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Implementing preferential procurement policies in the public sector in South Africa

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This paper identifies commonly encountered international objectives for procurement and preferential procurement policies, presents a taxonomy of methods for implementing such policies, describes the framework for procurement in South Africa embodied in the Constitution and reviews aspects of this framework in the light of international best practice and the new standards published by Standards South Africa (a division of South African Bureau of Standards) for monitoring and implementing preferential procurement policies.

The paper, using risk management techniques contained in AS/NZS 4360, analyses the commonly used international methods to implement preferential procurement policies and concludes that the methodology embraced in the Preferential Procurement Policy Framework Act is the one which minimises the risk of internationally accepted objectives of the procurement itself being compromised. The paper identifies commonly encountered South African practices that are not in accordance with the provisions of the Act and proposes an approach to the evaluation of tenders that is consistent with the Act.

INTRODUCTION

Procurement may be regarded as the process that creates, manages and fulfils contracts relating to

- the provision of supplies, services or engineering and construction works
- the disposal of property
- the hiring of anything, and
- the acquisition or granting of any rights and concessions

A preferential procurement policy is a procurement policy that promotes objectives additional to those associated with the immediate objective of the procurement itself. This being so, the question arises as to whether or not the objectives of preferential procurement policies conflict with primary procurement objectives, and if so, to what extent and how can this be managed within acceptable limits.

South Africa has undergone some fundamental reform in the regulation of procurement in recent years. It is one of the few countries in the world to have procurement subject to its constitution. Lawmakers have opted for the establishment of a regulatory framework within the constitution and the Preferential Procurement Policy Framework Act (Act 5 of 2000) and requiring accounting officers (heads of department / municipal managers) and accounting authorities (board or other governing body, or where there is no board or governing body, the chief executive officer) in organs of state (departments, municipalities, constitutional institutions, trading entities, public entities or municipal entities), through other pieces of legislation (Public Finance Management Act (Act 1 of

1999) and Municipal Finance Management Act (still a bill)) to conduct their procurements within this overarching framework. The procurement regime is still in the process of being transformed. Certain pieces of legislation still have to be repealed. Others are not yet fully implemented (World Bank 2002 and CIDB 2003). Nevertheless, the overarching framework that is applicable to all organs of state is very clear.

This paper examines the overarching procurement framework provided in South Africa's Constitution for the governance of procurement and the use of procurement to promote socio-economic objectives. It explores the tensions between primary and secondary objectives and ways of managing these tensions.

INTERNATIONAL OBJECTIVES FOR PUBLIC PROCUREMENT

The United Nations Commission for the International Trade Law Model law on Procurement of Goods, Construction and Services (UNCITRAL 1995) suggests that the immediate procurement objectives are

- maximising economy and efficiency in procurement
- fostering and encouraging participation in procurement proceedings by suppliers and contractors, especially where appropriate, participation by suppliers and contractors regardless of nationality, and thereby promoting international trade
- promoting competition among suppliers and contractors for the supply of the goods, construction or services to be procured

Table 1 Generic schemes for using procurement to attain socio-economic objectives

Scheme type	Description
Reservation	Contracts or portions thereof are reserved for contractors who satisfy certain prescribed criteria, eg contractors who <ul style="list-style-type: none"> • are owned, managed and controlled by a target population group • are classified as being a small business enterprise • have equity ownership by companies with prescribed characteristics, or • are joint ventures between non-targeted and targeted joint ventures
Preferencing	Although all contractors who are qualified to undertake the contract are eligible to tender, tender evaluation points are granted to those contractors who satisfy prescribed criteria or who undertake to attain specific goals in the performance of the contract.
Indirect	Procurement strategies and requirements are used to promote policy objectives by constraining the manner in which the procurement is delivered or by being used to generate offsets in parallel to the procurement, eg specifications require that work associated with the contract is undertaken in a manner that supports policy objectives or offsets whereby undertakings such as the provision of bursaries, participation in an economy, the provisions of community centres, etc, that are unrelated to the procurement itself are, in order to secure the contract, committed to.
Supply side	Supply side measures are provided to targeted enterprises to overcome barriers to competing for tenders or for participating in procurements within the supply chain, eg access to bridging finance and/or securities, mentorship, capacitation workshops, etc.

- the prohibition of discrimination against minority groups the improvement of environmental quality
- the encouragement of equality of opportunity between men and women, and
- the promotion of the increased utilisation of the disabled in employment

There are many international examples of the use of procurement as an instrument of policy over the last 75 years. In areas of regional policy, procurement preference schemes were first introduced in the 1930s to assist areas hit by the Great Depression, and following the Second World War, further schemes were adopted, some of which survived in Europe until 1991. A special scheme in Northern Ireland provided for a 5 % price preference for tenders where this would benefit employment in Northern Ireland. Set aside or reserved procurement strategies are used to encourage participation of small businesses and minority business enterprises in government contracts in the United States (Arrowsmith 1995). An Appropriation Act for Public Works in the Philippines in 1972 (Watermeyer 1999a) required the use of labour-based methods whenever technically possible and under the following conditions:

- providing for the fair and equitable treatment of all suppliers and contractors
- promoting the integrity of, and fairness and public confidence in, the procurement process, and
- achieving transparency in the procedures relating to procurement

a number of socio-economic or political (secondary) objectives including (McCrudden 1995):

- stimulation of economic activity
- protection of national industry against foreign competition
- improving the competitiveness of certain industrial sectors
- remedying regional disparities, and
- achieving certain more directly social policy functions such as
 - the fostering of the creation of jobs
 - the promotion of fair labour conditions and the use of local labour

- the estimated cost of labour-based construction does not exceed the best equipment alternative by more than 10 %
- the estimated duration of labour-based construction does not exceed the best alternative by more than 50 %

Many international organisations, including the World Bank, have objectives that are consistent with these objectives.

The procurement of supplies, services and engineering and construction works has been used internationally to support

Table 2 Methods used to implement preferential procurement policies

Scheme type	Methods	Actions associated with the method
Reservation	#1 Set asides	Allow only enterprises that have prescribed characteristics to compete for the contracts or portions thereof, which have been reserved for their exclusive execution.
	#2 Qualification criteria	Exclude firms that cannot meet a specified requirement, or norm, relating to the policy objective from participation in contracts other than those provided for in the law.
	#3 Contractual conditions	Make policy objectives a contractual condition, eg a fixed percentage of work must be subcontracted out to enterprises that have prescribed characteristics or a joint venture must be entered into.
	#4 Offering back	Offer tenderers that satisfy criteria relating to policy objectives an opportunity to undertake the whole or part of the contract if that tenderer is prepared to match the price and quality of the best tender received.
Preferencing	#5 Preferences at the shortlisting stage	Limit the number of suppliers / service providers who are invited to tender on the basis of qualifications and give a weighting to policy objectives along with the usual commercial criteria, such as quality, at the shortlisting stage.
	#6 Award criteria (tender evaluation criteria)	Give a weighting to policy objectives along with the usual commercial criteria, such as price and quality, at the award stage.
Indirect	#7 Product/service specification	State requirements in product or service specifications eg by specifying labour-based construction methods.
	#8 Design of specifications, contract conditions and procurement processes to benefit particular contractors	Design specifications and/or set contract terms to facilitate participation by targeted groups of suppliers.
Supply side	#9 General assistance	Provide support for targeted groups to compete for business, without giving these parties any favourable treatment in the actual procurement.

Table 3 Public procurement objectives in South Africa

Objective	Reference
Primary Procurement system is to be fair, equitable, transparent, competitive and cost effective.	Section 217 (1)
Secondary Procurement policy may provide for <ul style="list-style-type: none"> • 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 (2)

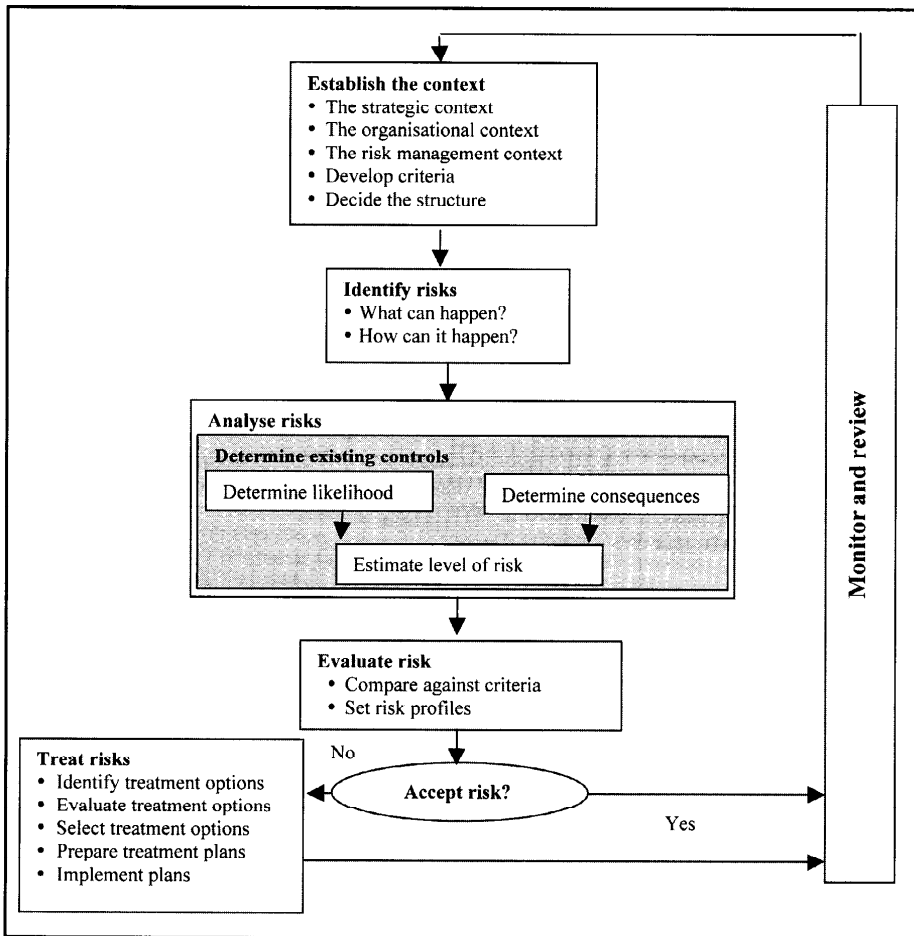


Figure 1 The process associated with establishing and implementing a risk management plan (after AS/NZS 4360:1999)

- the employment of workers for labour-based construction will not unduly impair agricultural production, and
- the technical quality is the same

The use of procurement as an instrument of policy is, however, not without controversy and questions have been raised regarding its legitimacy and effectiveness, and negative impacts on primary procurement objectives. All too often, the beneficial effects of policies that are promoted through procurement are doubtful or minimal. Even where benefits can be achieved, these must be weighed against the cost of doing so through procurement, either in terms of a price premium or a compromise on other matters such as time or quality. Enforcement costs and the erosion of core procurement values must also be considered.

METHODS USED TO IMPLEMENT PREFERENTIAL PROCUREMENT POLICIES

Procurement can be used to support socio-economic policies in a number of different ways, as indicated in table 1. For example, in the United States reservation schemes and supply side schemes are used to ensure market share of small business enterprises and minority business enterprises. Recent legislation in Botswana (Republic of Botswana 2001) makes provision for both reservation and preferencing schemes to promote citizen contractors, that is, companies that are wholly owned by Botswanan citizens. In South Africa, the Constitution (Act 108 of 1996) makes provision for preferencing schemes, many organs of state operate several supply side schemes, and the Department of Trade

and Industry operates a major indirect scheme (Industrial Participation Programme) whereby successful tenderers on certain high-value contracts tenders are required to participate in the South African economy to the extent that the total of all commercial/ industrial activity (subject to the department's crediting criteria) equals or exceeds 30 % of the imported content within a period of seven years.

Indirect schemes (see table 1), depending upon their nature, can relate directly to the procurement itself or be linked to a specific procurement and continue beyond the procurement. Indirect schemes that involve offsets, such as the Department of Trade and Industry's Industrial Participation Programme, usually apply only to high value procurements and have a life beyond that of the related procurement. They merely use procurement as a catalyst and not as a vehicle for delivering socio-economic objectives.

Several models for using public sector procurement interventions to achieve socio-economic objectives through a particular procurement, based largely on country specific procurement regimes and requirements, have evolved (Watermeyer 2000). Recently, however, the Public Procurement Research Group has developed a taxonomy of nine different methods for using public procurement to promote non-commercial objectives (Arrowsmith *et al* 2000). Table 2 summarises and categorises these nine methods in terms of the schemes listed in table 1. It should be noted that implementation methods 1 to 8 affect the procurement process directly, whilst method 9 does not.

PUBLIC SECTOR PROCUREMENT OBJECTIVES IN SOUTH AFRICA

The immediate and broad secondary procurement objectives in South Africa are established by Section 217 of the Constitution of the Republic of South Africa (Act 108 of 1996), as indicated in table 3.

The policy for the 'good governance' aspects of procurement captured in Section 217(1) establishes a comprehensive framework for procurement that is consistent with international norms and standards. Section 217(2) establishes South Africa's preferential procurement policy in that it provides for a preferencing scheme and measures to be taken to protect or advance persons disadvantaged by unfair discrimination.

It should be noted that the constitutional requirements for the procurement system is consistent with the objectives of the UNCITRAL model laws, and as such with international best practice.

Table 4 The risk of immediate procurements being undermined by secondary considerations in implementing preferential procurement policies which involve the targeting of enterprises and labour

Risk to be managed	What can happen	How it can happen (numbers in brackets refer to the method that is adopted – see table 2)
Loss of economy and inefficiency in procurement	Tenders are not awarded to the most advantageous offer. The tenders received/awarded do not represent value for money. Time taken to solicit and award tenders is excessive. Tenders are awarded to contractors who cannot deliver on time and to the required quality either in terms of policy objectives or due to imposed constraints relating to socio-economic objectives. Impositions on the contractor constrain contractors to the extent that they cannot operate efficiently.	(#7) forces contractors to utilise inefficient and costly technologies. Contractual conditions constrain the contractor in the performance of the contract. (#1), (#2) and (#5) reduce competition and exclude contractors who are capable of satisfactorily executing the contracts. (#6) contain too high a margin of preference and unduly distort the market. (#4) awards contracts to those who are not necessarily capable of performing the contract within the nominated contract price. (#3) impose inefficient and uneconomical restraints on contractors in the execution of the contract. (#8) by breaking work down into smaller contracts overextends the administrative capacity of the public body due to the high number of contracts awarded, cause economies of scale to be lost or extend the tender period unduly. Poor choices in method of policy implementation which place excessive and unnecessary risks on tenderers / overlook quality or capacity in the selection of contractors due to overriding socio-economic objectives.
The exclusion of certain eligible tenderers from competing for tenders	Enterprises which fall outside of those enterprises targeted in terms of a preferential procurement policy, or which fail to have achieved a certain staffing structure, are excluded from tendering or are discouraged from tendering.	(#1), (#2), (#5) can exclude or be used to exclude some contractors from participation. (#7), (#6), (#4), (#3), and (#8), make the procurement unattractive to some tenders.
Reduction in competition	Tenderers are not confident in the predictability of the system and as such decline to tender. The procurement procedures are designed to restrict competition.	Unfair and inequitable treatment of contractors cause prospective tenderers to decline to tender. Only a limited number of contractors are invited to submit tenders. Contracts are allocated and not competed for. Very few contractors can satisfy the requirements established in terms (#7) and (#3).
Unfair and inequitable treatment of contractors	Public bodies have double standards in dealing with contractors, based on factors other than ability and capacity to perform the procurement.	(#1), (#2), (#4), and (#5) unavoidably result in the unfair and inequitable treatment of contractors.
Lack of integrity and fairness	Those involved in procurement do not discharge their duties and obligations timeously and with integrity / behave equitably, honestly and transparently / comply with all applicable legislation and regulations. The method used to achieve an end does not inspire public confidence.	(#1), (#2), (#5), (#4), and (#8) can be applied subjectively. The manner in which (#7), (#6) and (#3) are applied do not inspire public confidence.
Lack of transparency in procurement procedures	Tenderers do not understand why they failed to secure a contract / failed to pre-qualify or where they are positioned with respect to a tender.	Reasons for administrative actions taken are not furnished. Eligibility criteria are not well defined / known. Tender prices and preferences in terms of award criteria are not made public or made known in procurement documents.
Failure to achieve socio-economic objectives through procurement	Socio-economic objectives are not achieved despite mechanisms being in place to do so.	Lack of compliance monitoring/enforcement. Practices and procedures that are not contractually enforceable.

IMPLEMENTING PREFERENTIAL PROCUREMENT POLICIES

Concerns regarding the undermining of primary procurement objectives are invariably expressed whenever procurement is used as an instrument of socio-

economic policy. Some countries have even gone so far as ruling out the use of procurement as an instrument of social policy. The World Trade Organisation (WTO) regulates 'discrimination' in procurement through the plurilateral Agreement on Government Procurement (GPA) but has not, as yet a multilateral agreement. The Doha Declaration, on the

other hand, expressly allows for discrimination (the secondary objectives) but has called for further negotiations on the primary objectives and, in particular, on transparency (Fenster 2002).

Predictability in the procurement system inspires confidence. Public perceptions are important in the selection of an implementation methodology.

Table 5 Probability of the risk being managed within acceptable limits in most procurements where labour and enterprises are targeted

Risk to be managed	Method of policy implementation (see table 2)							
	Reservation scheme				Preferencing scheme		Indirect scheme	
	#1: Set asides	#2: Qualification criteria	#3: Contractual conditions	#4: Offering back	#5: Preferences at short listing stage	#6: Award criteria	#7: Product/service specification	#8: Design of specifications, contract conditions and procurement processes to benefit particular contractors
Loss of economy and inefficiency in procurement	3	3	2	1	1	1	2	2
Exclusion of qualified tenderers from competing for tenders	3	3	2	-	-	1	2	2
Reduction in competition	2	3	2	2	1	1	2	2
Unfair and inequitable treatment of contractors	3	3	2	3	1	1	2	2
Lack of integrity or fairness	2	2	1	2	1	1	1	2
Lack of transparency in procurement procedures.	1	1	1	2	1	1	1	1
Failure to achieve socio-economic objectives through procurement	2	2	1	2	2	2	1	2

Legend 1 = favourable outcome will probably occur in most circumstances
 2 = unfavourable outcome might occur
 3 = unfavourable outcome likely in most circumstances

Typically the concerns raised by the international community revolve around the risk of the following occurring when implementing a preferential procurement policy:

- loss of economy and inefficiency in procurement
- the exclusion of certain eligible tenderers from competing for tenders
- a reduction in competition
- unfair and inequitable treatment of contractors
- lack of integrity or fairness
- lack of transparency in procurement procedures, and
- failure to achieve socio-economic objectives through procurement

The Australian Standard for Risk Management (AS/NZS 4360 1999) provides a generic guide for the establishment and implementation of the risk management process involving the establishment of the context and the identification, analysis, evaluation, treatment, communication and ongoing monitoring of risks (see figure 1). The risk of the aforementioned concerns being realised in the implementation of a preferential procurement policy can be assessed in terms of this standard. Risks associated with a programme of procurement can then be minimised

should the implementation methodology that has the least negative impact be adopted and this methodology be implemented within a well-defined framework.

Methods for implementing preferential procurement policies are well documented (McCrudden 1995, Arrowsmith *et al* 2000, and Watermeyer 2000). Qualitative and quantitative data on the outcomes of the implementation of preferential procurement policies is, however, generally lacking (Arrowsmith 1995). A recent study in South Africa, in 2000, found a lack of procedures at both national and provincial level to enable an accurate assessment to be made of how effective the preferential procurement policies were in reaching those for whom they were intended (Aus-Aid – SACBP 2000). A recently published independent assessment of target procurement in South Africa, which reviewed preferential procurement policies and not the instrument used to implement the policy, found that apart from the National Department of Public Works, precious few sources of information were available (Manchidi & Harmond 2002). The World Bank came to a similar conclusion in their review of the South African procurement arrangements (World Bank 2002).

AS/NZS 4360 recognises that any risk analysis may be undertaken to various

degrees of refinement, depending upon the risk information and data available. It suggests that consequences and likelihood may be determined using statistical analysis and calculations or, where no past data is available, subjective estimates which reflect an individual's or groups' degree of belief that a particular event or outcome will occur. Analysis may be qualitative, semi-qualitative or quantitative or a combination of these. AS/NZS 4360 permits the use of a qualitative analysis, which uses word form or descriptive scales to describe the magnitude of potential consequences and the likelihood that those consequences will occur, under the following three conditions:

- where an initial screening is required to identify risks which require more detailed analysis
- where the level of risk does not justify the time and effort required for a fuller analysis, or
- where the numerical data are inadequate for a quantitative analysis

The author conducted a qualitative risk assessment based on AS/NZS 4360 on the implementation of a preferential procurement policy which has objectives that can be realised by creating a demand for services and supplies from, or to secure

the participation of, targeted enterprises and targeted labour, using the first eight methods listed in table 2. This assessment, which unavoidably had to rely on subjective estimates, drew on both the author's experience and the experiences and views of colleagues in South Africa and the United Kingdom.

Table 4 presents the risks that are to be managed and identifies what can happen and how it can happen in relation to the methodology that is adopted. Table 5 presents the outcome of the risk assessment based on the author's subjective estimates and degree of belief that a particular outcome or event will occur, using a three-point scale. This qualitative analysis was carried out on the assumption that the implementation method under consideration is managed and implemented in a manner so as to achieve the most favourable outcomes.

The analysis indicates that 'preferencing schemes' (method 5 (preferencing at the shortlisting stage) and method 6 (award criteria)), whilst not guaranteeing that socio-economic objectives will be met, is the method that is most likely not to compromise immediate/primary procurement objectives if appropriately managed. The analysis furthermore indicates that method 3 (contractual conditions), method 7 (product/description specification), and method 8 (design of procurement to benefit particular contractors) have the potential under certain circumstances to satisfy primary objectives, while method 1 (set asides), method 2 (qualification criteria), and method 4 (offering back) are most likely to compromise such objectives.

Any preferential procurement policy distorts the market. The aforementioned risk assessment technique, conducted in accordance with the provisions of AS/NZS 4360, provides a useful means for indicating the extent to which the market is distorted by a particular policy.

SOUTH AFRICA'S APPROACH TO IMPLEMENTING PREFERENCES

Section 217(3) of the Constitution of the Republic of South Africa (Act 108 of 1996) establishes the manner in which South Africa's preferential procurement policy is to be implemented. Section 217(3), as promulgated in Section 6 of the Second Amendment Act (Act 61 of 2001), requires that national legislation must prescribe a framework within which the preferential procurement policy must be implemented.

The Preferential Procurement Policy Framework Act (Act 5 of 2000) was promulgated in response to this constitutional imperative. Accordingly, all organs of state must determine their preferential procurement policy and exercise a preference in accordance with the provisions of the Preferential Procurement Policy

Framework Act.

The Act makes use of award criteria (ie the allocation of tender evaluation points in the evaluation of offers) to implement the nation's preferential procurement policy. The lawmakers' reasoning in opting for this is understandable in the light of the above assessment. It is the method most compatible with the primary procurement objectives embedded in the constitution and is the method that is potentially acceptable to the international community and to foreign investors.

The Act provides for weightings of 10 % or 20 % for preferences, depending upon the financial value of the procurement, and requires the Minister of Finance to determine the threshold between these two weightings. The current regulation issued in terms of the Act (2001) makes preferencing optional, should the procurement have a value of R30 000 or less and nominates a value of R500 000 as the threshold above which the 10 % weighting is to be applied. The regulations also permit an organ of state to deviate from the framework in respect of predetermined tariff-based professional appointments.

Research based on quantitative data has indicated that the 10 % weighting, which yields a theoretical maximum direct cost premium of 11,1 %, produces acceptable outcomes at a nominal cost premium (Watermeyer *et al* 1998, Watermeyer 1999b, and Gounden 2000). Gounden (2000), based on the analysis of a comprehensive data set, has argued for this weighting not to exceed 10 % irrespective of the value of the contract and has advocated a lowering of the value to 5 % on a trial basis. It can be argued, however, in the case of the 20 % weighting, which yields a theoretical maximum direct cost premium of 25 %, that the distortion introduced into the market at this level may result in a significant risk exposure insofar as loss of efficiency and economy in procurement and a reduction in competition is concerned. Consequently, the analysis presented in table 5 is not valid where a weighting of 20 % is adopted.

The one perceived downside to the Act is that the methodology does not ensure that the intended beneficiaries do in fact always benefit directly from the use of procurement as a policy instrument. Target groups are not automatically guaranteed contracts or participation, that is, entitlement is not embedded in the methodology. There is always a risk, as reflected in table 5, that the successful tenderer may not be the tenderer that enjoys preferential treatment in terms of the policy or is not the one who offers the highest participation in a contract to target groups. This can be a source of frustration and needs to be overcome by implementing supply side measures to capacitate those for whom the policy is intended, to take advantage of the benefits that are offered (Watermeyer *et al*,

1998; Gounden 2000).

In recent years, organs of state have utilised a number of methods to implement procurement policies and have tended to combine some of the methods listed in table 2 in an effort to improve policy outcomes. Frequently minimum requirements are established (method 3) and tenderers who fail to satisfy these requirements are excluded from tendering or have their tenders rejected as being 'non-responsive'. Examples of such practices include the setting of mandatory threshold contract participation goals and the establishment of eligibility requirements for equity ownership by historically disadvantaged individuals or for joint venture formation. Others apply a hybrid form of the award criteria (method 6) in that points are awarded in respect of specific goals and some functionality or quality points are awarded for 'representativity' in respect of staff made available for the execution of the contract.

Another common practice, particularly in respect of professional services is to invite tenders only from those who satisfy policy criteria (method 2). These methods, however, all fall outside the provisions of the Preferential Procurement Policy Framework Act.

In newspaper advertisements, several institutions solicit tender offers from only designated persons or groups. This practice is in conflict with the Act, which is designed to grant a preference to tenderers who can achieve or satisfy the requisite goals and not to deny those who cannot the opportunity of tendering.

IMPLEMENTING THE PREFERENTIAL PROCUREMENT POLICY FRAMEWORK ACT

The Act in summary

The Preferential Procurement Policy Framework Act requires organs of state to determine their preferential procurement policy and to implement it within the framework provided by the Act. The Act requires that a preference point system must be followed, viz:

- For contracts with a rand value above a prescribed amount, a maximum of 10 points may be allocated for specific goals provided that the lowest acceptable tender scores 90 points for price.
- For contracts with a rand value equal to or below a prescribed amount, a maximum of 20 points may be allocated for specific goals provided that the lowest acceptable tender scores 80 points for price.
- Any other acceptable tenders which are higher in price must score fewer points on a pro rata basis, calculated on their tender prices in relation to the lowest acceptable tender in accordance with a prescribed formula.
- The contract must be awarded to the

tenderer who scores the highest points unless objective criteria in addition to that pertaining to specific goals justify the award to another tenderer.

The framework states that specific goals may include:

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

The framework furthermore requires that

- any specific goal for which a point may be awarded must be clearly specified in the invitation to submit a tender, and
- any goals contemplated must be measurable, quantifiable and monitored for compliance

It should be noted, however, that the regulations (2001) issued in terms of the Act make provision for the awarding of contracts on the basis of preference, price and functionality (quality), without defining the 'functionality', a term which is not encountered in international procurement systems.

The regulations issued in terms of the Preferential Procurement Policy Framework Act have several shortcomings, particularly in respect of regulations 13 and 17. In some instances they go beyond the provisions of the Act and convert the framework provided in the Act into a series of prescriptions. These provisions are *ultra vires*, that is, beyond the powers. It is understood that these regulations are in the process of being amended.

Legal interpretation of the application of the Act

The following extracts from Judge de Villiers' judgment in terms of the reported case (2002[3] All SA 336) of *Grinaker-LTA Ltd Ulusha Projects (Pty) Ltd v The Tender Board Mpumalanga and others* (case No 18276/2001) in the High Court of South Africa are pertinent:

- It is common cause that the award of a tender is an administrative decision. Bidders in a tender process are entitled to fair administrative action and have the legitimate expectation that their tender will be evaluated fairly, properly, justly and without bias, in accordance with the Act and public interest. Section 33 of the Constitution provides that administrative action shall be lawful, reasonable and procedurally fair. A public power vest-

ed in a functionary must be exercised in an objectively rational manner (paragraph 32).

- In terms of Section 2(1) of the Act the first essential of a preferential procurement policy and the implementation thereof is that a preference point system must be followed. Section 2(1)(f) provides that 'the contract must be awarded to the tenderer who scores the highest points, unless the objective criteria in addition to those contemplated in paragraphs (d) and (e) justify the award to another tenderer'. It is important to note that this subsection is cast in peremptory terms. The first step in determining to whom the contract must be awarded would accordingly be to determine which tenderer has scored the highest points. The next step would be to determine whether there are objective criteria in addition to those contemplated in paragraphs (d) and (e) which justify the award to another tenderer (paragraphs 38 to 41).
- It is clear that 'specific goals' and 'criteria' are differing concepts. Paragraph (f) refers to criteria in addition to those contemplated in paragraphs (d) and (e) which refer to specific goals which contemplate criteria by which it may be judged whether the goal has been achieved or not. Paragraph (f), in my view, contemplates objective criteria over and above those contemplated in paragraphs (d) and (e). The criteria contemplated in paragraphs (d) and (e) would, if the specific goal is clearly specified in the invitation to submit a tender, be the basis for the award of a maximum of ten points. To my mind, the legislature therefore envisaged that over and above the objective criteria contemplated in paragraphs (d) and (e), there might be objective criteria justifying the award to another tenderer than the tenderer who had scored the highest points. To put it differently: the legislature did not intend that criteria contemplated in paragraphs (d) and (e) should be taken into account twice, firstly in determining what score was achieved out of ten in respect of criteria contemplated in these paragraphs and secondly, in taking into account those selfsame criteria to determine whether objective criteria justify the award of the contract to another tenderer than the one who had scored the highest points (paragraphs 59 and 60).
- The government is not entitled to 'pay a premium' for empowerment. Empowerment is specifically catered for in the points system. It is specifically excluded by s 2(1)(f). There is no basis in fact or in law for a 'premium' to be paid for empowerment (paragraph 66).
- The task of the Tender Board has been and will always be primarily to ensure that government gets the best

price and value for that which it pays. If that were not the prime purpose of the Tender Board and policy considerations were to override these considerations, the very purpose of the Tender Board is defeated and no Tender Board needs to exist (*Cash Paymaster Services (Pty) Ltd, supra*, at 351 G-H approved in *SA Post Office Ltd v Chairperson of the Western Cape Provincial Tender Board and Others 2001*) (paragraph 67).

What then are objective criteria? Article 6 of the UNCITRAL Model Law on Procurement of Goods, Construction and Services (1995) proposes that ... in order to participate in procurement proceedings, suppliers or contractors must qualify by meeting such of the following criteria as the procuring entity considers appropriate in the particular procurement proceedings:

- that they possess the necessary professional and technical qualifications, professional and technical competence, financial resources, equipment and other physical facilities, managerial capability, reliability, experience, and reputation, and the personnel, to perform the procurement contract
- that they have legal capacity to enter into the procurement contract
- that they are not insolvent, in receivership, bankrupt or being wound up, that their affairs are not being administered by a court or a judicial officer, their business activities have not been suspended, and they are not the subject of legal proceedings for any of the foregoing
- that they have fulfilled their obligations to pay taxes and social security contributions in this State
- that they have not, and their directors or officers have not, been convicted of any criminal offences related to their professional conduct or making of false statements or misrepresentations as to their qualifications to enter into a procurement contract within a period of ... years preceding the commencement of the procurement proceedings, or have not been otherwise disqualified pursuant to administrative suspension or debarment proceedings.

The abovementioned qualification criteria, which can be applied at any stage of the procurement proceedings, relate to compliance with legislative requirements and commercial risk exposure. They are unrelated to compliance with the requirements of the tender. The UNCITRAL Model Law in article 34(2)(a) deals with this issue, viz 'the procuring entity may regard a tender as responsive if it conforms to all the requirements set forth in the tender solicitation documents or if it has minor deviations that do not materi-

ally alter or depart from the characteristics, terms, conditions and other requirements or it contains errors or oversights that are capable of being corrected without touching the substance of the tender'. Deviations must, however, be quantified to the extent possible and appropriately taken into account in the evaluation and comparison of tenders.

Section 83 (2) of the Local Government Municipal Systems Act (Act 32 of 2000) states that 'subject to the provisions of the Preferential Procurement Policy Framework Act (Act No 5 of 2000), a municipality may determine a preference for categories of service providers in order to advance the interest of persons disadvantaged by unfair discrimination, as long as the manner in which such preference is exercised does not compromise or limit the quality, coverage, cost and developmental impact of the services'. Treasury regulation 16.6.7 for departments, trading entities, constitutional institutions and public entities (May 2002) issued in terms of the Public Finance Management Act (Act 1 of 1999), which pertains to public-private partnerships, states that 'the procurement procedure may include a preference for categories of bidders, in terms of the relevant legislation, such as persons disadvantaged by unfair discrimination, provided that this does not compromise the value for money requirement'. This Act and regulation in effect interprets 'other objective criteria' to include the impact of preferences on the financial viability and the quality of the procurement itself.

An approach to the evaluation of tenders that is consistent with the Act is to

- reject all tenders received that are not responsive to requirements (ie make a determination as to whether or not the tender complies in all respects with the specifications and conditions of tender as set out in the tender document)
- reject as unacceptable all tenderers who have not satisfied their tax obligations or, if stated in the tender documents, are not in compliance with the requirements of the Employment Equity Act or any other piece of legislation
- reject all unrealistically priced tender offers (ie those offers which are judged not to be possible to execute within the financial offer) as being unacceptable as their use as the benchmark for the calculation of price will distort the scoring and may result in negative values being recorded if the current formula in the regulations is adopted (the evaluator should ascertain whether or not there is a valid reason for the tender price being unrealistic, and if not, eliminate the tender from further consideration. Such tenders would have in any event been rejected when objective criteria are considered)
- score the remaining responsive ten-

ders received and confirm that the commercial risk in awarding the tender to the tenderer scoring the highest tender evaluation points is acceptable. If not, record the reasons for overlooking this tenderer and consider the tenderer with the next highest number of points, etc

It should be noted that a tender may not be declared to be non-responsive/unacceptable, and as such be rejected, should a tenderer not comply with requirements relating to a preferential procurement policy, for example for failing to provide a minimum amount of equity in the tendering entity or to commit to a minimum contract participation goal that may be established by the employer. Such requirements are not provided for in the Act.

Evaluating quality alongside preferences

The Act makes no specific provisions for introducing quality in the evaluation of tenders. The regulations, however, introduce the term 'functionality' without defining it. The regulations permit price to be broken down into functionality and price.

Quality can form part of the

- specific goals for which a preference is provided
- other objective criteria, provided that the quality criteria is communicated to tenderers
- eligibility criteria included in the conditions of tender
- price used for comparative purposes where quality impacts on life cycle costs or the attainment of procurement objectives and outcomes, or
- tender offer

Recent court cases (see *Grinaker-LTA Ltd Ulusha Projects (Pty) Ltd v The Tender Board Mpumalanga and others* and *Judgment in the matter between RHI Joint Venture and the Minister of Roads and Public Work, the Premier of the Eastern Cape, Basil Read (Pty Ltd) and the Chairman of the Provincial Tender Board of the Eastern Cape*) (High Court (Bisho) Case No 769/02) have indicated that care must be taken to include all preferences only in the form of a specific goal. Accordingly, quality criteria should be considered to be preference when they are required as desirable (goals) but not essential features or characteristics. For example, an SABS mark for a product or tenderers having ISO 9000 certification can be a specific goal if they are desirable but not a requirement for the procurement.

Quality criteria which form an integral part of the tender offer, and hence the outcome of the procurement, should be scored together with the financial offer when the quality criterion is essential to the attainment of satisfactory outcomes

and is interlinked with the financial offer, for example proposals to provide professional services in response to broad project objectives and desired outcomes. Where this is the case, the points for price should be weighted between the financial offer and the non-financial offer (quality). Tenderers must, however, be notified of the value of such weightings prior to submitting tender offers.

Tariff-based professional appointments

The regulations permit a deviation from the framework in respect of predetermined tariff-based professional appointments. Any such deviation must nevertheless be fair, equitable, transparent, competitive and cost effective.

The World Bank in their recent review of South Africa's procurement arrangements have expressed concerns over the widespread practice of appointing consultants on a non-competitive basis (World Bank 2002). National Treasury in its draft Framework for Supply Chain Management (Section 76(4)(c) of the PFMA) (November 2002) requires that consultants be generally appointed by means of competitive bidding. There is accordingly a shift away from the non-competitive selection of consultants.

A preference in accordance with the framework provided in the Preferential Procurement Policy Framework Act can be readily incorporated in the quality-based approach to the evaluation of tender offers advocated by the United Nations Commission on International Trade Law, the World Bank, the Fédération Internationale des Ingénieurs-Concils, the International Union of Architects, and others. Consultants can be evaluated on the basis of quality and preference should the tariff be fixed in respect of an appointment or in terms of price, quality and preference where consultants are required to tender a percentage increase or decrease in respect of a specified tariff of fees. The regulation for functionality already permits this approach.

Care must however be taken to ensure that 'preferences' are not scored in the quality component of the tender evaluation.

THE ACCEPTABILITY OF OTHER METHODS TO IMPLEMENT PREFERENTIAL PROCUREMENT POLICIES IN SOUTH AFRICA

The Preferential Procurement Policy Framework Act makes provision for the use of only the 'award criteria' (method 6) to implement preferential procurement policies. The question that arises is: Can any other method be used and under what circumstances?

Although the Act does not make pro-

Table 6 Outline of the parts 1 to 6 of SANS 1914 (Standard for targeted construction procurement)

Part		Target groups provided for TE = targeted enterprise TP = targeted partner TL = targeted labour	Means of satisfying contract participation goals (CPG) requirements
#	Title		
1	Participation of targeted enterprises	TEs (and TPs who are TEs)	By one or more of the following: <ul style="list-style-type: none"> • performing the work as a TE prime contractor • subcontracting portions of the contract to TEs • obtaining supplies from suppliers who are TE • purchasing materials from manufacturers who are TEs • obtaining bonds and insurance policies from TEs • engaging service providers who are TEs • engaging non-TEs who in turn engage TEs – entering into a joint venture with one or more TPs • engaging non-TEs who in turn enter into joint ventures with TEs
2	Participation of targeted partners in joint ventures	TPs	By forming a joint venture at the prime contract level with one or more TPs
3	Participation of targeted enterprises and targeted partners in joint ventures	TPs and TEs who are not necessarily TPs	By <ul style="list-style-type: none"> • forming a joint venture at prime contract level with one or more TPs • engaging TPs as subcontractors/service providers/manufacturers and suppliers (At least two thirds of the CPG must be made up by forming joint ventures with TPs)
4	Participation of targeted enterprises and targeted labour (local resources)	TEs (including targeted manufacturers and suppliers) and TL	By either <ul style="list-style-type: none"> • <i>Method 1:</i> By virtue of TE status, provided that 50 % of wages and allowances are paid to TL, and engaging TEs in the performance of the contract, or by • <i>Method 2:</i> By engaging TEs and TL in the performance of the contract
5	Participation of targeted labour	TL	By engaging targeted labour in the performance of the contract
6	Participation of targeted enterprises in concession contracts	TEs (and TPs who are TEs)	By one or more of the following: <ul style="list-style-type: none"> • by engaging one or more TEs • by engaging non-TEs who in turn enter into joint venture agreements with one or more TPs • by engaging non-TEs who in turn engage one or more TEs

vision for preferencing at the shortlisting stage, the National Treasury has recommended this practice in public-private partnerships. This practice is in harmony with the intent of the approach to preferencing in the Act and will most probably be addressed at some future stage.

Reservation schemes, with the exception of contractual conditions (method 3), apart from not being provided for in the Preferential Procurement Policy Framework Act, also violate some of the requirements of the Constitution for procurement to be fair, equitable, competitive and cost effective.

Contractual conditions (method 3), product specifications (method 7) and the design of specifications, contract conditions and procurement processes to benefit particular contractors (method 8) can be used should it be satisfactorily demonstrated that the procurement remains fair, equitable, transparent, cost effective and competitive (refer to Section 217(1) of the Constitution, Sections 38(a)(iii) and 51(a)(iii) of the Public Finance Management Act and Section 35(a)(iii) and 58(a)(iii) of the Municipal Finance Management Bill, 2001). Put in another way, the use of these methods may not compromise value for money or exclude firms

who have the ability and capacity to perform the procurement from competing for the contracts.

NATIONAL STANDARDS PERTAINING TO TARGETED PROCUREMENT PROCEDURES

The Technical Committee for Construction Standards of Standards South Africa (a division of the South African Bureau of Standards) has recently developed several standards relating to targeted procurement procedures that may be applied in any procurement regime. These standards were developed around the recommendations developed by a focus group comprising industry stakeholders under the auspices of the Interministerial Task Team for Construction Industry Development, the work of the Procurement Forum and the documents published by the Department of Public Works.

A Standard for Implementing Preferential Procurement Policies using Targeted Construction Procurement Procedures (SANS 10396, 2003) has been published. This standard

- sets out the issues and principles which should be considered when formulating preferential procurement policies and developing associated implementation mechanisms
- sets out the principles associated with the engagement of targeted enterprises and targeted labour
- establishes a range of techniques and mechanisms which may be used to provide a framework within which access to markets for targeted enterprises and/or targeted labour can be provided and goals relating to the engagement of such enterprises and/or labour can be set, monitored and evaluated at both project and programme level
- establishes targeting frameworks and strategies which can be used with a number of different procurement regimes
- describes techniques for the monitoring and evaluation of the outcomes of a preferential procurement policy
- provides guidance as to how targeted procurement procedures can be activated in procurement documents, and
- provides guidance on the design and

implementation of programmes associated with the implementation of a preferential procurement policy

SANS 10396 documents the following targeted procurement procedures and establishes practical guidelines to facilitate implementation:

- defining target enterprises (ownership, control, independence, size, declaration affidavits and statements by auditors)
- defining targeted labour
- goals associated with targeted procurement procedures
- resource specifications (drafting principles, standardised resource specifications, structured joint ventures, activating the standardised resource specifications in procurement documents and variations to the standardised resource specifications)
- incentives for contractors to embrace goals (goal/price mechanism and bonus incentives)
- third party management support
- electronic rotating data bases (rosters)
- equity in tendering entities
- financial penalties

SANS 10396 also establishes targeting frameworks and strategies flowing out of standard combinations of targeted procurement procedures for a range of commonly encountered socio-economic objectives, including unbundling strategies, targeting frameworks for contractor development programmes and targeting frameworks for employment intensive projects. Monitoring for contract compliance is also considered with specific reference to confirming the bona fides of targeted enterprises at tender stage, monitoring where direct preferences are granted and monitoring of contract participation goals using resource specifications. It also provides guidance on how to evaluate programmes with specific references to standard indices and touches on aspects of software programmes to monitor and report on policy outcomes.

Six standard targeted construction procurement standards (resource specifications) (SANS 1914 parts 1 to 6, 2002) are provided to

- describe the general requirements for engaging targeted enterprises and/or targeted labour on a contract for the provision of supplies, services or works, as relevant
- specify the contract participation goal (the value of a percentage of the value of the contract which represents the inputs of targeted enterprises and/or targeted labour in the performance of the contract)
- set out the methods by which the contract participation goal will be measured, quantified and verified in the performance of the contract
- describe the means by which – progress towards the attainment of

the contract participation goal is to be monitored

- compliance with requirements will be verified and monitored, and
- the contract participation goal will be adjusted to accommodate variations to the scope of the contract

These standards make provision for the engagement of targeted enterprises (TEs), targeted partners in joint ventures (TPs) and targeted labour (TL), as indicated in table 6. The users of these specifications are required to define the targeted enterprises, targeted partners and targeted labour, as required.

These South African National Standards in effect standardise the implementation methodology where preferential procurement policies seek to provide business and employment opportunities for target groups. They present a comprehensive tool kit for implementing preferential procurement policies in a number of procurement regimes, both in the public and private sectors. For example, the SANS 1914 standards can be used to implement preferencing using award criteria (method 6) in South Africa and set asides (method 1) in Botswana and the United States of America.

THE USE OF SOUTH AFRICAN STANDARDS IN IMPLEMENTING PREFERENTIAL PROCUREMENT POLICIES IN SOUTH AFRICA

Well-formulated preferential procurement policies should outline clear policy themes, establish priorities where there is more than one policy theme, and project policy outcomes. Short- and medium-term targets (deliverables) should be established to give direction to implementing officials as to the targeting strategies that should be adopted for specific contracts. Specific goals at project level need to be clearly defined to make them contractually enforceable; measurable and quantifiable to allow them to be monitored and evaluated; and verifiable and auditable for reasons of transparency and ensuring that the policy intent is achieved.

The guidance provided in SANS 10396 facilitates the development of comprehensive policies and implementation plans (see appendix for an example). The targeted procurement procedures described in SANS 10396 and the SANS 1914 not only allow goals to be measured, quantified and monitored in accordance with the requirements of the Preferential Procurement Policy Framework Act, but also facilitate the aggregation and evaluation of goals and the evaluation of the efficiency of targeting strategies to be made at programme level. It

furthermore enables the progress towards the attainment of specific policy objectives to be monitored.

CONCLUSIONS

There are several methods available to implement preferential procurement policies. It is possible, through the use of preferencing at the shortlisting stage and tender evaluation criteria, to implement preferential procurement policies to attain socio-economic objectives without compromising the internationally accepted immediate objectives of the procurement itself or best value objectives.

The South African legislative framework for procurement as enshrined in the Constitution and the implementation of preferential procurement policies in accordance with the Preferential Procurement Policy Framework Act, apart from the requirement for a 20 % weighting in respect of relatively low-value contracts, is consistent with international best practices. Care must be taken, however, in implementing preferential procurement policies to ensure that socio-economic objectives are promoted solely through the evaluation mechanism provided for in the Act, unless it can be demonstrated that the procurement remains fair, equitable, transparent, competitive and cost effective.

The new South African national standards (SANS 10396 and SANS 1914 parts 1 to 6) provide a range of tools suitable for implementing preferential procurement policies in accordance with South Africa's legislative framework and provide practical guidance for organs of state on how to formulate preferential procurement policies, define target groups, monitor for contract compliance in the performance of the contract and monitor policy outcomes.

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APPENDIX

Example of the design of a preferential procurement policy

Job creation in civil engineering infrastructure

Focus	Job creation by increasing employment per unit of expenditure in civil engineering construction (ie the ratio of total construction costs excluding VAT but including any management fees directly related to construction activities to the total volume of employment generated (person hours) in the construction of civil engineering infrastructure).
Key performance indicators	Expenditure on semi-skilled and unskilled workers expressed as a percentage of the total cost of construction.
Target	At least 30 % of the cost of construction represents the expenditure on semi-skilled and unskilled workers.
Direct impact of procurement policy	Provide incentive through preferences to contractors to select construction work methods and technologies which promote the creation of employment so as to promote the creation of employment.
Indirect effects of procurement policy	Unskilled and semi-skilled workers will receive some training. Money will flow from the project into the local community.
Strategy for implementation	<p><i>Policy for the employment of temporary (contract specific workers), acceptable to stakeholders will be put in place in order to minimise risk exposure.</i></p> <p>A mechanism in terms of which contractors can define the portion of the excavation works which will be excavated by hand methods will be included in procurement documents along the lines of that proposed in Annex G of SANS 10396.</p> <p><i>Tenderers will be permitted to choose which road construction technology they wish to make use of. No tender evaluation points will be granted in respect of contract participation goals less than 10 %. Tenderers will be granted preferences in proportion to their tendered contract participation goal with the maximum points being awarded to the tenderer with the highest tendered contract participation goal.</i></p>
Target groups	South African citizens who permanently reside within the boundaries of ... and earn wages and allowances amounting to less than R9,00 per hour.
Actions	<p>Give preferences for participation by targeted labour in the evaluation of tenders.</p> <p>Gather statistics on employment generated in different types of civil engineering infrastructure projects.</p> <p>Review labour-based technologies to enable tenderers to exercise a wide choice of technologies in contracts.</p>
Targeting strategies	Direct participation using the SANS 1914-5 specifications, depending upon the nature of the project (0 points for 10 % contract participation goals and maximum points granted to the tenderer offering the highest contract participation goal. Weighting factor = 1,0).
Data capture	<p>Capture the following data upon award and termination/completion in respect of</p> <ul style="list-style-type: none">• choices / options selected• goals tendered and achieved• price (successful tenderer and price used in determination of the preference)
Monitoring for contract compliance	<p>Monitor for compliance with conditions attached to the granting of preferences</p> <p>Monitor the attainment of contract participation goals in terms of Annex H of SANS 10396</p>
Evaluation	<p>Calculate increase in employment per unit of expenditure from the following formula:</p> $\frac{\text{Sum of (contract participation goals x contract value)}}{\text{Sum of (contract value x 10)}}$ <p>Produce report on a quarterly basis which provides details at both a project and programme level.</p>
Review	The policy outcomes, targeting strategy used to achieve policy outcomes, and the selected technologies in specific projects will be reviewed on an annual with a view to improving performance in subsequent years.