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NTINGA LINK - CONSTRUCTION SECTOR RESEARCH Analysis and Overview

Introduction and Response to

**Sub-Sector Analysis and
BDS Market Assessment of
the South African Construction Sector**

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Submitted to:

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I. INTRODUCTION

World Education Ntinga (WEN) is pleased to present the findings and report on the Sub-Sector Analysis and BDS Market Assessment of the Construction Sector, prepared by its Ntinga LINK programme partner, Upstart Business Strategies.

In this brief overview, the World Education team highlights key findings that will have a bearing on programme strategies and activities.

This document captures how the WEN team is internalising and incorporating the research findings into programme design and delivery strategy.

Many of the findings confirm our initial estimates of the potential for results in this sector – in terms of impacting at micro-enterprise level and performance of a market-development facilitation programme. However, we are also cognisant of the constraining factors in the sector, which will have to be managed to allow maximum impact.

WEN views the Sub-sector Study not as a static document – but rather a dynamic tool that itself could undergo revisions and re-thinking, as new information comes to light during actual programme activities. Already, parallel to the formal “research” and survey processes, the information obtained and the contacts made are providing new partnership leads, under-scoring aspects meriting attention right away, and helping distinguish between concrete vs. longer-term or ephemeral opportunities.

We thank and commend our colleagues at UBS for all their hard work, and also thank Consultant Marshall Bear, for his guidance and input to both organisations during the process, and in the absorption and analysis of the findings by the WEN team.¹

1 . Although colleagues from UBS and Consultant Marshall Bear provided invaluable input and insights, and contributed to debate and discussion, World Education Ntinga bears full responsibility for the interpretation of the findings, making of informed choices, and resultant strategies and activities.

II. CHRONOLOGY OF STUDY AND ASSESSMENT PROCESS

The research process began in August, with the preparation and discussion of a Terms of Reference for the exercise, indicating the type of information being sought. Once agreed to by Upstart and World Education Ntinga, the first phase of secondary research and key informant interviewing took place (in early September.) A brief summary of findings – outlining the broad structure of the sector, the general nature of relationships, and potential growth areas and constraints – was presented to World Education Ntinga.

A half-day discussion session on the same was held in mid-September, which then provided the way forward for the field work in the three selected areas. During that discussion, sector structural issues were clarified, and an initial breakdown of the kinds of “market” for Construction Sector products and services began to take shape.²

The two teams jointly agreed on geographic parameters for the research, and focus on sub-sectors or product groups, as per the following matrix:

Table 1: RESEARCH MATRIX - Geographic Areas/Product Group mix

Product groups/ sub-sectors		Civil wks	Low-inc Hs'g	Public Bldg/ Maint.	Casino /hotels	Indus. Dev. Zones	Urban Renewal
Provinces	Areas						
GAUTENG	'Greater' Gauteng	✓	✓	-	-	✓City Deep	✓Alex
KWAZULU- NATAL	Durban metro	✓	-	-	✓	-	✓Ushaka Inanda
	Richards Bay/ Empangeni	✓SDI Other	-	✓	✓	✓New port	-
EASTERN CAPE	N.M Metrop (Port Eliz.)	✓	✓	-	-	✓Coega	-
	Umtata/ Wild Coast	✓	✓	✓	-	-	-

By the third week of September, field research tools had been designed and reviewed, and UBS team members undertook field research over a three week period, carrying out both key informant and SMME interviews.

In mid-October, with the arrival of Consultant Marshall Bear, the initial field findings were presented and discussed. Given the rich array of both quantitative and qualitative information, WEN/Bear proposed certain “data presentation” formats to help summarise and digest the data in a form that would be relevant and usable in designing and placing programme interventions.³

During this process, the WEN team, interpreting the data as well as bringing in its own data and experience in the sector, began to draft a Sub-sector RELATIONSHIP map, that is being used to identify BDS gaps and possible intervention areas (as shown and discussed in Section IV.)

Also in October, a tool and process for the BDS supplier assessment was designed, and the supplier research was carried out in early November. Submission of a Draft Final report in mid-November was followed by feedback, and a few additional key informant interviews – particularly targeting established private sector players in the Gauteng area.

2 . See Annex A – Initial Product group map

3 . See Annex B – Data Format Tables

The final draft was completed in the first week of December, in conjunction with World Education's analysis of the findings and its integration into intervention and programme design.

As always, time was in short supply. To thoroughly understand a complex and dynamic sector – which one source described as the “engine” of the economy – would take a lot more time, and involvement of many more players. However, in keeping with the spirit of action-research, World Education Ntinga intends to use the study's findings to date as assumptions and hypotheses that will be applied and either affirmed or adapted during the first phase of implementation.

III. COMMENTS ON CONTEXT & PROCESS

➤ Selection of SMMEs and of service providers for the study

In order to unearth information and viewpoints not normally available to World Education Ntinga from its existing network of service providers, stakeholder partners, and client contacts, the process of selecting participant SMMEs and Service Providers for the Sub-Sector study was somewhat deliberately “managed.”

Size of firms – SMMEs & Providers

The aim was to ensure that SMMEs surveyed were operational within the sector, and had some track record – so as to be able to speak with an informed voice and some authority, and to determine whether their performance and perceptions mirrored the broader (and better known and studied) characteristics of the micro- and small enterprise sector in general. Thus, start up or very new micro-enterprises – which typically form the majority of non-profit providers' clientele – were excluded.

Similarly, on the supply or service provider side, the tactic was to identify and question service providers who are not part of World Education's usual partnership roster. Thus, rather than the BDS (business *development* services) providers, the survey targeted BSPS's (Business Services & Professional Services) providers. This resulted in a more technically-oriented group of respondents, including quantity surveyors, draughtsmen, project managers, engineers, etc.

Not surprisingly, the data and findings are thus weighted in a particular direction – in terms of indicating perhaps higher levels of awareness, competence, and/or capacity than is the norm for the vast majority of PDI-owned micro-enterprises – and the service providers that serve that segment of the market.

Is public sector involvement 'distortive'?

Interestingly, on the service provider side, the Ntinga LINK study found that even private, for-profit firms (i.e. 35 out of the 36 respondents were for-profit), view and cater to government or public sector as their *major* client.

It has become more apparent to the team that government in almost every robust economy is a major consumer or buyer of construction sector products and services, by its very nature of requiring stock and infrastructure for its own operations. This is a major strategy for fulfilling government's mandate to provide an enabling environment, wherein private sector investment can flourish.

Thus it is incorrect to view public sector “purchasing” of product and services in the Construction Sector as a non-economic or market-distorting factor.

For instance, when one examines responses around enterprises' awareness of and access to services — the relatively high responses are in contrast to the widespread reality at grass-roots level, where a majority of micro and very small enterprises are still excluded from the system by basic information constraints. Similarly, because the surveyed enterprises are quite entrenched in the sector, they displayed use and payment characteristics that are considerably rarer among the broader array of entry-level enterprises, particularly those in non-urban areas.

Nevertheless, the study findings are no less valid and relevant for indicating perhaps higher levels of awareness, competence, and/or capacity than is the norm for the vast majority of PDI-owned enterprises – and providers. In fact, because the data represents the status of somewhat more “successful” – although still constrained – market segments of small firm contractors and service providers, it helps provide some benchmarks and real-life examples against which to phase and assess the development and growth of programme-targeted providers and clients.

When taken in combination with nationally available data on the status of South Africa's SMME sector, the findings of a December 2001 survey of micro-enterprises (box below), and the practical experience of members of the team, World Education believes it has a relatively comprehensive overview and understanding of sector practices, constraints, and opportunities as relevant to the targets and goals of Ntinga LINK.

In Dec. 2001, World Education surveyed 70 enterprises, of whom 45% were engaged in Construction/ Manufacturing activities.

Awareness of availability of business linkage services averaged around 40%; and usage averaged 40% of those aware.

Reasons for BDS use cited by construction sector respondents specifically were:

- Business growth (which parallels the findings of the sub-sector report) – 56%
- Business problems – 24%
- Recommendation of friend – 11%
- Free of charge – 9 %

The two top reasons for non-use, were:

- Not sure how the service would help – 36%
- Could not afford to pay – 29%.

This indicates that for the level of entrepreneur being targeted by Ntinga LINK a fuller understanding of the value of appropriate services and where they fit in the business of construction, as well as developing innovative, affordable payment mechanisms will be key.

In terms of source of services utilised, the construction/manufacturing responses in some aspects paralleled the current studies findings – with private firms or “consultants” being ranked as top sources, and NGOs/government as less frequently used sources.

Payment rates for services accessed were less than 50% -- in contrast to the nearly 100% cited by both enterprises and BDS suppliers in the sub-sector study.

Urban, peri-urban bias

Three of the five study locations were large metropolitan areas – in and around Johannesburg, Durban, and Port Elizabeth, which are among South Africa's five largest cities. The other two areas – Umtata and Richards Bay – are mid-sized towns, set in deep rural areas, but somewhat more industrialised and with better infra-structure and facilities than rural towns. Umtata has a largely agricultural-based economy, while Richards Bay's economic is billed on minerals/ore processing, and shipping.

The five research areas were selected on the basis of known opportunities, relative ease of access to SMMEs, and existence of a core group of service providers. Going further afield, which WEN would have liked to do, would have cost more time and money – and most likely would have then included service providers of the traditional NGO variety only.

➤ **BEE (Black Economic Empowerment): The double-edged sword**

As with the previous National Sector Scan, the Sub-Sector Study respondents and findings makes numerous references to BEE as a key factor in the Construction Sector. It seems appropriate at this juncture to provide some context that will help address the issue of whether BEE is “distorting” the market to such an extent as to make any interventions of doubtful economic value or sustainability.

Comparing BEE in South Africa to affirmative action policies in the US, while easily done, is actually dangerous as the similarities are only superficial.

Current BEE policies – and the push to legislate them – can be considered an “intervention” in the marketplace. However, it is an intervention in a distorted marketplace and an attempt – albeit flawed or not always appropriately managed -- to correct or reduce those distortions and level the playing field for all business persons.

It must be recalled that South Africa's relatively impressive economic infrastructure and performance was actually built within a thoroughly distorted market, rife with government intervention and legislation. Through racially delineated policies of support and subsidies

BEE – a brief definition

A concerted effort, led by the public sector, to redress past economic inequities and imbalances.

General strategy is to promote effective participation and benefits for greater numbers of PDIs, through increasing access and role in economic opportunities – be it via ownership, management, control, and skilling.

More simply, BEE is predicated on “outsourcing” opportunities to PDIs at certain levels or percentages – normally 20% – 30% of total contract values.

for a 10% minority of the population, and artificial exclusion or constraints on the majority's access to skills, opportunities, and resources, a sort of “pyramid” economy has been built – where the top tier has many of the trappings and characteristics of a first world, free-market system. But it rests on a base of complex and entrenched inequities and non-competitive barriers, that of necessity must be dismantled – whether by economic imperatives of growth and globalisation; political and social pressure from a long-disenfranchised majority; or a combination.

For the present, despite pressure from some quite vocal sectors, government has resisted legislating BEE or imposing quotas. Rather, the tactic favoured by both the established or traditional private sector and government has been to negotiate “empowerment charters” within key industries or

sectors, the most notable being the recent Mining Charter. Parallel to such negotiations, the private and para-statal sector have already taken steps to broaden or encourage involvement of ABE (affirmable business enterprises) – firms owned and managed by “black” individuals. The most efficient means for doing this has been through outsourcing or un-bundling – especially of non-core business. The traditional economic establishment, while still reluctant in some quarters, recognises that for both bottom-line and market-share purposes, as well as due to the declining size of the qualified minority business population (through emigration and early retirement), inclusion of black-owned firms into the system makes all-around business sense.

Nevertheless, both our experience and the study findings show that BEE can be a two-edged sword: It is opening doors and opportunities that until now were closed to the small, PDI-owned firm. Yet, these very firms are struggling to reap the benefits of BEE – due to severe internal informational and capacity constraints, political interference, and some disarray or power struggles among business associations and chambers.

The challenge for Ntinga LINK – and particularly the participating service providers – is to not allow the easy lure of BEE pressures to inform and dictate all services and products, but rather to develop an appropriate product line for this market, while maintaining other core products and services that are integral to the Construction Sector, itself.

➤ Terminology and definitions

The sub-sector report includes a Glossary of acronyms and terms. But, for the purposes of this analysis, the following *precis* of key terms – as used in South Africa in economic and political contexts - should provide a useful basis from which to read the report:

Acronym	Term	Usage in this study, and by World Education Ntinga
ABE	Affirmable Business Enterprise (also PDI firm or “emerging” firm)	Generally, an ABE can be any firm with majority ‘black’ ownership or shareholding. Thus, the large black-shareholding companies listed on the Johannesburg Stock Exchange would be ABEs. But, for our purposes, ABE refers primarily to the smaller end of the spectrum – micro or small firms owned and run by “PDIs.”
Affirmative Procurement	Affirmative Procurement	Similar to BEE, as it refers to outsourcing or sub-contracting activities, which are usually issued under competitive bidding or tendering procedures.
Black		Mainly individuals of African descent; but also, commonly and as a short-form, inclusive of those who may be classified as “coloured” (mixed race) or India. Non-white.
Emerging firms		Interchangeable with PDI firm or ABE – again, usually referring to smaller, under-resourced black/PDI-owned businesses
PDI (also HDI)	Previously (or Historically) Disadvantaged Individual	Term that refers to Africans (77%) Asians (2.5%), and Coloureds (8.7%), all of whom were officially discriminated against in varying levels until the formal abolition of apartheid in 1994. Women of all races are also sometimes referred to as PDIs.

IV. RELEVANT FINDINGS

While nearly all the information in the study is useful and relevant, in this instance, World Education would like to highlight the following.

- **Positive Growth Trend in the Construction Sector:** Economic expenditure patterns in various sub-sectors have been confirmed, and several product groups are expected to grow— infrastructure and civils, industry-led demand (e.g. from the mining and tourism sectors), public-sector demand for housing and educational products; and, of course, ongoing building and maintenance of existing stock. Planned levels of public investment are staggering – although experience and the research show that such ambitious spending targets are not easily achieved. Discrete private-sector investments in the sector are also not insubstantial, but need to be sought out and tracked more carefully, as they are not always publicly announced or publicised.

An interesting fact brought out by the report regards the “backlogs” in infra-structure and housing – which have resulted from the deliberate neglect and cordoning of areas under the past system, and which can no longer be countenanced in the new South Africa, for both political and purely economic reasons. The extent of these backlogs – which would not have come about had the South African economy been market-based to begin with – indicates that business opportunities will be available for several years to come.

Implication of finding for Ntinga LINK: The growth trends confirm that the Construction Sector is a good choice for undertaking an MDA facilitation activity such as Link. Concrete opportunities exist, and by being opportunity-driven, the programme will be better able to make attractive “offers” to all segments of the sector. However, Ntinga LINK will have to select a judicious combination of sub-sectors or product groups. By targeting lower risk sub-sectors such as public installations and maintenance, prospects for outreach and achieving targets are better – but the ultimate reward to enterprises may be limited. Sub-sectors such as urban renewal initiatives or major civil works, offer greater financial rewards –but un-managed risks could threaten the survival of the emerging firm.

- **Involvement of Micro-enterprises in the Sector:** The findings – on numbers of firms, relative role and share of business, constraints and problems – generally and specifically substantiate World Education’s original understanding of the situation. The majority of firms in the sector are micro and very small. Yet the major share of higher-margin work and returns accrues to a relatively small proportion of established firms, both large and medium. The large firms are generally what is termed “traditional”– white-owned and managed. In the medium category, there is a healthy sprinkling of PDI-owned entities – several of them having come up as a result of spin-offs or un-bundling from the large firms. However, highly technical or specialised construction trades and capital-intensive services tend to still be the domain of “traditional” medium and (larger) small operators.

Although competition is stiff, smaller PDI firms possess certain advantages – in terms of cost structures, mobility, and close-to-site presence. When such firms have the required capacities in place, or at the least genuine interest and desire to learn and deliver, they are able to carve out a market niche, build a track record, and obtain repeat business.

Implications for LINK: This finding confirms that micro-enterprises are constrained by lack of access and lack of success in the sector. It indicates that there re both nascent and un-tapped demand for value-adding business services that can bring small and large

firms together through profitable linkages. The “market” exists – but, currently, the demand for linkage services at the lower end is not being fully met by the available supply.

- **Small Firm Constraints:** According to entrepreneurs themselves, as well as key informants and the BDS suppliers surveyed, small firms face critical constraints or weaknesses in the areas of:
 - Inability to respond to and submit winning tenders, which are the primary vehicles for doing business in the sector.
 - Lack of required compliance – ranging from basic registration to technical accreditation and delivery documentation.
 - Inability to negotiate reasonable or appropriate payment and performance terms with both government and big business
 - Inadequate marketing and relationship-building skills to interest and bring in larger firms
 - Lack of access to finance – during the pre-construction phase, which may disqualify them from meeting guarantee and performance bond requirements; and during the construction phase, which leads to cash-flow problems, incomplete work, and possible liquidation
 - Lack of business and project management skills is a major constraint to efficient delivery on jobs obtained.
 - Understanding project flows, and accessing and managing materials supplies for maximum cost- and time-efficiency

The results of these constraints are that the small firms end up foregoing opportunities too big/risky for them; they are not well known or marketed to key players in the sector; they have difficulties managing growth, when they do get large contracts; and they often don't know where to turn for service solutions to business problems.

Implications for LINK: Given such a clear “list” of priority needs in acquiring and executing work, Ntinga LINK providers can be quickly supported to market or develop appropriate products that address these. These disadvantages might be overcome with better linkages between firms of different size, identification and expansion of win/win situations between ABEs and larger firms, and responding to both market signals and/or extra-market incentives/sanctions (e.g. BEE).

- **Availability and Quality of BDS in the Sector:** There is a dichotomy that reflects the broader dichotomy in the South African economy as a whole. Those who are in the formal or mainstream of the industry or sector possess the necessary information, have the necessary relationships, and are accessing and using required business services – both professional and developmental. Those at the lower end – the Ntinga LINK and USAID target groups – are not operating at this level yet.

According to the Sub-sector study, the business or professional services suppliers operating within the sector who were surveyed for the report cited their own constraints as including limited:

- Professional or technical skills among staff
- Management experience
- Finances, for obtaining new work and/or for upgrading skills
- Understanding of BEE issues

Interestingly, BDS (business development services) providers who are not entrenched in the construction sector per se, cite some parallel constraints⁴ to their capacities to grow and deliver value adding services:

- Non-availability or lack of technical and management skills
- Limited finances for upgrading such skills
- Lack of client understanding of the value of services
- Client unwillingness to pay
- Competition from free or subsidised services

Implication for LINK: Where providers show the initiative and ability to adapt, LINK can assist with product and service delivery innovations, based on their identified local market and opportunities.

- **Sub-contracting and Out-sourcing** have always been part of the way the sector does business – and would offer opportunities even without the current push for BEE. It is primarily a business decision from the larger firm’s point of view – whether economically or politically motivated, it looks to ensuring the bottom line well into the future. Sub-contracting is a more economically attractive option for large firms on certain types of projects – such as, for example, building of employee or low-income housing, refurbishment or building of schools in rural areas.

Implication for LINK: The programme targeted enterprises have traditionally been involved in less-skilled, lower-margin, or labour-only type sub-contracts – although that picture is slowly changing. BDS that help make the leap from these to higher-value, specialised sub-contract services is expected to be a focus of the Ntinga LINK providers’ market strategies.

- **Small Firm-Large Firm Links:** These, too, are currently taking place – but, aside from some exceptions, the general pace, frequency, and performance of such linkages is uneven and largely unsatisfactory, according to the range of survey respondents.

For instance, large firms struggle to identify and work with capable or genuine ABEs. A common complaint is that, the PDI firms that enter into Joint Ventures are unable and unwilling to fulfil their part of the deal – leaving the large firm to do all the work, while still taking a share of the return. Small firms on the other hand, complain of exploitation by the large firms – and are in the main unable to negotiate effective partnerships or ventures with large firms.

Implication for LINK: Preparing for, arranging, and managing “win-win” Joint Ventures is a clearly emerging product or service line, that enterprising BDS providers can sell to both small and large contractors, small and large professional services providers, and to an array of firms involved in the materials supply, non-core, and financial-administrative services chain.

4 . This data culled from World Education’s Dec. 2001 survey of 18 “general” BDS suppliers – 50% each being for-profit and non-profit providers.

- **Evolving PPP pattern:** Public-private partnerships are being put into practice effectively in the construction sector, because government does not have the funds – or the capacity – to address and deliver on infrastructure backlogs at the pace required.

Thus, the system of “concessions” on large projects is being followed. The most common example is in the areas of new road construction or highway refurbishment’s. Private sector firms are selected on a competitive basis, where after putting up a substantial share of the costs for carrying out the work, they are then granted a management concession for a period of time, during which to recoup costs and make profits. The new “campus” for the Department of Trade and Industry in Pretoria is another such example. The winning firm will have the contract to manage and maintain the entire facility for a 30 year period, including provision of all services and franchising as appropriate. The opportunities for small contracts (as well as non-construction sub-contractors) in just this one case are substantial.

Implication for LINK: Some of the public information strategies of LINK could focus on opportunities emerging through PPP, and on exploring examples or cases of successful small firm engagement.

- **Role of local government:** No market development programme can ignore government’s role as either an enabler or barrier to economic growth and innovation. In the South African context, especially in the construction sector, it is very important to understand the role of local and provincial government. The main “opportunity” emanating from this player is that of purchasing power of funds for investment (as evidenced by government’s medium term expenditure framework).

However, as the Sub-sector study notes on several occasion, issues of capacity, politics, and emerging practice in the tendering of public sector construction work are problematic. Local authorities often do not understand or are not able to put together reasonable tender specifications, and manage the bidding process in a timely or transparent way. While some are well-intentioned, others are politically motivated.

The government practice of “spreading benefits” among many small contractors – while understandable from an equity perspective -- has unintended negative business consequences on the very small contractors they are trying to help. In other words, while the local tenders promote participation of ABEs – they are now placing limits on the size of work or project size, and the amount of repeat business any one entrepreneur can be awarded. This limits the contractors ability to build a track record with substantial sized contracts and gain repeat business.

Implications for LINK: Through core groups of service providers, and directly, Ntinga LINK will likely engage local authorities through public seminars, spread awareness about good practice in the procurement sphere, and possibly facilitate area-specific partnerships among local government and BDS providers and/or contractor networks.

In sum, the World Education Ntinga team is pleased with the range and variety of programme of opportunities revealed by the research to date. The aim of facilitating demand and supply of qualified BDS is more achievable, given the identified gaps and niches that can be summarised under the main categories of:

- **Small firm capacity and performance constraints** in acquiring and executing business.
- **Sector-wide information, relationship, and operational constraints** faced by both large and small firms in jointly executing construction projects.
- **BEE demonstration and compliance requirements**, that suggest a “product line” for providers which could be marketed to end-user firms at all levels of the sector.

V. STRATEGY FOR IDENTIFYING BDS OPPORTUNITIES, AND EXPLORING SPECIFIC SERVICES

Based on the research findings, and existing sector relationships and practices, the WEN team has developed a “Sub-sector map” tool⁵ that it has used and will use to help:

- Assess gaps and opportunities for targeted BDS
- Guide marketing or development of demand-led and opportunity-driven responses by programme BDS partners
- “Place” such BDS within the market for maximum outreach and sale potential

1. Assessing the gaps and opportunities

The Relationship Map (next page) shows all the players, functions and processes that must be present to deliver a construction product against specifications profitably.

The map is a tool to help identify **where** (functions and players) and **when** (in which stage/step in the process) relationships break down in performing the steps necessary to meet owner/buyer specifications.

Ntinga LINK’s specific interests are to identify where small firms (primarily ABEs) perform – or could perform -- important functions in the industry, the constraints to their performance and the impact of these constraints on the entry, competitiveness and growth of such firms in the construction sector.

The map identifies all areas where industry growth affects small firm participation. For example, a key player in the construction industry is the principal building contractor, which is one area where the research has identified constraints and opportunities for small firm entry and growth. Other areas where small firms can take advantage of construction industry growth include technical services (e.g. quantity surveying, project management, drafting), skilled building trades (there are 35 building trades in SA), semi skilled labour, materials supply (e.g. brick works, hardware), equipment and tools leasing, and non-core services (e.g. protective clothing, on site food services). All small firms in these functional/service areas are potential targets for LINK.

5 . Development of this map and systematizing its use was a key output of the consultancy with Marshall Bear.

Construction Sector Relationship Map: Players and Processes

