionality must then be evaluated on price and Broad-Based Black Economic Empowerment (BBBEE) status, according to an 80/20 or



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90/10 formula. So the message is; your tender application must first meet all the technical criteria, second it must be competitively priced and third, you should have a high BBBEE rating.

For contract values under R1 million, the 80/20 weighting applies. This means that 80 points are allocated for the price and the balance of twenty points are allocated for BBBEE rating, with L1 scoring the full 20 points and lower ratings scoring a sliding scale of lower points – 18, 16, 12 and 8 points scored for L2, L3, L4, L5 respectively, and so on. This weighting gives proportionately greater favour to the BBBEE status of the applicants, making it a little easier for small black suppliers to compete.

The balance shifts to 90/10 for contract values above R1 million, which places greater pressure on applications for multi-million-rand contracts to be competitively priced. 90 points are allocated to price, while a maximum of 10 points count towards BBBEE status, with L1 scoring the full 10 points, followed by 9, 8, 5 and 4 points for L2, L3, L4 and L5 respectively down to non-compliant bids that get zero.

In both cases, the contract must be awarded to the tenderer who scores the highest number of points out of 100. If this does not happen, the other candidates may challenge the procurement decision.

A high BBBEE rating could be a tangible benefit for companies that want to charge a bit more for a project. In other words, a L1 or L2 candidate may still win on points even if his price is higher than that of his competitors. This is certainly an incentive for companies to clear the Level 3 barrier and get into the top end of the tender evaluation.

Conditions of outsourcing

One significant condition is that contracts can no longer be awarded to black intermediaries who then simply pass on the actual work to a non-compliant company. If the tenderer intends sub-contracting more than 25% of the value of the contract to any other enterprise, that sub-contractor must have a BBBEE status equal to or greater than that of the tenderer, or the work must go to an exempt micro enterprise (EME); otherwise the BBBEE points of the tenderer will not be counted in the total score. This should also put a lid on corrupt tendering practices and encourage the development of capacity within black-owned companies.



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A second significant condition is the Local Content Clause: the contractor may not renege on contract terms that stipulate a minimum threshold of local production and local content. This means, for example, that you cannot, after being awarded a contract, decide to source cheaper materials from the east rather than use local materials; you are obliged to meet the contract requirements for local manufacture and services. Government has already started to identify designated sectors, such as the automotive industry, where local content rules will be applied diligently.

If you are found to be in breach of these conditions, the penalties may be disqualification, having to pay for costs and damages incurred, cancellation of the contract, being barred from doing business with government (any organ of state) for ten years, or criminal prosecution.

When the Preferential Procurement regulations come into force the result will be a more level playing field for tender applications and an emphasis on using compliant suppliers who can do the work themselves. Regulations are always onerous, but these are designed to drive transformation more effectively, opening the way for real participation of black and BEE compliant suppliers in the economy.