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EVALUATING THE IMPACT OF PUBLIC SECTOR TARGETED PROCUREMENT STRATEGIES ON THE DEVELOPMENT OF SMEs IN THE CONSTRUCTION INDUSTRY

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Abstract
This paper examines the targeted procurement (TP) strategies of public sector clients such as state-owned enterprises (SOEs) in South Africa and whether these strategies impact on the development of SMEs in the construction industry. The rationale for this study stems from reports that while TP has been widely used as an instrument to improve the position of SMEs in the South African construction industry, three out of five SMEs do not become established firms. In addition, the nature of the impact of TP strategies on the growth performance of SMEs in the construction industry is not known. This stage of the study adopts a literature survey, mainly employing theoretical perspectives to establish the TP strategies used by public sector clients and the nature of its impact on SME development in the construction industry. Preliminary findings reveal that the TP strategies frequently used in the construction industry include unbundling, mandatory subcontracting, preferencing, third party management and incentives for KPIs and that TP strategies directly influence SME growth performance, however this relationship is mediated by the level of supply chain integration. It can be inferred from these findings that SOEs would need to carefully choose and implement the most appropriate TP strategy that enhances the integration between targeted SMEs and other entities in the supply chain.

Keywords: construction industry, procurement, SMEs, supply chain integration, targeted procurement

1 Introduction

Interacting with almost all spheres of human endeavour and having strong links with other sectors of the economy, the construction sector and its activities occupy a critical position that influences national strategic socio-economic development and improvement in the quality of life (Rwelamila, 2012; UNCHS, 1996). Government's understanding of the construction industry's significant role in the economy is well-documented in literature (London, 2008; Rwelamila, 2012; Shakantu, 2012). Implicitly, there has also been an increasing understanding of the need for the government to intervene in the construction industry that is largely dominated by albeit specialized, underperforming small and medium-sized enterprises (SMEs) (Egan, 1998; Latham, 1994; UK BIS, 2013; Wolstenholme, 2009).

SMEs have long been recognised to play an important role as key drivers of economic growth (Abor and Quartey, 2010; Shakantu, 2012; Vosloo, 1994). The South African architectural, engineering and construction (AEC) subsector, accounts for about 34.2% of total small business employment (Schüssler, 2012), making it the second largest employer among SMEs. Construction SMEs are very diverse and highly specialized; and they constitute a significant

part of the construction industry supply chain (Dainty et al., 2001). The sustained significance of construction small businesses has led to the focus of government's policies on promoting the advent of capable small contractors and supporting their continuous development and sustainability (Egan, 1998).

Consequently, some governments have implemented prescriptive measures to promote small contractor development (Gounden, 2000; Hawkins, 2012; Ofori, 1996; Watermeyer, 2003). Others have gone ahead to set-up and implement supportive procurement programmes (demand side interventions) and well-structured contractor development models (supply side interventions) (Dlungwana and Rwelamila, 2004). These interventions are usually implemented through public procurement where the government becomes an active participant in the market economy as a major client contributing significantly to GDP – up to 50% of entire domestic construction expenditure in South Africa (Ncwadi and Dangalazana, 2006). Therefore governments progressively use their purchasing power to intervene in the construction industry towards achieving a broad range of national socio-economic goals including the development and sustainability of the de facto drivers of economic growth, i.e. local SMEs.

Targeted procurement (TP) is an innovative government procurement intervention strategy designed to promote the participation of targeted enterprises and targeted labour in contracts (cidb, 2008a; Ofori, 2009; Watermeyer et al., 2001); in a bid to achieve the state entities' contractor development goals which are included as a relevant criterion for contract award, along with other functional criteria e.g. price and quality. While fewer studies have been undertaken to assess the impact of TP in South Africa, there have been more studies (e.g. Gounden, 2000; Kajimo-Shakantu, 2007; Letchmiah, 2012; Manchidi and Harmond, 2002) relating to preferential procurement policy generally. Previous reports (Letchmiah, 2012; Manchidi and Harmond, 2002) indicate that TP have successfully opened up the construction industry to SMEs with their contract-winning rate and market share increasing significantly; however, SMEs remain deprived in a competitive industry where three out of five SMEs do not become established firms (Greyling, 2012; Mofokeng and Thwala, 2012).

The TP process in the construction industry is made-up of a network of supply chain relationships between targeted SMEs and other entities in the project supply chain. Manchidi and Harmond (2002) highlight the difficulty of targeted enterprises to form genuine quality contracting relationships (or integration) with other entities in the supply chain, which limit their ability to develop organizational and operational capacities (Kajimo-Shakantu, 2007). This paper therefore examines the TP process of public sector clients, specifically state-owned enterprises (SOEs) in South Africa using a literature survey, to identify the prevalent TP strategies used when targeting SMEs in the construction industry, and whether the quality of relationships formed with other entities in the TP process interacts with the TP strategies implemented to influence the growth performance (or development) of SMEs.

2 Overview of targeted procurement strategies, supply chain relationships and measures of SME growth performance

The phenomenon being investigated by this study (i.e. the relationship between TP and SME development), has its theoretical underpinnings in the field of industrial organisation economics. Industrial organisation economics builds on the theory of the firm, which is a group of economic theories that explains and predict the nature of the firms – existence, behaviour, structural organisation, and their relationship to the market or industry as a whole. However industrial organisation economics focuses on two main areas, i.e. the structural and behavioural characteristics of the industry, and how these influences the performance of firms in the industry (Bain, 1959; Martin, 1993). Two schools of thought exist in the field of industrial

organisation economics, namely: the Chicago School and the Structure-Conduct-Performance (SCP).

The Chicago School argues for economic rationalism, i.e. market forces rather than government intervention should dictate the allocation of economic resources and determine the performance of firms within the industry (Stilwell, 1993). This approach is usually applied to markets in perfect competition, which is not always the case, as some experience market failure or severe socio-economic challenges e.g. income inequality in South Africa (Palma, 2005; Rwelamila, 2012; UNDP, 2013). While the SCP school of thought argues for government intervention. The rationale is that because market structure has a direct influence on, and is central to the firm's economic conduct/behaviour, which in turn affects the firm's performance in the market, it is necessary for governments in their role as the regulator of the economy, to intervene in altering the market structure towards influencing the growth performance firms and the market as a whole (Bain, 1959). Targeted procurement – a form of government intervention, adheres to the SCP paradigm, and evidence (Kajimo-Shakantu, 2007; Letchmiah, 2012) shows that TP has changed the structural characteristics of the construction industry with the market share of SMEs increasing significantly.

2.1 Targeted procurement strategies

The ADB (2012) reveals that SME development procurement initiatives are most often applied by governments in two broad ways: bid price preferences that load the lowest non-SME bid or provide a discount to the lowest SME bid, and set-asides which provide quotas for targeted SMEs to bid competitively against each other. For example, in Singapore, bidding preferences were offered to local construction firms and joint ventures (Ofori, 1996).While, Botswana implemented bid preferencing schemes to promote engagement of citizen contractors (Watermeyer, 2003). On the other hand, set-asides or reserved procurement strategies have been used to encourage participation of small businesses and minority business enterprises in government contracts in the US, South Africa, Indonesia and Malaysia (Arrowsmith, 1995; Hawkins, 2012) and to develop minority enterprise and counter the effects of past discrimination (Bolton, 2006; Chatterji et al., 2014).

Preferential procurement practices in public procurement are an important government intervention strategy for stimulating the growth and development of SMEs in the construction industry of many countries including South Africa (Hawkins, 2012; Watermeyer et al., 2001). The adoption of preferential procurement policies in South Africa as a vehicle for contractor development, in a practice called targeted procurement is well documented in literature (London, 2008; Shakantu, 2012; Watermeyer, 2003). As part of national procurement reforms to address past imbalances and stimulate SME growth and development, the Department of Public Works, in 1996, introduced innovative TP strategies to promote the participation of targeted SMEs in public sector contracts (Shakantu, 2012).

The various public sector TP strategies used in public procurement include (cidb, 2008b; Letchmiah, 2012; Watermeyer, 2005):

- Unbundling of Contracts – where contracts are broken down into smaller contracts or packages to facilitate the participation of SMEs and/or emerging contractors in procurement as main or prime contractors;
- Mandatory Subcontracting – where larger main contractors are required to subcontract a portion of the works to SME contractors using client-prescribed procurement procedures;
- Preferencing – where tender evaluation points are granted to those contractors who satisfy prescribed preferencing criteria (such as joint ventures between large and SME contractors);

- Third Party Management – where larger established contractors and/or consultants are required to provide construction management support, and mentor SMEs and/or emerging contractors in the execution of contracts as prime contractors and monitor satisfactory progress of their work; and
- Incentives for KPIs – where a specified target (key performance indicator) has been set, contractors who achieve the KPIs are awarded incentive payments. Public sector clients tend to combine some of the identified TP strategies in an effort to maximize outcomes.

2.2 Supply chain relationships and review of existing models

Construction industry projects are often characterized by a highly fragmented supply chain and a less fragmented demand side that is organized and linked via supply chain relationships (Oyegoke et al., 2009). The supply chain management concept aims to integrate the interests of all stakeholders (suppliers and customers) towards the common goal of efficiently delivering best value to the client (Brown et al., 2001; Cox and Townsend, 1998; Oyegoke et al., 2009). According to Pryke (2006), the construction project can be viewed as a network of relationships between firms that make up the project supply chain.

Emerging in the purchasing and supply sector in the mid-1990s, supply chain relationship models has subsequently been introduced in the construction industry to describe, measure and improve the relationships between the key partners of a construction supply chain. Seven existing models that describes the change in supply chain relationships from the traditional to the collaborative have been identified in this paper. They include: the client-contractor working relationship model (Larson, 1995), the model of partnering (Ellison and Miller, 1995), the Construction Industry Institute's (CII) partnering continuum (Thompson and Sanders, 1998), the Best Practice in Partnering Group's (BPiPG) partnering positioning matrix (Jones and O'Brien, 2003), the Strategic Forum for Construction's (SFfC) supply chain maturity assessment grid (SFfC, 2003), the supply chain position matrix (Hines, 1994), and the supply chain relationship maturity model by Meng et al. (2011).

Six of the models are all related to the construction industry, while Hine's supply chain position matrix is a comprehensive model developed in the purchasing and supply sector that provides a good comparison with construction specific models. Three of the construction-oriented models focus on the relationships between clients and main contractors, and have not paid attention to downstream relationships where majority of SMEs in the construction industry are clustered. With the exception of Meng et al.'s supply chain relationship maturity model, the other three models that try to examine the supply chain as a whole have limited use in practice as they are only applicable to integrated supply chains, which makes them difficult to use when different types of relationships exist in different parts/tiers of the supply chain such as the construction industry. Most of the existing models are further characterised by either inappropriate definition of relationship levels, or biased towards the collaborative end of the supply chain relationship spectrum by establishing one level for a traditional relationship and three levels for different partnering (Meng, 2010). However evidence shows that most supply chains in the construction industry are still very traditional, as partnering is yet to be fully entrenched in construction practice (Briscoe and Dainty, 2005; Meng et al., 2011).

In comparison, Meng et al.'s supply chain relationship maturity model builds on the inherent weaknesses of the other models such as incomplete coverage of key criteria, and develops a robust systematic model that explores the special characteristics of the construction industry supply chain. Developed in the UK construction industry, the model adopts the capability maturity approach (Paulk et al., 1993), and establishes four construction supply chain relationship maturity levels in matrix format with 24 assessment criteria in eight categories at each of the four maturity levels. This model will be adapted to reflect supply chain relationships

in the context of the South African construction industry. The adopted supply chain relationship maturity model focuses on specific relationships between customer and supplier rather than the whole supply chain. This will allow for a robust understanding of the quality of relationship between targeted SMEs and other key partners of the construction supply chain.

The key component of the model that sum up the quality of supply chain relationships are the four maturity levels which describes the progression of relationship improvement from adversarial, through limited cooperation and short-term collaboration, to close and long-term collaboration. They are: Price competition (Level 1), Quality competition (Level 2), Project partnering (Level 3), and Strategic partnering (Level 4). The supply chain relationship at Level 1 is characterized by self-interest, mistrust, lack of mutual objectives, and win-lose business philosophy that results in adversarial or arms-length relationships. Level 2 is characterized by partial win-win benefits, and trust is mainly built on the capability of each party to execute quality work; this is regarded as a transition from traditional to collaborative relationship. At Level 3, mutual objectives are achieved on a single project, partners work together collaboratively as an integrated project team, goodwill trust and win-win attitude fosters the project partnering relationship. At Level 4, objectives are aligned over a series of projects, close collaboration is achieved across the whole supply chain, high degree of trust exist between partners, and an attitude of performance measurement and continuous improvement is adopted.

2.3 Measures of SME growth performance

Small firm growth theorists (Davidsson et al., 2005; Penrose, 1959; Starbuck, 1971) refer to growth as the change in an organization's size – a multidimensional phenomenon that necessarily happens over time. Unlike large firms that tend to grow through acquisitions, small firms usually grow organically (Penrose, 1959). In the analysis of firm growth from the change-in-size perspective, growth has been measured with a range of different indicators in the literature; the most frequently suggested being sales, revenue, employment, assets, physical output, market share and profits (Ardishvili et al., 1998; Delmar, 1997; Weinzimmer et al., 1998; Wiklund, 1998). In specific industry studies, more specialized measures are conceivable (Davidsson et al., 2005). For example, in construction, increase in turnover and employment are the most frequently used by scholars in construction management research (Abu Bakar et al., 2011, 2012; Ofori and Chan, 2000; Tucker et al., 2015). However, in the context of this study, multiple indicators of increase in turnover, assets (plants and equipment), and number of permanent and skilled employees will be used to measure SME growth performance (development) in relation to targeted procurement objectives. These indicators are selected because the South African Construction Industry Development Board (cidb) uses increase in financial and works capability plus number of registered skilled professionals in a firm's employment as the main requirements for progressing through the cidb contractor grading system – a holistic measure of company growth and development in the South African construction industry.

3 The impact of Targeted Procurement strategies on SME development

According to Chatterji et al. (2014) and Letchmiah (2012), little is known about the actual effectiveness of preferential procurement in promoting the growth and development of SMEs, and only a handful of studies have attempted to analyse whether these programmes have met their goals in the construction industry. Reports from previous studies on the impact of set-asides in the US construction industry indicate that set-asides: significantly increased contract awards to SMEs (Marion, 2007); have a positive and significant empirical impact on SME growth regardless of how growth is measured (House-soremekun, 2006); and plays a significant role in the net survival rates of these SMEs (Marion, 2007). However, Blanchflower

and Wainwright (2005) argue that these programmes have not achieved their objective of improving the position of SMEs in the construction industry.

In South Africa, four major previous studies (Gounden, 2000; Kajimo-Shakantu, 2007; Letchmiah, 2012; Manchidi and Harmond, 2002) have been identified in literature. Three key similarities can be drawn from the results of these independent studies – the application of TP strategies significantly contributed to increased participation of SMEs in government tendering process, led to greater success in winning government contracts, and promoted the development of business linkages between historically empowered firms and historically disadvantaged SMEs. However, attempts to measure the impact of TP on individual SME growth performance in the construction industry has been evasive so far. Furthermore, it is unknown, how and whether, the quality of relationship interacts with the implemented TP strategies to influence the growth performance of SMEs.

4 Conceptual framework

This study draws on the theories of industrial organization economics, strategic management and supply chain management (Davidsson et al., 2005; London, 2008; Martin, 1993). Based on literature review, a conceptual model is developed showing that there is a relationship between targeted procurement strategies, supply chain integration and the development of SMEs through the procurement process (see Figure 1) (Quality of relationships and supply chain integration are used interchangeably in this paper). The constructs for SME development are turnover, assets (plants and equipment) and number of skilled employees (Abu Bakar et al., 2011, 2012; Ofori and Chan, 2000; Teruel-Carrizosa, 2006; Tucker et al., 2015). Quality of supply chain relationships/integration are price competition (Level 1), quality competition (Level 2), project partnering (Level 3), and strategic partnering (Level 4) (Meng et al., 2011). While TP strategies identified are unbundling, mandatory subcontracting, preferencing, third-party management, and incentives for KPIs (cidb, 2008b; Letchmiah, 2012; Watermeyer, 2005).

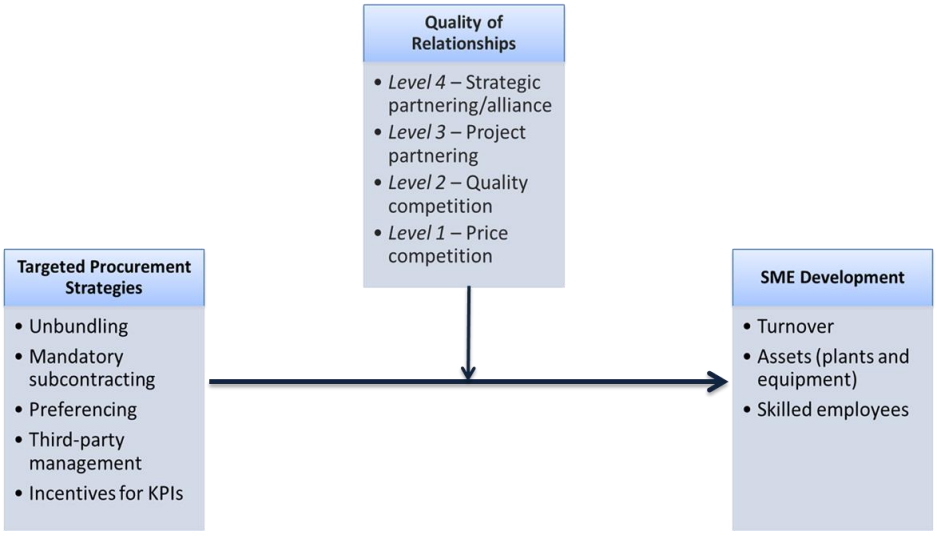

Figure 1. Conceptual framework

The conceptual model proposes that there is a direct linear relationship between TP strategies (independent variable) and SME development (the primary variable, which is also the dependent variable); while quality of supply chain relationships (moderating variable) mediates the relationship between TP strategies and SME development. However it is not known, how and whether, the quality of supply chain relationships/integration interacts with the implemented TP strategies to influence the growth performance of SMEs. Thus further

empirical research is required to determine how TP strategies and corresponding relationships impact on the development of SMEs in the construction industry. The relationships among targeted procurement strategies, quality of relationship, and SME development are also modelled using linear (Equations 1, 2, and 3) and multiple regressions (Equation 4).

$$Y\ (SME\ Development) = X\ (Targeted\ Procurement\ Strategies) \quad \ldots\ldots\ldots\ldots\ 1$$

$$Y\ (SME\ Development) = X\ (Quality\ of\ Relationships) \quad \ldots\ldots\ldots\ldots\ 2$$

$$Y\ (Quality\ of\ Relationships) = X\ (Targeted\ Procurement\ Strategies) \quad \ldots\ldots\ldots\ldots\ 3$$

$$Y\ (SME\ Development) = X1\ (Targeted\ Procurement\ Strategies) + X2\ (Quality\ of\ Relationships) \quad \ldots\ldots\ 4$$

In both equation 1 and 2, SME development is the dependent variable while TP strategies and quality of relationships is the independent variable respectively. This implies that SME growth performance changes depending on the TP strategy used, and the level of supply chain integration. In equation 3, quality of relationships is the dependent variable while TP strategies is the independent variable meaning the level of supply chain integration changes depending on the TP strategy used. Because SME development is a dependent variable to both TP strategies and quality of relationships in equations 1 and 2 respectively, it suggests that TP strategies interact with quality of relationships within the supply chain entities to influence SME growth performance. Hence, SME development becomes a function of this interaction as shown in equation 4, where SME development is the dependent variable and TP strategies and quality of relationships/integration between the supply chain entities are independent variables.

5 Conclusion and further research

The study examines the TP strategies of public sector clients such as state-owned enterprises (SOEs) in South Africa and whether these strategies impact on the development of SMEs in the construction industry using theoretical perspectives. The literature survey conducted established that the targeted procurement strategies used in the construction industry include unbundling, mandatory subcontracting, preferencing, third party management and incentives for KPIs and that TP strategies directly influence SME growth performance, however this relationship is mediated by the level of supply chain integration. Further empirical research is required to measure the impact of TP on individual SME growth performance in the construction industry and to determine the type of contracting relationships formed by SMEs with other entities in the supply chain and whether this impacts on their growth and performance.

The proposed further research is to be conducted in South Africa, because the South African construction industry possesses all the legal and structural underpinnings for the proposed investigation. The study will follow a three-stage sequential triangulated mixed-method approach – emphasizing qualitative techniques, but also combining quantitative methods to enrich answers to the research questions. Through deep and robust narratives, qualitative data will provide analytical insights that will help in understanding the quality of relationships that develop in the project delivery process, while quantitative data will provide measurable indicators of outcomes to improve generalizability and transferability of research findings.

The unit of analysis for this study will be the TP projects of identified SOEs such as South African National Roads Agency Limited (SANRAL), Airports Company South Africa (ACSA), Passenger Rail Agency of South Africa (PRASA), Petroleum Oil and Gas Corporation of South Africa (PetroSA). Respondents will be selected from supply chains of SOEs that have developed in response to a TP project. Primary focus will be on the construction cluster in the supply chain, thus excluding the design cluster. Selected respondents will be limited to cidb Grade 3 – 6 contractors that have executed TP projects within the last 5 years. Grade 1 to 2 contractors are excluded because they are unlikely to reflect the growth performance been sought, while Grade 7 to 9 contractors are excluded because these are

considered established contractors. Finally, collected research data will be analysed via statistical categorical data analysis, and interpreted in both qualitative and quantitative manner.

Outcomes of this study will include an empirically tested and validated model that proposes a strategy for selecting and implementing the most appropriate TP strategy that enhances the quality of relationship formed between targeted SMEs and other entities in the supply chain. The study will also contribute to the body of knowledge in strategic construction management research that helps decision-makers, researchers and policy makers in better understanding the role of procurement regimes in stimulating the growth and development of SMEs in the construction industry, and will also enable organs of state to better measure their procurement policy objectives against intended outcomes.

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