CONSTRUCTION INDUSTRY
FINANCIAL MODELING OPTIONS FOR
CONTRACTOR SUPPORT AND DEVELOPMENT

CIDB
Construction Industry Development Board

NCDP
National Contractor Development Programme
FINANCIAL MODELING OPTIONS
FOR CONTRACTOR SUPPORT AND DEVELOPMENT

Date: September 2011
# CONTENTS

Acronyms and abbreviations 4  
Definitions 4  
Executive summary 5  
Background information 8  
cidb and NCDP 8  
The South African Construction Industry 10  
Status of contractors grading in South Africa 10  
Construction sector analysis 11  
Market share by contractor type 12  
International Funding models 14  
Local contractor financing models 14  
Products offered by banks 15  
Pros and Cons of current financial support 23  
Enterprise Development financing model 23  
Constraints of current strategies and products 24  
Segmented product innovation 24  
Stakeholders participation at the financial modeling workshop 25  
Short Term Finance Model Options 28  
Option A: Khula Model 28  
Option B: Bank in-house Contracting Agency 29  
Option C: Use of entity e.g. NURCHA/ECDC model 30  
Option D: Contract finance model 32  
Medium-term model: Bank in-house Contracting Agency and Enterprise Development 33  
Long-term model: Contracting Agency 35  
Establishment and role of the Contracting Agency 36  
Role of cidb 37  
The Role of Government 37  
Role of Banks 38  
Role of Industry Players 38  
The role of Insurance Companies 38  
How will the Contracting Agency be funded? 40  
Rollout Plan for Implementation of the agency 40  
Summary 41  
Appendix 1: What is the scenario of contractor performance 43
ACRONYMS AND ABBREVIATIONS

ASGISA  Accelerated and Shared Growth Initiative for South Africa
BBBEE  Broad Based Black Economic Empowerment
CCC  Construction Contact Centre
CETA  Construction Education and Training Authority
cidb  Construction Industry Development Board
Dti  Department of Trade and Industry
DPW  Department of Public Works
ESDA  Employment, Skills Development Agency
EPWP  Expanded Public Works Programme
GDP  Gross Domestic Product
GFCF  Gross Fixed Capital Formation
HDI  Historically Disadvantaged Individual
MEC  Member of the Executive Council (within a province responsible for Public Works)
MINMEC  Ministers and Members of Executive Council
NCDP  National Contractor Development Programme
NDPW  National Department of Public Works
NHBRC  National Home Builders Registration Council
NURCHA  National Urban Reconstruction and Housing Agency
PDPW  Provincial Department of Public Works

DEFINITIONS

**Contracting Agent:** A board or commission of the state, or a state institution supported in whole or in part by state or private sector funds, authorised to enter into a contract to support emerging contractors both financially and non-financial for Government or private sector projects or to perform a state project by the direct employment of labour.

**Emerging contractor:** Any Contractor within cidb level 1 to cidb level 5, to be registered in recognition of their cidb grading for appropriate development support and progression within the cidb programmes.

**Enterprise development:** Support for existing, or the fostering of, new black SMEs and BEE companies in the construction, financial and other sectors of the economy.

**Funding:** Provision of financial support to emerging contractors through enterprise development finance and any other financial support provided by Government or private sector for the development of emerging contractors.
EXECUTIVE SUMMARY

Construction plays an indispensable role directly and indirectly as a contributor to growth in the South African economy. It is a significant employer of people; it creates numerous economic opportunities for medium and small enterprises; and the life span of construction products unleash abundant economic opportunities for their consumers; and it contributes directly to improving quality of life.

The economy is buoyant – albeit ending in recent years on growth rates below that anticipated – and the Rand has been strengthening progressively. In early 2011, interest rates are at an all-time low and the official rate of inflation is at its lowest level in 50 years and well within the range set by government. The Finance Minister confirmed with the release of the Medium Term Expenditure Framework (MTEF) that the fiscal framework is growth-orientated and reflected government’s commitment to long-term sustainability, a commitment reinforced through the continued declining cost of servicing debt as a share of GDP. The release of the MTEF further reaffirmed government’s commitment to the rollout of social and economic infrastructure through the Expanded National Public Works Programme (EPWP) as well as through increased government and parastatal investment.

Employment numbers and type remain a key challenge to the country: data obtained from the census indicates that almost 44% of South Africans in the age category 15-65 years are not economically active. The type of employment presents its own challenges: by occupation and within the employed category aged 15-65 years, the highest percentages are for elementary occupations, with altogether more than two in every ten of the employed in elementary occupations (StatsSA). The construction sector has its own challenges in this regard. It employs the fourth highest number of persons having no education, behind agriculture, households and mining. Construction also has the fourth smallest percentage of employed persons with a higher education qualification, behind households, agriculture and mining.

The challenge of infrastructure development in developing countries remains immense. With the world’s population expected to increase by another two billion between 2010 and 2023 (most of it in urban centres), the challenge will become acute. An estimated 1.2 billion people globally lack access to safe water; 2.4 billion lack access to adequate sanitation; 2.5 billion lack access to energy supplies and 900 million people in rural areas have no reliable roads to give them access to jobs or markets for their products (www.csir.co.za). In Sub-Saharan Africa, less than 8 percent of the population is connected to the power grid. The World Bank has estimated that the present annual investment levels will need to double from about US$15 billion to US$30 billion to reach the Millennium Development Goals aimed at reducing poverty by 2015 (www.worldbank.org). This places huge significance on the efficient use of scarce capital in developing countries. The 2001 Census indicates that South Africa’s needs match those included above.

In South Africa during 2010, the construction industry delivered an output in excess of R220 billion per annum, of which approximately 58% came from public sector orders and tenders, 13% from public corporations and 30% from the private sector. This constitutes almost 30% of total investment
in South Africa (StatsSa 2010). National spending priorities include infrastructure to support industry development, i.e. making sure that the public infrastructure is in place to support industrial investment, and the future maintenance thereof.

However, there is serious concern within the industry at the high rate of enterprise failure and the potential consequences of that on the industry’s ability to deliver. According to StatsSA there were 532 liquidations of construction companies in 2007, 554 in 2008, and 371 in 2009. Whilst the drop in liquidations is to be welcomed, the fact remains that over 1,400 contracting enterprises could not remain viable over the past three years. The reason for at least some of this failure is to be found in the current lack of profitability in contracting: a measurement of profitability established within the industry has indicated a continual decrease in this regard over the long term.

The Construction Industry Development Board (cidb) has identified a need for the financial support to emerging contractors and the working together of financiers in the development of financial models to bridge this gap. The cidb by facilitating this research and bringing together financial sector role players aims to have the recommended models embraced by the sector so as to consolidating existing financial and non-financial support to contractors, and develop appropriate tailored models, products and packages that target the needs of the emerging construction contractors.

The project was designed in three phases:

**Phase I**
Conducting a desk top study of available financial support available to contractors; and

**Phase II**
Consolidating and proposing appropriate financial model options. Workshops were conducted by cidb in which relevant stakeholders participated. This included participation by the major banks, construction industry stakeholders, Government and the insurance industry. It was from these interactions that the need for a phased approach (short-term, medium and long-term) of models be developed.

**Phase III**
Proposed packaging and implementation for rollout.
BACKGROUND INFORMATION

cidb AND THE NCDP

The cidb was established to provide leadership to stakeholders and to stimulate sustainable growth, reform and improvement of the construction sector for effective delivery and the industry’s enhanced role in the country’s economy.

Creating an enabling environment for Contractor Development is a major focus and deliverable for the cidb, hence the initiative of developing financing models, which will assist financiers to look at suitable models, and in turn assist in mitigating their risks. Financiers and the private sector are therefore invited to participate in this developmental initiative, which will assist in the growth of the economy and contractors.

The cidb is mandated through the Construction Industry Development Board Act 38 of 2000 to support contractor development and emerging sector participation throughout government and industry. MINMEC specifically, has mandated the cidb in collaboration with the National and Provincial Departments of Public Works to devise and implement a National Contractor Development Programme (NCDP). The objectives of NCDP as indicated in the cidb - Framework – National Contractor Development Programme – January 2010 (Updated September 2011) is to:

• Improve the grading status of contractors in targeted categories and grades - effectively improving the supply side capacity available to public and private sector clients;
• Increase the number of black, women, disabled, and youth-owned companies in targeted categories and grades - increasing the representatively of contractors in all categories and grades;
• Create sustainable contracting enterprises by enabling continuous work through a competitive process - and thus creating the platform for sustained employment and skills development;
• Improve the performance of contractors in terms of quality, employment practices, skills development, safety, health and the environment; and
• Improve the business management and technical skills of these contractors.

The NCDP is a government programme comprising of a partnership between the cidb, national and provincial Department of Public Works and other willing stakeholders. The participating stakeholders commit their effort and resources to develop previously disadvantaged contractors, by:

• Establishing an enabling environment for contractor development;
• Enhancing and strengthening contractor development mechanisms, including emerging contractor development programmes (ECDP’s), joint ventures (JVs) and other appropriate mechanisms;
• Facilitating performance improvement of contractors; and
• Supporting the creation of a pool of skilled artisans, supervisors, technicians and technologists for the construction industry.
It is therefore important for cidb to ensure development of emerging contractors by having access to funding and non-financial support; which would enable them to execute the contracts awarded to them.

**Benefits of participation in the NCDP:**

- Continuous and profitable work opportunities are provided to learners / contractors within the programme;
- Procurement strategies and development mechanism to target the learners and contractors within the programme with continuity of work;
- Standardised designs and specifications;
- Appropriate contract conditions addressing supportive practices regarding sureties, guarantees, retention policies;
- Link to other existing Government or partnering stakeholders and resources e.g. CCC, DTI-SEDA’s NHBRC;
- Prompt payment of contractors for work completed satisfactorily;
- Client reporting to cidb on Contractor Development initiatives and their various contributions, for co-ordination and identification of areas for support;
- Appropriate contract management and quality assurance oversight is provided by the departments running the contractor development programmes;
- Contractors are able to access finances for working capital, (i.e. to provide sureties, purchase materials, hire plant and equipment, pay labour etc.);
- Contractors have appropriate technical capability and capacity;
- Contractors have appropriate construction management and quality control expertise;
- Contractors have access to an appropriately skilled workforce;
- Contractors have access to cost effective, appropriate, quality materials supply;
- Contractors have access to cost effective, quality plant and equipment; and
- Contractors have access to information and technology.

These benefits go beyond direct benefits to emerging contractors but contribute to an environment with enhanced quality performance, and decreased risk to the likes of clients, financiers, established main contractors and the industry or country at large.
THE SOUTH AFRICAN CONSTRUCTION INDUSTRY

The World Bank rates economic growth as one of the most effective ways of reducing poverty. Government, through its micro economic strategy, has confirmed that infrastructure development is one of the key pillars of economic growth. Investing in good infrastructure, including its long term maintenance thereof along with other drivers of growth such as the necessary and appropriate skills development, improved health and education services, an investor-friendly economic climate, and good governance, is central to the objective of reducing poverty.

Infrastructure development such as good roads and efficient port facilities and rail lines, can boost a developing country’s ability to trade nationally and internationally, thereby creating opportunities for improving the standard of living. The infrastructure needs of South Africa remain immense and will continue to be so as the population grows. “There is now a strong recognition in the development community of the key role that infrastructure plays in achieving the Millennium Development Goals” World Bank President James Wolfensohn.

The 2009 Intergovernmental Fiscal Review acknowledges that capital expenditure promotes service delivery and expands economic opportunities. It confirms the belief that improving the quality of infrastructure will improve the likelihood of efficient service delivery, reduce the cost of doing business and act as a catalyst for higher economic growth and job creation. In a bid to revitalise investment in infrastructure, government has developed plans to intensify its involvement through increasing its investment in this sector.

However, this challenge will not be met by government’s intervention alone. The private sector investment will have to improve significantly if the backlog in infrastructure is to be reduced. Significant interventions will be required, however, if private sector investment is to be secured. Essentially, a positive investment climate will have to be created within the construction industry. This involves regulation, performance improvement, quality end products and world class practices.

STATUS OF CONTRACTORS GRADING IN SOUTH AFRICA

The Construction Industry Development Board Act of 2000 requires the cidb, to establish a Register of Contractors (RoC). The RoC grades and categorizes contractors according to their works and financial capability. Contractors must register with the cidb in order to be assessed for award of contracts within the public sector. 88% of contractors are graded as 1 and only 12% are graded as 2-9 as at December 2010.

The RoC serves as a first level risk management tool with enhancements that will evolve in terms of a detailed works capability and quality measure. For the most part, this register serves the public sector in terms of regulation and risk management. The extension and use of the register to the private sector and other risk management entities or sectors, e.g. the financial are areas now needing exploration.
CONSTRUCTION SECTOR ANALYSIS

An appropriate current available analysis of the construction industry would be the business conditions survey conducted quarterly by the Bureau for Economic Research for the cidb. The SME Business Conditions Survey measures contracting business conditions amongst cidb registered contractors in Grades 3 to 7. The Survey measures, amongst others, the business confidence, and construction activity, tendering competition, employment and labour constraints amongst cidb registered contractors at a provincial level and in various contractor grades.

The latest survey available is the 2010 Q4 survey (Source: www.cidb.org.za December 2010), Sixty one per cent of respondents to the 2010 Q4 survey indicated that the growth in building activity under-performed expectations. However, the volume of work executed remained stable at a low level when compared with the previous quarter survey. A net 85% of the respondents to the survey reported that insufficient demand for building work was constraining their business operations.

Tendering competition intensified during 2010 Q4. Profit margins remained under pressure, and a net 67% of survey respondents indicated that the growth in the profitability of their businesses worsened during the quarter. The pace of labour shedding stabilised in 2010 Q4.

Although business conditions are likely to remain tough, respondents expect some improvement in 2011 Q1. The business confidence of Grades 3 & 4 and Grades 5 & 6 rose slightly in 2010 Q4. Grades 7 & 8 showed a substantial improvement. Regionally, business confidence showed a slight improvement in the Eastern Cape, the Western Cape and in Gauteng. However, a slight weakening was observed in KwaZulu-Natal.
The construction market share is further demarcated into various class of works as depicted in the table 2 below.

Table 2: Market share by contractor type

<table>
<thead>
<tr>
<th>Type of construction</th>
<th>Large R million</th>
<th>Medium R million</th>
<th>Small R million</th>
<th>Micro R million</th>
<th>Total R million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Site preparation</td>
<td>1,754</td>
<td>428</td>
<td>98</td>
<td>26</td>
<td>2,306</td>
</tr>
<tr>
<td>Construction of buildings</td>
<td>17,629</td>
<td>8,028</td>
<td>3,153</td>
<td>4,307</td>
<td>33,117</td>
</tr>
<tr>
<td>Construction of civil engineering structures</td>
<td>22,396</td>
<td>4,021</td>
<td>363</td>
<td>518</td>
<td>27,478</td>
</tr>
<tr>
<td>Construction of other structures</td>
<td>165</td>
<td>485</td>
<td>323</td>
<td>542</td>
<td>1,515</td>
</tr>
<tr>
<td>Construction by specialist trade contractors</td>
<td>1,233</td>
<td>1,517</td>
<td>559</td>
<td>770</td>
<td>4,079</td>
</tr>
<tr>
<td>Plumbing</td>
<td>357</td>
<td>591</td>
<td>374</td>
<td>790</td>
<td>2,112</td>
</tr>
<tr>
<td>Electrical contracting</td>
<td>1,039</td>
<td>1,700</td>
<td>985</td>
<td>1,918</td>
<td>5,642</td>
</tr>
<tr>
<td>Shop fitting</td>
<td>169</td>
<td>335</td>
<td>202</td>
<td>119</td>
<td>825</td>
</tr>
<tr>
<td>Other building installations</td>
<td>5,870</td>
<td>1,992</td>
<td>503</td>
<td>627</td>
<td>8,992</td>
</tr>
<tr>
<td>Painting &amp; decorating</td>
<td>403</td>
<td>355</td>
<td>309</td>
<td>544</td>
<td>1,611</td>
</tr>
<tr>
<td>Other building completions</td>
<td>3,071</td>
<td>3,363</td>
<td>1,519</td>
<td>672</td>
<td>10,625</td>
</tr>
<tr>
<td>Renting of construction equipment</td>
<td>1,099</td>
<td>694</td>
<td>194</td>
<td>153</td>
<td>2,140</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>55,185</strong></td>
<td><strong>23,689</strong></td>
<td><strong>8,582</strong></td>
<td><strong>12,986</strong></td>
<td><strong>100,442</strong></td>
</tr>
</tbody>
</table>
INTERNATIONAL FUNDING MODELS

Globally, just as in South Africa, construction projects do not require a large capital expenditure outlay but rather a large working capital to finance the projects. Unfortunately, for small contractors there are very limited options available from banks or other lending institutions to cover this large working capital requirement in the absence of sufficient collateral.

The “line of credits” model is the general banking facilities that are offered to any client with enough security for the required financing. The “Contract Finance” model is generally recommended for construction contracts but the problem for small contractors is security. Investigations have revealed that the USA, Brazil and India are three of the countries that have some common models – they have adopted the concept of project finance successfully.

Project finance is a non-recourse type of financing, which is asset based financing of an economically separable capital investment project. The lenders in this case look primarily into the cash flow from the project as their source of fund to service the loans and provide a return on the equity being invested in the project.

The model does not place reliance on the financial position of the Contractor but on specific projects. Contractor business plans are not considered, as they are irrelevant to contract financing. Functionality is an important factor, as Contractors need to have capacity to deliver. The distinguishing feature of project financing from conventional financing is that unlike conventional financing the lenders do not have recourse to the entire portfolio of assets of the contractor (balance sheet), instead rely only upon the cash flow of that specific project. It becomes possible for the lenders to take on high risk in these projects.

Project/Contract Financing models in Brazil, India and USA incorporates appropriate risk assessment and risk transfer. However variants of this form do exist in models wherein the lenders have a limited recourse to the asset portfolio of the project sponsor. In any project finance model the terms of the debt and equity are tailored to the cash flow characteristics of the project.

LOCAL CONTRACTOR FINANCING MODELS

At the time of this report there were minimal industry proposed financing model available to contractors except general banking facilities (GBF) available to all banking clients. All financiers or banks offer similar products except recently there have been efforts by some financiers to tailor-make some products to certain international models, like the Khula and ECDC models.
PRODUCTS OFFERED BY BANKS

The banks in South Africa offer various products to companies but very few of these are industry specific. Based on assessment of the various financing products offered by the different banks, no bank has emerged as a major player in construction financing.

Most may offer contract financing with little extension to softer skills and support. Products are generally generic ones that are then packaged for specific applicants.

The banks generally are risk averse and wouldn’t fund a business which doesn’t have a track record, collateral to offer, financial statements and cannot make a contribution to the funding requirements of a business. Small construction industries mostly fall into this category.

The Khula model, whereby Khula issue guarantees to a bank in cases where a contractor can’t provide the necessary collateral to a bank is successfully used by all the major banks. However, the lead times are very long and don’t address all the needs of a small construction company. Notably, some banks e.g. Nedbank has set up joint ventures with suppliers like Cashbuild, to finance contractor materials, a step in a supportive and facilitative enabling direction. Some of the products offered by financiers are as indicated on table 2 below:

National Empowerment Fund (NEF)

<table>
<thead>
<tr>
<th>Role players</th>
<th>Purpose</th>
<th>Finance provided</th>
<th>Process</th>
<th>Terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent Development Trust (IDT), the National Empowerment Fund (NEF) and Siseko Se-Afrika (SACE)</td>
<td>To contribute towards the upliftment and empowerment of disadvantaged communities by providing opportunities to existing contractors as well as emerging entrepreneurs in the building and construction industries.</td>
<td>Providing a loan facility for the working capital requirements of qualifying contractors who participate in the CDP.</td>
<td>In the process of submitting tender documents, the contractors are also required to complete NEF Loan Application forms.</td>
<td>Loans at prime less 2% (two percent). The working capital is made available to the SMME’s in a staggered manner depending on the value of the contract and the experience of the SMME.</td>
</tr>
</tbody>
</table>
### Development Bank of Southern Africa (DBSA)

<table>
<thead>
<tr>
<th>Role players</th>
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<th>Process</th>
<th>Terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>DBSA</td>
<td>To accelerate sustainable socio-economic development by funding physical, social and economic infrastructure. DBSA’s goal is to improve the quality of life of the people of the region.</td>
<td>Currently no direct funding to contractors. The DBSA is currently working on a venture fund related to enterprise development but it’s in the early stages of development.</td>
<td>However if a contractor comes with a project application within their mandate areas the project may be considered for funding.</td>
<td>N/A</td>
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</tbody>
</table>

### Khula Enterprise Finance Ltd

<table>
<thead>
<tr>
<th>Role players</th>
<th>Purpose</th>
<th>Finance provided</th>
<th>Process</th>
<th>Terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>KHULA Banks: • Standard • FNB • ABSA • Nedbank</td>
<td>Khula was established to facilitate access to finance for SMEs. It is a wholesale financier. Khula finance is a good option for business owners who have insufficient or no assets to offer as collateral.</td>
<td>Khula provides a guarantee to the bank.</td>
<td>An entrepreneur needs to approach the bank that then applies for finance on behalf of its client to Khula.</td>
<td>A contractor needs to contribute a percentage of the amount they want to borrow, either in cash or equipment that will be used in their intended business. An annual fee is required in advance for the duration of the loan. Khula also provides services to guide and counsel contractors in various aspects of managing their business.</td>
</tr>
</tbody>
</table>
### Khula Emerging Contractors Fund

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<tr>
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<tbody>
<tr>
<td>Khula Eastern Cape Department of Public Works The Fund is managed by Business Finance Promotion Agency (BFPA), which is one of Khula’s Retail Financial Intermediaries in the Eastern Cape province. BFPA’s offices are in Port Elizabeth and East London.</td>
<td>To provide finance to emerging black contractors in Grades 1 to 6 who have been awarded tenders by the Eastern Cape Department of Public Works.</td>
<td>Bridging Finance. The fund finances work in the following fields: civil engineering, electrical engineering, general building, mechanical engineering and specialist works. The contractors are those that have been assessed by Construction Industry Development Board (cidb) to have the capacity to handle projects up to a maximum of R10 million.</td>
<td>The applicant must be a South African citizen. The applicant must be a black emerging contractor. The applicant must have a cidb grading of 6 or below. The applicant must have been awarded a tender/contract by the Eastern Cape Province - Department of Public Works. The project for which funding is required must be financially viable. A mentor must be attached to the project, where required.</td>
<td>The applicant must have a business account which they are willing to have the Fund Manager (BFPA) sign as a co-signatory.</td>
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### Small Enterprise Development Agency (SEDA) - DTI

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<tr>
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<tbody>
<tr>
<td>Small Business Enterprise Development Agency.</td>
<td>SEDA is the DTi’s support agency for the development of small business in South Africa.</td>
<td>None. Some provinces e.g. KZN have partners with both a client (eThekwini) and financier (ABSA) to offer incubated support to construction entities.</td>
<td>A contractor needs to register with SEDA.</td>
<td>SEDA offers entrepreneurs help with business plans, technical advice and marketing, and information on exporting, tenders and incentives.</td>
</tr>
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</table>
## Standard Bank

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<tr>
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</thead>
<tbody>
<tr>
<td>Standard Bank</td>
<td>Standard Bank has developed a contract finance offering, which provides finance to businesses that require funding to be able to perform in terms of a contract they have been awarded. In partnership with cidb, softer skills are offered to contractors via financial training service providers.</td>
<td>Businesses can obtain credit facilities such as medium term loans, vehicle and asset finance and working capital. Security is not always necessary to obtain contract finance; however, a company must be willing to put up some of their own funds to meet their financial requirements.</td>
<td>SMME application</td>
<td>Written, signed contract to supply goods or services for a defined rand value within a specified time. It is essential that the contractor have a complete, written, signed contract to supply quantified goods or services to a blue chip company or government department for at least 12 months.</td>
</tr>
<tr>
<td>Government Department</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Blue Chip companies</td>
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## ABSA

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</thead>
<tbody>
<tr>
<td>Financial Support ABSA SMME FUND’s</td>
<td>Contract and other finance offerings to SME’s who portray entrepreneurial skills and have the potential ability to service their debt. No security required and clients with bad credit history will not be excluded.</td>
<td>Funding is provided in line with the contract e.g. term.</td>
<td>SMME fund application.</td>
<td>Signed contracts, orders and ONCE of orders from Government or blue chip companies.</td>
</tr>
<tr>
<td>Non-Financial Support Enterprise Growth Programme</td>
<td>Due to the high business failure rate in South Africa, ABSA has implemented the Enterprise Growth Programme to assist the SMME’s to grow and sustain their businesses.</td>
<td>Varies other financing options available.</td>
<td>Finance limited on the customer’s behalf for credit guarantees</td>
<td>Any SMME.</td>
</tr>
<tr>
<td>Enterprise Development Centre’s’s</td>
<td>EDC’s offer financial advice and non financial support to SMME’s at no cost.</td>
<td>Support Support Support Support Support Support Support Support Support</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business Advantage</td>
<td>Create growth and sustainability to any SMME</td>
<td></td>
<td></td>
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Any SMME
## FNB

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<tr>
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<th>Terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>FNB</td>
<td>Match your financing requirements to the funding profile and keep your overdraft facility for your working capital requirements. Structure your term loan so that the repayments align with your cash flow. Know what you are going to be paying each month so that you can plan and budget accordingly.</td>
<td>Medium to long-term loans to finance capital expenditure or to alter or expand business premises.</td>
<td>Qualifying criteria for clients who wish to apply for term finance in order to service our clients in a responsible manner. Your business should have been operating for a minimum period of 2 years with an annual turnover of between R1 million and R40 million and a well conducted bank account. If the primary bank account is not with FNB, the business owners must be willing to transfer their business account and provide copies of their bank statements for the past 6 months. <strong>Satisfactory credit records</strong> Must be able to offer some form of tangible collateral e.g. a covering bond over their residential or business property. Khula guarantees are available to clients who have a well-run business but lack collateral to secure a loan process.</td>
<td>Loan repayment terms are flexible: from a minimum of 12 to a maximum of 120 months (loan periods of up to 120 months can be approved if fully secured by property). The usual period is 60 months. The minimum loan amount is R50,000; the maximum depends on affordability.</td>
</tr>
</tbody>
</table>

## Nedbank

<table>
<thead>
<tr>
<th>Role players</th>
<th>Purpose</th>
<th>Finance provided</th>
<th>Process</th>
<th>Terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nedbank</td>
<td>Assist you in realising the opportunities in your enterprise. We are dedicated to providing qualifying business with innovative ways to develop and grow. PS: Nedbank are the current N.DPW EPWP financier and are up-ramping their resources and tailoring to construction delivery and up-skilling.</td>
<td>Businesses can obtain credit facilities such as medium term loans, vehicle and asset finance and working capital.</td>
<td><strong>SMME application</strong> Nedbank Business Banking offers tailor-made solutions to black-owned (25% and more) businesses that are generating an annual turnover between R5 and R35 million.</td>
<td></td>
</tr>
</tbody>
</table>
### Role players

<table>
<thead>
<tr>
<th>Tusk</th>
<th>Alexander Forbes</th>
<th>Hannover RE</th>
<th>NURCHA</th>
<th>COFACE</th>
</tr>
</thead>
</table>

Offers their clients professional construction support services as well as financial assistance. Emerging contractors have advanced to successful businessmen and women under the guidance and support received from Tusk.

Working capital loans and performance guarantees (predominantly on Nurcha financing)

Which projects does Tusk and Nurcha assist with funding?

Infrastructure and Community facilities projects (roads, drainage, water reticulation, building of clinics, schools, libraries), the refurbishment of buildings building of subsidy houses or RDP houses.

An applicant must be the main contractor appointed by the supplier. He/ She must have an appointment letter stipulating the value of a contract or project including the duration of the project.

- The requirements to apply for a loan: must be a registered contractor as a CC / (Pty) Ltd;
- Have a cidb certificate / grading;
- Must be registered with nhbrc if building houses;
- Must be registered for vat with SARS;
- Must have a Tax Clearance;
- Must have Raft design and Plans if building houses; and
- Must provide actual bill of Quantities.

The interest rate is charged at Prime + 1%. Are there other fees charged over the above interest. Tusk charges additional fees for professional service rendered in terms of administration, legal, financial management and material purchases. Provide performance guarantee based on the agreement between the contractor and Tusk and the value of the project.

### Nurcha

| Nurcha - which also offers management support to the contractors – would have discontinued bridging finance loans this year were it not for the partnership with Future growth. On behalf of its pension fund clients, Future growth contributes 70 percent of the partnership’s capital used to fund the contractor’s bridging finance requirements and thus facilitates private sector investment directly into rural infrastructure projects. | Bridging Contract Finance. | Use of risk managers/ construction support service entities (mentors and project managers). |
Ithala

<table>
<thead>
<tr>
<th>Role players</th>
<th>Purpose</th>
<th>Finance provided</th>
<th>Process</th>
<th>Terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ithala</td>
<td>To provide bridging finance and performance guarantees (guarantees linked to bridging finance only) to small contractors in the building and allied trades based on a secured contract.</td>
<td>The term of the loan is dependent on the nature of the contract, normally not longer than 18 months.</td>
<td>SMME application.</td>
<td>Repayment period as per approved cash flow of the contract. Security Cession over contract payments, personal sureties and any other available security.</td>
</tr>
</tbody>
</table>

China Construction Bank

<table>
<thead>
<tr>
<th>Role players</th>
<th>Purpose</th>
<th>Finance provided</th>
<th>Process</th>
<th>Terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>CCB</td>
<td>Nthabi</td>
<td>Wholesale finance</td>
<td>Minimum of $50 million</td>
<td>None</td>
</tr>
</tbody>
</table>

A summary of the more common products offered by banks are as follows:

<table>
<thead>
<tr>
<th>Overdraft facility</th>
<th>Revolving credit</th>
<th>Contract financing</th>
<th>Vehicle and Asset finance</th>
<th>CPF</th>
</tr>
</thead>
<tbody>
<tr>
<td>An overdraft facility on a business account is the ideal way to help a contractor to manage cash flow, especially when there is a shortage and the contractor wants quick access to credit. It is linked to a Business Current account and a limit is set, which is repayable on demand. The contractor only pays interest on the amount they use and not on the full overdraft amount. Sole proprietors can increase or decrease their limit on the internet, by telephone, cellphone.</td>
<td>A Business Revolving Credit Plan is a loan where repayments are made in equal monthly instalments. The contractor only pays interest on the amount used. Once the contractor has accessed the facility the revolving facility will be rolled over as long as the Contractor can service the loan. Normally paid back 25% of the loan, he can withdraw funds up to the original limit.</td>
<td>Various banks have developed a contract finance offering, which provides finance to businesses that require funding to be able to perform in terms of a contract awarded.</td>
<td>Financing any vehicle or asset. Fleet management with options ranging from a Personal MotorCard for individuals to a full fleet management System.</td>
<td>A business mortgage offers contractors the opportunity to purchase, extend, or improve a residential property where up to 50% of the property will be used for business purposes. What are the benefits of this product? • The repayment period can be up to 20 years. • A contractor could normally get a loan of up to 80% of the property’s assessed value and linked to an AccessBond facility.</td>
</tr>
</tbody>
</table>
**PROS AND CONS OF CURRENT FINANCIAL SUPPORT**

<table>
<thead>
<tr>
<th></th>
<th>Contract Finance</th>
<th>Traditional finance models</th>
<th>Equity</th>
<th>Venture Capital</th>
<th>Development Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks determine what projects to fund.</td>
<td>Bank overdrafts, Asset based finance, commercial property finance.</td>
<td>Owners normally don’t have equity.</td>
<td>Limited high net worth individuals</td>
<td>Early stages of development and not available to the market.</td>
<td></td>
</tr>
<tr>
<td><strong>CONS</strong></td>
<td>Contractor may not perform, costly, sustainability (only one contract).</td>
<td>Time delays costly.</td>
<td>Dilution of ownership if new investors comes in.</td>
<td>Bureaucratic</td>
<td>Not generally available in SA.</td>
</tr>
</tbody>
</table>

**ENTERPRISE DEVELOPMENT FINANCING MODEL**

Enterprise Development as defined above is where big companies offer operational assistance to small, black-owned enterprises and is seen by many companies as a way to participate in Black Economic Empowerment (BEE) (Broad-based Black Economic Empowerment Act, 2003 (“BEE Act”) Section 9, 2 in 2004).

The problem is that few medium to large companies have a firm understanding of it. Many companies are not sure how to integrate enterprise development into their transformation strategy and align to the Construction Charter and DTI scorecard. Industry associations such as SAFCEC do however make efforts in supporting establishing companies in this regard. Developing black-owned and black-run businesses can be an inexpensive way for a company to implement an aspect of its transformation agenda, whilst claiming various rating credits.

Some companies that are already implementing it do not receive the relevant recognition or referencing in terms of their contribution to empowerment. In general, enterprise development is a missed opportunity for many companies. There is a perceived lack of understanding on what enterprise development is, and how it can benefit entities and the country. This means that the enterprise development support given by financial institutions to black-owned businesses may not be fully understood, recognized and exploited.

To change this, companies must be educated on what counts as enterprise development. For example, support such as preferential credit terms and business skills training given by large companies to emerging black-owned businesses can be counted as enterprise development.
Compared with other forms of empowerment, such as bringing in a black shareholder, enterprise development is relatively inexpensive. It also has the advantage of building the capacity of smaller contractors, giving them the ability to do larger deals and improving their profitability.

Enterprise development should not be confused with procurement. Buying goods from empowered companies is a continuous activity, while enterprise development can be a one-off event.

There are cases where enterprise development and procurement can work hand in hand. For example, if a company offers its truck drivers the opportunity to become subcontractors instead of remaining employees, it is empowering them. By giving them business skills training and providing terms for them to pay for the trucks, the company earns points for enterprise development. If the company goes on to lock these drivers into a long-term contract, it then also gets points for procurement.

Some companies are providing more hands-on assistance with financial support, operational guidance and infrastructure. This could also include mentoring, coaching and training.

**Benefits of centralising Enterprise Development in the Construction Sector:**

- Recognition by banks;
- Recognition by and of large construction companies;
- Enterprise development done by specialists who understands enterprise development;
- Recognition for and of insurance companies; and
- Enterprise development is focused and the results are measurable.

**CONSTRAINTS OF CURRENT STRATEGIES AND PRODUCTS**

- Contractors are often first-time borrowers without any track records at the bank;
- Contractors are unable to fulfil the collateral requirements of the bank;
- Contractors cannot present financial statements to the bank (Appendix 1);
- Contractors are unable to finance 20-50 % of the investment from their own resources as required by the bank; and
- It takes a long time from securing a contract to securing finance.

**SEGMENTED PRODUCT INNOVATION**

One of the most pressing challenges faced by emerging contractors in construction projects is the working capital and liquidity required to support day-to-day activities. Construction projects do not require a large capital outlay but a large working capital is needed to finance the projects.

Unfortunately, for small contractors there are limited options available from banks or other lending institutions to cover this large working capital requirement, especially in the absence of sufficient collateral. The various banks in South Africa have developed and implemented a project finance model but it has not been implemented successfully.
The “line of credit” model is the general banking facilities that are offered to any client with enough security for the required financing, yet this is not suitable for contractors in this industry.

The “Project Finance” model is generally recommended for construction contracts but the problem for small contractors is lack of collateral/ security.

STAKEHOLDERS PARTICIPATION AT THE FINANCIAL MODELING WORKSHOP

A workshop was facilitated by independent consultants on the 25th November 2010 to collect ideas and solicit participation of different stakeholders who are insurers, financiers and industry leaders (some of whom are party to cidb Memoranda of Agreement in supporting contractors to access financial support).

Participants included the following:
- Nedbank
- Standard Bank
- First National Bank
- Government (Department of Trade and Industry)
- cidb
- Dawn Advisory Services (Pty) Ltd
- Nurcha
- Eastern Cape Development Corporation (ECDC)
- Insurance Industry
- Construction Industry stakeholders

A model was presented which included a proposed Contracting Agency. All stakeholders at the workshop favourably received the model. However, because it will take some time to implement it, short, medium-term and long-term phased models were also proposed. Also no specific model should be imposed on the banks and other financial institutions; therefore alternative models are included as options for adaptation.

Further engagements were conducted post workshop with other stakeholders like ABSA and others.

In terms of what can be defined as enterprise development contributions from companies or banks to the agency, these will have to align to such respective financial and construction charter definitions and may include human resource skills support, skills (business) training, preferential other procurement and CSI contributions (credit forms etc or parts thereof) could also be transferred to the agency for relevant use / spend.
Proposed roll out plan for phased models is indicated below.

<table>
<thead>
<tr>
<th></th>
<th>Activity</th>
<th>Short Term</th>
<th>Medium Term</th>
<th>Long Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Approval of models by cidb</td>
<td>31 March 2011</td>
<td>31 March 2011</td>
<td>31 March 2011</td>
</tr>
<tr>
<td>2</td>
<td>Presentations to all major banks</td>
<td>15 February 2011</td>
<td>February 2012</td>
<td>February 2013</td>
</tr>
<tr>
<td>3</td>
<td>Acceptance (by banks) of models and support from cidb on product</td>
<td>30 April 2011</td>
<td>30 April 2012</td>
<td>30 April 2013</td>
</tr>
<tr>
<td></td>
<td>development and packaging</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Presentation of roll-out plan by banks (to cidb)</td>
<td>31 January 2012</td>
<td>31 December 2012</td>
<td>31 December 2013</td>
</tr>
<tr>
<td>5</td>
<td>Pilot projects by all banks to be presented to cidb</td>
<td>31 January 2012</td>
<td>31 March 2013</td>
<td>30 June 2014</td>
</tr>
<tr>
<td>6</td>
<td>cidb discussions with large players in the construction industry</td>
<td></td>
<td></td>
<td>15 March 2012</td>
</tr>
<tr>
<td></td>
<td>to get their buy-in for Enterprise Development and Agency</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Establishment of Contracting Agency</td>
<td></td>
<td></td>
<td>31 March 2013</td>
</tr>
<tr>
<td>8</td>
<td>Approval of mandate of the Contracting Agency</td>
<td></td>
<td></td>
<td>15 April 2013</td>
</tr>
<tr>
<td>9</td>
<td>Invite proposals for people to serve on the Board of the Contracting</td>
<td></td>
<td></td>
<td>30 April 2013</td>
</tr>
<tr>
<td></td>
<td>Agency</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
SHORT TERM FINANCE MODEL OPTIONS

OPTION A: KHULA MODEL

- Financing will be arranged by the contractors themselves;
- Khula will issue a guarantee to the bank (Appendix 1);
- The Bank will confirm the contractor grading with the CIDB;
- Banks will provide working capital to contractors on the basis of a contract profitability;
- Bank account will be controlled by the bank and the contractor (ring fenced cash flows/Escrow account);
- Money will be released to suppliers and employees of the contractor in accordance with a payment plan; and
- The client will pay the money into bank account and once the bank has been repaid the balance left in the account will be paid to the contractor.

Implementation of option A by banks
The banks will have to make a decision as to making this their preferred funding model for all CIDB registered contractors and mobilise their employees to implement this within a period of six months. This model will be implemented in the current year.
OPTION B: BANK IN-HOUSE CONTRACTING AGENCY

- Bank will have their own in-house Contracting Agency (centralised unit within the bank);
- Financing will be arranged by the contractors themselves;
- The Bank will confirm the contractor grading with the CIDB;
- Khula or insurance companies will issue a guarantee to the bank;
- Banks will provide working capital to contractors on the basis of contract profitability;
- Bank account will be controlled by the bank and the contractor (ring fenced cash flows/Escrow account);
- Money will be released to suppliers and employees of the contractor in accordance with a payment plan; and
- The client will pay the money into bank account and once the bank has been repaid the balance left in the account will be paid to the contractor.
Implementation of option B by banks
The banks will have to make a decision as to making this their preferred funding model for all cidb registered contractors and mobilise their employees to implement this within a period of 12 months. Banks need to commit to assist contractors as they will be managing the risk internally.

OPTION C: USE OF ENTITY E.G. NURCHA/ECDC MODEL
• An alternative model is for banks to provide funding to the Contracting Agency on the back of a guarantee issued by an insurance company. Only contractors registered with the cidb will be able to apply for this funding;
• The bank will provide a facility to the Contracting Agency based on a guarantee by Government or an insurance company;
• This is another way in which insurance companies may participate in the process;
• This will have significant benefits for the banks as they only have to provide a single facility to the Contracting Agency as oppose to thousands of contractors;
• The Contracting Agency will provide funding to the contractor;
• A bank account will be opened for the contractor and jointly controlled by the Contracting Agency and the contractor;
• The client of the contractor will agree up-front to pay directly into the joint bank account and agrees to a session of contract to the Contracting Agency (Appendix1) (e.g. Investments, Guarantees, Insurance, Retentions, etc);
• The Contracting Agency will assist the contractor to negotiate better terms with the client and the insurance company as the overall risk of contracting with a small contractor will be reduced through the intervention of the Contracting Agency;
• The Contracting Agency will not be involved in grading contractors; the grading process has to be independent in order to provide credibility to the various stakeholders;
• The Contracting Agency will provide the contractor with enterprise development support in the form of technical assistance, personal development, financial management, business management, contracting procedures etc;
• The Contracting Agency will assist in facilitating and negotiating a performance guarantee and retention guarantee on behalf of the contractor, which may speed up the process of financing and free-up working capital for the contractor;
• Insurance guarantees may be funded from CSI or parts of enterprise development contributions but the contractor has to refund this to the Contracting Agency at the end of the contract in order to ensure sustainability;
• The contractor receives the opportunity to build its own track record with the bank and the insurance company;
• The cidb is able to track the progress of the contractor; if the contractor does not perform, the Contracting Agency will be able to take the necessary steps to protect all stakeholders; e.g. additional mentoring or project management support;
• Government is able to track the progress of contractors; and
• Centralise enterprise development in the construction industry.
Implementation of option C by banks
This model is already implemented at NURCHA and ECDC, hence need to be adopted by other financiers. Rollout of this model will assist a number of contractors in the short term.

Project finance model is a model used internationally with countries like Brazil, China, India, Russia and USA being leaders on this model. Cash flow is ring fenced and projects contracts are financed according to their profitability. The Contractor receives a contract from the client and submits an application to the bank for finance. The bank assesses the project, if it is profitable, and the Contractor provides performance guarantees or has a history of delivery of similar projects the bank will finance. The bank and contractor have a dual responsibility on the Escrow account.

The bank pays all creditors and employees on behalf of the contractor from the Escrow account. The residual or profit is then transferred to the Contractor’s primary account.
Implementation
The project contract finance model is existent in South Africa as part of general banking products. This can then be modified to suit the construction industry and be implemented immediately as the banks have resources in their specialised and structured finance divisions.

MEDIUM-TERM MODEL: BANK IN-HOUSE CONTRACTING AGENCY AND ENTERPRISE DEVELOPMENT

- **Guarantees:**
  - Government
  - Insurances
  - Khula etc.

- **Bank own enterprise Development Contributions utilised for the benefit of contractors**

- **Financial Institutions**
  - Bank in-house department

- **Performance Guarantee**

- **Government Department of Works Programme**
  - Other Clients

- **Contractor**
  - Registered with CIDB and CIDB Rating

- **Issue contract**

- **Apply for funding**

- **Bank Account jointly controlled by Bank and Contractor**

- **Working Capital**

- **Payment**
Implementation continued

- A bank will have its own in-house Contracting Agency (centralised unit within the bank). This is the hybrid of the short term model as it combines enterprise development and internal risk management;
- The bank could use part of their enterprise development contributions (or CSI Dev funds, etc) to fund contractors, including the cost of guarantees;
- Enterprise Development is offered by banks (support in various forms, including assistance with financial management);
- Financing will be arranged by the contractors themselves;
- The bank will confirm the contractor grading with the cidb;
- The bank may cover the cost of Khula guarantees;
- The banks will provide working capital to contractors on the basis of a contract profitability;
- Bank account will be controlled by the bank and the contractor (ring fenced cash flows/Escrow account);
- Money will be released to suppliers and employees of the contractor in accordance with a payment plan; and invoices as vetted by client, contractor and agency department; and
- The client will pay the money into bank account and once the bank has been repaid the balance that is left in the account will be paid to the contractor.

Implementation of medium term option by banks

The banks will have to make a decision on their preferred funding model for all cidb registered contractors and mobilize their resources to implement this within a period of 12 months.
The Contracting Agent could be established as an arm of Government and private sector (Public Private Partnership) which will be responsible for developing and training (mentoring) of contractors. This can be a joint venture between Government and private sector or a private sector initiative. Highly skilled manpower could be recruited to manage the Agency, which will include Engineers, Consultants, Accountants, Bankers, Insurers, Trainers and other relevant professionals. Ownership of the Contracting Agency will be decided at a later date depending on private sector and Government needs and commitments.
Its responsibilities could include among other things:

• Financing will be arranged by the newly established Contracting Agency (appendix 1);
• Contracting Agency will facilitate the necessary insurance guarantees which is often required by clients; this may also include the likes of a Khula guarantee;
• The Contracting Agent will assess viability of contracts taking into consideration the cost of financing and recommend to banks for financing;
• Contracting Agency will facilitate the necessary insurance guarantees which is often required by clients; this may also include a Khula guarantee;
• Banks, large construction companies, insurance companies could also pay part of their contributions (e.g. ED, SCI etc) to the Contracting Agency;
• Contributions may also include expertise in the form of time spent for coaching by experienced engineers, trainers and other professionals;
• The Contracting Agency will provide entrepreneurial support to the contractor as part of a formal enterprise development programme;
• Banks could provide working capital to contractors on the basis of a contract’s profitability;
• Bank account will be controlled by the bank, the Contracting Agency and the contractor and profits will then be transferred to the primary account of the contractor;
• Money will be released to suppliers and employees of the contractor in accordance with a payment plan and invoices as vetted by the client, contractor and agency department; and
• The client will pay the money into the joint bank account and once the bank has been repaid the balance left in the account will be paid to the contractor as agreed arrangement.

ESTABLISHMENT AND ROLE OF THE CONTRACTING AGENCY

The Contracting Agency will be a legal entity, independent body, managed by representatives from the industry i.e. construction industry stakeholders, the Insurance Sector, major banks, Government, and the private/established sector. The Contracting Agency will extend its role into monitoring, reworking legal and technical support, particularly regarding assessing the profitability, viability of contracts and providing non-financial support.

The Contracting Agency will be a conduit through which contractors will apply for working capital funding:

• Only contractors registered with the cidb (Grade 1 to 8) will be able to apply for funding with the assistance of the Contracting Agency;
• The bank will provide a working capital facility to the contractor based on the fact that the contractor is registered with the cidb and the application process for funding is done through the Contracting Agency;
• The bank account will be jointly controlled by the contractor, the bank and the Contracting Agency (Escrow account);
• The client of the contractor will agree to up-front payment directly into the Escrow account and agrees to a session of the contract to the bank and the Contracting Agency;
• The Contracting Agency will assist the contractor to negotiate better terms (e.g. interest, guarantees, insurance retentions etc) with the client, the insurance company and the bank, as the overall risk of contracting with a small contractor will be reduced through the intervention of the Contracting Agency;
• The Contracting Agency will not be involved in the grading of contractors. The grading process has to be independent in order to provide credibility to various stakeholders;
• The Contracting Agency will provide the contractor with enterprise development support in the form of technical assistance, personal development, financial management, business management, contracting procedures etc.;
• The Contracting Agency (Secretariat and Chair will be appointed by participants and the secretariat could initially be government / cidb) will assist in facilitating / arranging performance guarantee and retention guarantee on behalf of the contractor, which will speed up the process of financing and free up working capital for the contractor;
• Insurance guarantees may be funded from CSI or parts enterprise development contributions but the contractor has to refund this to the Contracting Agency at the end of a contract in order to ensure sustainability of both the agency and the Contractor;
• The contractor receives the opportunity to build its own track record with the bank and the insurance company;
• Government is able to track the progress of contractors;
• Centralise Enterprise Development in the construction industry; and
• Assist in co-ordination and centralisation of Enterprise Development in the construction industry.

ROLE OF cidb

The cidb will play a facilitation and co-ordination role, which will include lobbying Government and Private Sector to work together in developing emerging contractors, adopting the models, packaging and tailor making products, and establishing the agency. The promotion of the models and agency, promoting standard application process, streamlining procurement processes amongst government client departments, promoting contractor support, training and mentorship, and profiling of contractors will be the major roles that the cidb will play. The cidb will encompass and promote the financial modeling options as part of the NCDP (National Contractor Development Programme).

THE ROLE OF GOVERNMENT

Government departments have a responsibility to develop Emerging Contractors through NCDP, job creation and business opportunities through EPWP (Expanded Public Work Programme). The establishment of a Contracting Agency will assist Government to meet its targets of employment creation and empowerment of communities. Government will be encouraged and requested to provide funding for this initiative and become a roleplayer together with private sector.
ROLE OF BANKS

As mentioned earlier the major challenge for contractors is access to working capital. Banks and other financiers will be invited to be the leading players in this initiative. The Contracting Agency will provide the risk management process to all participating banks while managing the risk. Managing risk will include training, mentoring and providing the necessary business management skills to contractors. Contractors will be able to deliver on the contracts issued to them as they will be assessed for profitability before the contractors can start working on the project. The benefits to banks include:

- Reduction in bad debts;
- Economic growth as a result of contractor performance; and
- Employment creation which will result in more people opening new accounts.

Banks will be expected to adopt the models, package and tailor make targeted and construction specific products, and support the establishment of the Agency.

ROLE OF INDUSTRY PLAYERS

The BBBEE Chapter requires companies to assist and promote emerging entrepreneurs by providing finance and other assistance which will result in the companies scoring points (maximum of 15 points). Large construction and engineering companies are required to spend 3% of their profit after tax on enterprise development; which will increase their BBBEE scorecard and preferential procurement. The benefits will include:

- Ownership in the Contracting Agency;
- Accessing work through development of emerging contractors (business development);
- Skills development and employment creation; and
- Access to EPWP.

THE ROLE OF INSURANCE COMPANIES

Contractors are normally required to offer its clients a Performance Guarantee, Advance Payment Guarantee, Retention Guarantee or a Tender Bond. This may also include materials on/off site guarantees.

The provision of a construction guarantee may carry with it a lot more than its financial value. It is, in the first instance, a professional third party opinion of the contractor and in particular, of the contractor’s ability to perform successfully in terms of the contract.

In legal terms, a guarantee puts the insurance company in the position of co-principal debtor with the contractor, adding to the peace-of-mind of the beneficiary of the guarantee. Insurance companies have the technical, financial and legal expertise to assess the risks associated with such liabilities.
The company’s assessment is based on the following criteria and steps:
• Establishing the adequacy of the applicant’s financial, managerial and physical resources;
• Determining the exact nature and extent of any obligations and the underlying terms and conditions of such obligation;
• Ascertaining the effect these obligations will have on the applicant’s performance and as a consequence, on a guarantor’s responsibilities; and
• Assessing and evaluating the applicant’s ability to fulfil the required obligation.

Whilst there are many types of guarantees, there are an even greater number of formats. Almost each and every principal/employer has its own specific requirements.

There are insurance companies in South Africa that serve the entire spectrum of the construction industry - from the very large to the emerging.

The focus has to be on affordability, does not have onerous collateral requirements and is underwritten by people who understand that glossy financial statements are not the defining issue.

Not only will they provide guarantees, but they extend services into monitoring, legal and technical support, particularly regarding assessing the profitability and viability of contracts.

Benefits for contractors:
• Much lower collateral requirements than banks;
• Speedy delivery of guarantees;
• One point of access to address all its needs;
• Improved cash flow and working capital to allow for contractor’s growth and investment opportunities; and
• Non monetary support.

Benefits for insurance companies:
• The insurance company will rely on the Contracting Agency for assessment and viability of contract;
• Established relationship with Contracting Agency will allow the insurance company to build a profile of the contractor;
• Product: lower total-guarantee-cost than banks;
• Service: speedy delivery of quality-checked guarantees from a specialist group;
• Personnel: a highly qualified and experienced engineering, legal and financial team with extensive knowledge of building, engineering and contracting will assist contractors;
• Lower total cost-to-company guarantees than the banks; and
• Assurance of sound backing accepted.
HOW WILL THE CONTRACTING AGENCY BE FUNDED?

The Contracting Agency will be funded by contributions from:

• Large construction companies providing a percentage of their enterprise development or CSI contributions in terms of the BBBEE charter applicable to the construction sector to the Contracting Agency (a percent of their profit);
• The BBBEE charter applicable to the construction sector was issued on 5 June 2009 and presents the construction industry with the ideal opportunity for the advancement of transformation and BEE in the procurement of construction programmes and services. The Code also seeks to regulate a target of 30% black ownership in the industry over the next 10 years.
• Insurance companies providing parts of their enterprise development or CSI contributions to the contracting agency;
• Banks providing part of their enterprise development or CSI contributions to the Contracting Agency;
• Government;
• Levies and fees from contractors; and
• Donor funding.

ROLLOUT PLAN FOR IMPLEMENTATION OF THE AGENCY

<table>
<thead>
<tr>
<th>Action</th>
<th>Implementation period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Development of standard financing models and process map</td>
<td>February 2011</td>
</tr>
<tr>
<td>• Financial models</td>
<td></td>
</tr>
<tr>
<td>• Action strategy</td>
<td></td>
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<tr>
<td>Stakeholder participation</td>
<td>March 2011</td>
</tr>
<tr>
<td>• Workshops and consultation</td>
<td></td>
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<tr>
<td>Sector financing standardisation</td>
<td>June 2011</td>
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<tr>
<td>• Models alignment</td>
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<tr>
<td>Appointment of an implementing agent</td>
<td>June 2011 to June 2014</td>
</tr>
<tr>
<td>• Stakeholder awareness</td>
<td></td>
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<tr>
<td>• Rollout of the models</td>
<td></td>
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<tr>
<td>• Contractor education</td>
<td></td>
</tr>
<tr>
<td>• Fund raising (Enterprise Development, Government and Donor financing)</td>
<td></td>
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<tr>
<td>Model rollout</td>
<td>January 2012 to June 2014</td>
</tr>
<tr>
<td>Government support and prioritisation</td>
<td>June 2011 to June 2014</td>
</tr>
<tr>
<td>• Lobbying for Government support through EPWP</td>
<td></td>
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<tr>
<td>Awareness and education</td>
<td>June 2011 to June 2014</td>
</tr>
<tr>
<td>Industry commitment through enterprise development</td>
<td>June 2011 to June 2014</td>
</tr>
</tbody>
</table>
SUMMARY

Development of emerging contractors is one of the Government’s priorities. The Government is inviting all interested stakeholders to participate in the development of emerging contractors. It is Government’s intention to lead and allow the private sector to participate, contribute and mutually benefit in this project. The impact of the success of this project will include:

- Creating an enabling environment for emerging contractors to core exist with large contractors;
- Allowing sharing of resources and skills within the industry;
- Sustainable empowerment and economic growth;
- Access to EPWP where the Government has budgeted to spend R300 billion over the next three years in infrastructure development; and
- Growth and employment creation in the construction industry and other feeder industries like insurance, banking and service sectors.
## APPENDIX 1: WHAT IS THE SCENARIO OF CONTRACTOR PERFORMANCE

<table>
<thead>
<tr>
<th></th>
<th>What if the contractor fails to perform the job? Then who will perform the job and who will pay the bank?</th>
<th>The contracting agent will provide mentorship and training to contractors; If then the contractor is still not performing, the client might appoint another contractor to perform the job; or The bank will take cession of the contract.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>What if the client does not pay?</td>
<td>Amounts to breach of contract. Insurance payout; Banks to provide bridging finance.</td>
</tr>
<tr>
<td>3</td>
<td>What if the sub-contractor does not perform?</td>
<td>Primary contractor is responsible for the scope (this is only applicable when work is subcontracted)</td>
</tr>
<tr>
<td>4</td>
<td>How does the contractor’s bank become eligible for holding the session on the contract?</td>
<td>The bank will release payments to the contractor’s supplier in accordance with a contract/ pre-signed plan. The contractor will submit the payment request to the Contracting Agency that will approve the payment and the bank will then release the payment.</td>
</tr>
<tr>
<td>5</td>
<td>What if, due to the nature of the project, the progress is non-linear and results in an abrupt increase in working capital requirement, thus rendering the start-up money arrangement with the bank futile?</td>
<td>The borrowing plan/contract should be in accordance with progress, whether linear or non-linear.</td>
</tr>
<tr>
<td>6</td>
<td>What if the project cost overruns?</td>
<td>Contractor will indemnify personally (personally liable / personal surety) or through insurance if outside scope. Else Scope / Contracting agency revisions with client) or through insurance.</td>
</tr>
<tr>
<td>7</td>
<td>What if the contractor’s project incurs a loss for some reason? How will the bank be indemnified?</td>
<td>The project will be pre-evaluated by the Contracting Agency to ensure that it’s a viable contract. Progress will be evaluated at various stages and appropriate action taken by the Contracting Agency if required. Insurance cover will have to be pre-signed and Guarantees from agency to bank. Agency to recover losses from contractors.</td>
</tr>
<tr>
<td>8</td>
<td>What if the client rejects some material that has been paid for by the bank, but has not been paid for by the owner yet?</td>
<td>Defective material will be covered by warranty. Damage due to accidents will be covered by insurance.</td>
</tr>
<tr>
<td>9</td>
<td>What if the banker is not knowledgeable enough to understand the construction process in order to oversee disbursement?</td>
<td>Assistance from Contracting Agency/ support entity will be available and there will be buy in from all major banks.</td>
</tr>
<tr>
<td>Question</td>
<td>Answer</td>
<td></td>
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<tr>
<td>-------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------------------------------------------------------------------------</td>
<td></td>
</tr>
<tr>
<td>Why should the banker be assigned as a third party beneficiary to all of the invoices if the payment bonds already indemnify him?</td>
<td>The Banker is to receive and control payments into the bank account.</td>
<td></td>
</tr>
<tr>
<td>Why should a client cooperate with a contractor with such an arrangement if he can find another contractor who can operate traditionally?</td>
<td>Numerous hidden benefits for the client, the country, enterprise development, contractor development, banks and insurance companies meet developmental goals and minimises risk. Risk sharing and management. Although no contract between client and bank, in context of a CDP developmental objects could be derived.</td>
<td></td>
</tr>
<tr>
<td>If a contractor has a track record of having successfully and profitably executed projects, why should he agree to retention of his profit in the bank account?</td>
<td>Security to bank and incentive for contractor to finish early.</td>
<td></td>
</tr>
<tr>
<td>What if there is a labour strike?</td>
<td>Losses can be recovered under insurance;</td>
<td></td>
</tr>
<tr>
<td>What if the contractor has exhausted his bonding capacity in other projects?</td>
<td>Risk in this model is low, hence insurance company could consider increase in bonding capacity.</td>
<td></td>
</tr>
<tr>
<td>In allowing such tight control by the bank, is there not a risk of losing ownership of the contractor’s company?</td>
<td>Bank will not have an equity stake in the contractor’s company.</td>
<td></td>
</tr>
<tr>
<td>Why should a bank lend without collateral or with minimum collateral when currently they seek and get collateral for their lending?</td>
<td>Contractors are a high-risk segment to bankers yet the segment is currently not exploited. The country needs the development of contractors in various forms, whilst the banks need the clients, turnover, credit facility extensions. Mutual benefits.</td>
<td></td>
</tr>
<tr>
<td>What if the viability / dispute/ legal costs are so high that the project becomes non-viable?</td>
<td>Cost Benefit analysis may have to be done before abandoning the acceptance of the proposed project. If project underway consider project cancellation.</td>
<td></td>
</tr>
<tr>
<td>What if a ‘Force Majeure’ event occurs on site and the material or works not paid for by the owner are lost or destroyed?</td>
<td>Stands covered by insurance</td>
<td></td>
</tr>
<tr>
<td>What if the bank makes a mistake or defrauds and authorises release of more money from the joint bank account?</td>
<td>The bank will have insurance in place to cover this.</td>
<td></td>
</tr>
<tr>
<td>What if the bank and the contractor or the Contracting Agency individually or together collude and attempt to defraud the trust fund account or conduct irregular activities?</td>
<td>The model does not offer immunity to fraud. Zero tolerance. Legal, criminal procedures. cidb action and de-registration. Contract and/or employee terminations.</td>
<td></td>
</tr>
</tbody>
</table>