

# Increasing local content in the procurement of infrastructure projects in low income countries

Briefing note



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# Foreword

The need to increase local labour, goods and services, 'local content', in the delivery of infrastructure projects in developing countries is an issue recognised by the multi-lateral development banks, the World Trade Organisation and all the major UN agencies.

Increasing local content in the delivery of infrastructure projects can make a major contribution to the achievement of the UN's Millennium Development Goals. It can improve the local economy, it can lower project costs and it can also help ensure infrastructure is well maintained.

In 2004-5, I chaired the ICE Presidential Commission, Engineers without Frontiers (EwF). Research commissioned by EwF suggested that the way in which infrastructure projects are procured can have a significant impact on the performance of the asset, as well as upon the achievement of broader economic and social development objectives.

However, as things currently stand, the procurement of infrastructure projects does little to benefit consultants, contractors, suppliers and manufacturers from the least developed countries.

ICE and Engineers Against Poverty believe that a major increase in local content can be achieved by making only minor changes to the procurement policies of governments and donors.

This briefing note sets out a number of actions that together constitute the elements of a policy for promoting local content in public infrastructure procurement. It follows from a report produced in 2006 by ICE and Engineers Against Poverty called *Modifying Infrastructure Procurement to Enhance Social Development*, which sets out how current procurement practices hinder or enable social development.

The note is one of the outcomes of ICE and Engineers Against Poverty research that has involved assembling evidence of successful attempts to use procurement to deliver social, economic and/or industrial development objectives.

I recommend that governments, public sector clients and donors consider this briefing note when embarking on commissioning public sector infrastructure.



Paul Jowitt  
Senior ICE Vice President and Chairman International Development Policy Group  
November 2008

# Executive summary

It is now widely accepted that sustained economic growth is necessary to alleviate poverty and achieve the UN's Millennium Development Goals (MDGs). But the extent of poverty reduction will depend on the degree to which the poor participate in the growth process and share in its proceeds.

Increasing the input of local labour, goods and services ('local content') in the delivery of infrastructure projects in low income countries could make a major contribution to economic growth. At the same time it would open up opportunities for the poor to participate in the growth process through the creation of jobs in the construction and supply industries.

However, few countries have a clear policy for the promotion of local content in infrastructure provision and those that do often have difficulty implementing it.

This briefing note has two aims:

- to show policy-makers that expanding the local content of infrastructure projects is an achievable objective with real long-term benefits
- to provide practical guidance to assist governments to achieve this through actions at various stages of the procurement cycle

The immediate benefits and development outcomes of the successful implementation of a local content policy are set out in figure 1. The immediate benefits are more employment in the construction and supply industries, opportunities for local consultants, increased

work for local contractors and market openings for suppliers of materials and components. The contributions to development outcomes are inclusive growth, poverty alleviation and more sustainable infrastructure services.

The note is intended for the use of developing country governments, local governments, procurement officials, public sector clients and clients' advisers. There are also issues addressed to donors. While some change in donor policies would be welcome, this note is aimed primarily at governments and shows what can be achieved without any change (or by making only small changes) to procurement regulations.

Part I of this briefing note focuses on promoting local content as a policy objective, while Part II provides detailed options for actions to address the challenges and promote local content at various stages of the procurement cycle.

We show in Part I that much of the funding currently invested in infrastructure in low income countries does not benefit contractors, suppliers and workers from these countries. Increasing local content in the construction and maintenance of infrastructure would generate income and employment locally and contribute to economic growth and poverty reduction. The use of procurement

to achieve this objective was recently supported by the UK House of Commons International Development Committee. Its report on DFID and the African Development Bank states that 'it believes that procuring, goods and services to support infrastructure locally creates more sustainable outcomes and helps to generate skills, income and employment.'<sup>1</sup> It is also supported in principle by international agencies and has been practised by a number of countries over many years.

However, the ability of some of the poorest countries to use procurement to support development is in practice constrained by conflicting interests amongst donor and beneficiary governments, the failure of international agencies to balance objectives and lack of knowledge among procurement officials.

Part II describes a number of ways to promote the objectives of generating local employment, promoting local enterprises and developing the capacity of the local supply chain, without necessarily sacrificing on cost or quality.

We also show that this can be done without any major changes in procurement policies.

**“Much of the funding currently invested in infrastructure in low income countries does not benefit contractors, suppliers and workers from these countries.”**



Actions are recommended at each stage of the procurement cycle. They may be summarised as follows:

### 1. Initial planning

The decisions taken at the project identification and initial planning stage of a project can have the biggest impact on the achievement of local content objectives. Essential steps are:

- consulting with local users and affected communities
- developing an operation and maintenance strategy for each new project
- evaluating alternative solutions and designs for the opportunities presented to build local capacity

### 2. Detailed design

Detailed designs should, where appropriate, specify technologies and methods of work that are within the capability of local contractors. Standardising designs allows local contractors to build their skills and increase their efficiency, while specifying locally produced materials, components and equipment can generate employment and business opportunities in the supply industries. Designing for labour-based approaches can create additional employment opportunities, often at lower cost and saving on foreign exchange.

### 3. Appointment of consultants

The important role that consultants can play in promoting local content through design and specification suggests the need for careful evaluation of their track record and their proposals in these areas prior to appointment. Clients should set out their requirements clearly in the terms of reference or scope of works and consultants' technical submissions should contain suggestions for the

## “Increasing local content in the construction and maintenance of infrastructure would generate income and employment locally and contribute to economic growth and poverty reduction”

promotion of local content on the project and a written plan for the transfer of technology to local consultants and building of skills.

### 4. Procurement strategy

It is important to consider the most appropriate procurement strategy to deliver the objectives of the project. Clients can do much to ease the financial constraints facing local contractors by waiving the requirement for bonds, introducing a prompt payment regime, or separating the procurement of materials and labour. Involving communities in procurement may benefit local enterprises, generate ownership and increase the chance of the facility being maintained

### 5. Appointment of contractor

Prequalification and local registers can be used to ensure that local contractors with the right experience are awarded work, while serial contracts can ensure continuous work for promising contractors. Unbundling contracts into different sized packages can both increase the number of submissions from the local contracting community and allow contractors to grow. Clients' procuring entities should also take advantage of the opportunities within existing guidelines to 'set aside' contracts for local firms.

### 6. Contract agreement

Contracts should be appropriate to the size, nature and location of the project and available in local languages. They may require that unskilled labour be locally sourced. While any of the recommendations presented above may be adopted on any

individual projects, together they constitute the elements of a national policy for promoting local content in public infrastructure procurement.

They could be turned into a series of guidelines for public sector clients to consider.

Some of the more experienced and innovative clients may be willing to take the lead in piloting the guidelines on a range of projects. Monitoring and evaluation of the pilots will reveal what works and provide more information on the trade-offs. Revised guidelines could then be disseminated throughout the public sector.

As a relatively easy first step, government might consider actions to assist local enterprises with access to capital at reasonable rates of interest. Donors, for their part, should recognise that building local capacity is a valid objective and support countries that are seriously trying to do this.

### 7. Handover, operation and maintenance

The contractor who built the facility should be contracted to provide guidance to the team responsible for operation and maintenance (O&M) for a specified period of time. If O&M is contracted out, the measures suggested above apply equally to the appointment of the O&M contractor.

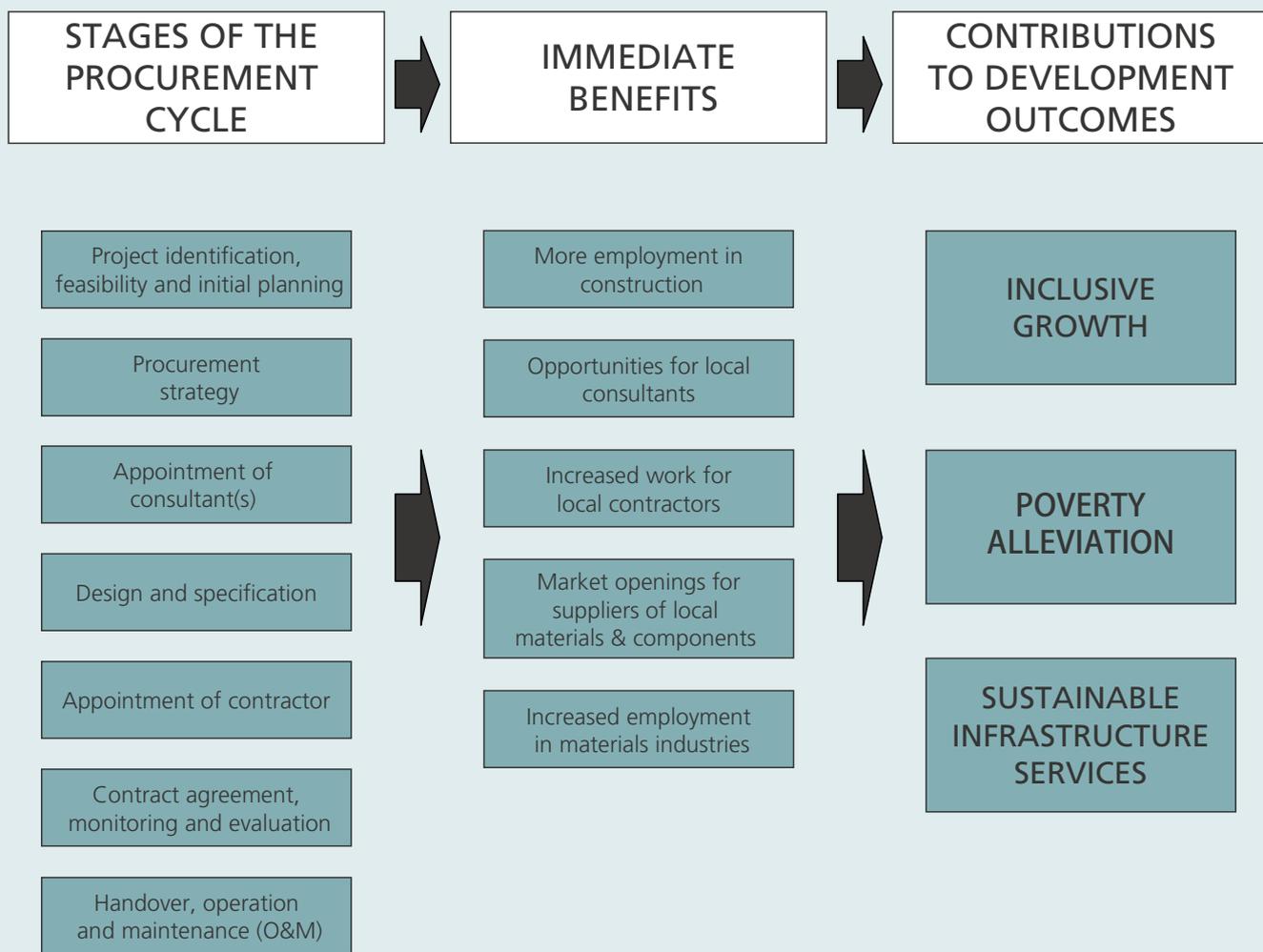


Figure 1: Potential benefits from promoting local content

### Box 1: Background

Recent research by ICE/EAP suggests that the way in which infrastructure projects are procured can have a significant impact on the performance of the asset, as well as upon the achievement of broader economic and social development objectives. A report setting out how current procurement practices are hindering, or enabling, social development was published in November 2006 under the title “Modifying Infrastructure Procurement to Enhance Social Development”.<sup>1</sup> In the second phase of the research we have been assembling evidence of successful attempts to use procurement to deliver social, economic and/or industrial development objectives. This note is one outcome of the process.

<sup>1</sup> The report can be downloaded from [www.engineersagainstopoverty.org](http://www.engineersagainstopoverty.org) or [www.ice.org.uk/procurement\\_report](http://www.ice.org.uk/procurement_report)



# Introduction

It is now widely accepted that sustained economic growth is necessary for the alleviation of poverty and achievement of the UN's Millennium Development Goals (MDGs). But the extent of poverty reduction will depend on the degree to which the poor participate in the growth process and share in its proceeds .

Increasing the input of local labour, goods and services ('local content') in the delivery of infrastructure projects could make a major contribution to economic growth. At the same time it would open up opportunities for the poor to participate in the growth process through the creation of jobs in the construction and supply industries. It should therefore be a high priority for low income countries.

However, few countries have a clear policy for the promotion of local content in infrastructure construction and those that do often have difficulty implementing it.

The briefing note has two aims:

- to show policy-makers that expanding the local content of infrastructure projects is an achievable objective with real long-term benefits
- to provide practical guidance to assist governments to achieve this through actions at various stages of the procurement cycle

The immediate benefits and development outcomes of the successful implementation of a local content policy are set out in figure 1.

The note is intended for the use of developing country governments (especially policy makers in ministries of finance, industry/enterprise, labour and infrastructure) local governments, procurement officials, public sector clients and clients' advisers.

There are also issues that are addressed to donors who are seeking to increase the effectiveness of aid, in part through the strengthening and greater use of country procurement systems, under the Paris Declaration . This note supports these objectives and aims to show how country systems may be more supportive of local enterprise and labour. While some change in donor policies would be welcome, this note is addressed primarily to governments and shows what can be achieved without any change (or with only small changes) to procurement regulations.

The briefing note is divided into two parts:

Part I focuses on promoting local content as a policy objective. It addresses the following questions:

1. What do we mean by local content in infrastructure procurement?
2. Why is it important to promote local content in infrastructure delivery?
3. Why is it necessary to use public procurement to achieve this?
4. What are the key challenges?

Part II provides options to address the challenges and achieve specific policy objectives through actions at various stages of the procurement cycle.

The specific policy objectives are:

- increasing employment opportunities throughout the construction supply chain
- creating opportunities for local consultants
- increasing work for local contractors
- creating market openings for locally produced materials and components

While any of these actions may be adopted on any individual projects, together they constitute the elements of a national policy for promoting local content in public infrastructure procurement.



# Part I – Promoting local content as a policy objective

## 1. What do we mean by local content in infrastructure procurement?

- Infrastructure is defined as the physical assets needed for the delivery of a service, rather than the provision of the service: hence the note is about the procurement of 'works' and consultant services.
- Procurement is broadly defined to encompass all stages from the identification of need to the delivery and subsequent maintenance of the asset, as illustrated in figure 2.
- Local in this context is understood to mean national, but it could be defined to mean any geographic or administrative area.

- Local content is a recognised term in the oil and gas industry. It can be defined in terms of the ownership and/or location of the enterprises involved in production and/or the value-added in the production process. Some approaches to defining local content in order to award 'domestic preference' in procurement are set out in table 1 in the appendix. It can be seen that ownership or location of the enterprise are the usual criteria in the procurement of works, with added value more likely in the procurement of goods.
- We shall define local content in construction to include the involvement of local enterprises and labour in planning, design and construction services, as well as the locally added value in transactions occurring throughout the contractor's supply chain.
- Promoting local content is

not the same as capacity building although there is a relationship between them and this is often reciprocal. For example, buying from local enterprises is one of the most effective means of building their capacity, while building the capacity of local enterprises (e.g. by training) can enhance their ability to tender and win contracts.

The immediate benefits of expanding local content lie in increased opportunities for local people to earn income through employment on the construction site or in the supply industries, better opportunities for local businesses as contractors, subcontractors, producers or suppliers of material and equipment and increased local knowledge and skills. The longer term development outcomes are poverty reduction, inclusive economic growth and more sustainable infrastructure. These benefits are illustrated in figure 1.

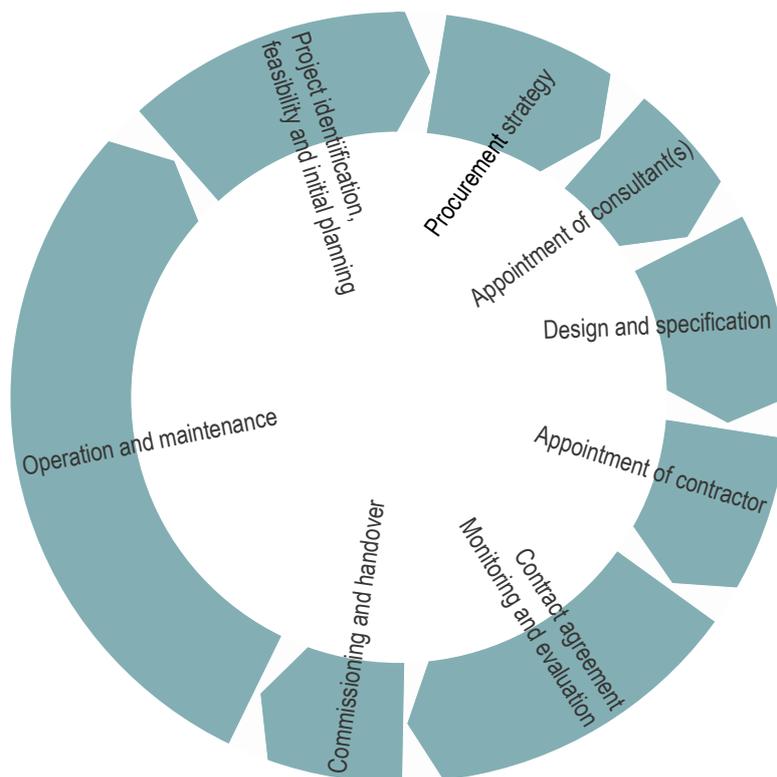


Figure 2: Stages of the procurement cycle



## 2. Why is it important to promote local content in infrastructure delivery?

Currently much of the funding invested in infrastructure in low income countries does not benefit contractors and suppliers from these countries. Analysis of World Bank funded projects in 1998 and 1999 showed that foreign construction firms dominate in developing country markets<sup>4</sup>. This is particularly so in sub-Saharan Africa. The African Development Bank reported less than 40% by value of new works contracts in 2006 were awarded to companies from the subcontinent. And this figure includes contracts awarded to international firms (e.g. from China) that have set up offices in African countries<sup>5</sup>.

Procuring services and goods from local contractors and suppliers and using techniques adapted to the local resource endowment, will generate income locally and make a substantial contribution to economic growth.

Creating opportunities for local people to earn income through employment is one of the major means of alleviating poverty in the developing world. The process of constructing, operating and maintaining infrastructure facilities offers significant opportunities for the generation of employment and there is a broad consensus for maximising these opportunities<sup>6 7</sup>.

The use of procurement to achieve this objective was recently supported by the UK House of Commons International Development Committee. In its report on DFID and the African Development

Bank, it state 'it believes that procuring, goods and services to support infrastructure locally creates more sustainable outcomes and helps to generate skills, income and employment.'<sup>8</sup>

World trade is currently unbalanced. Many low income countries supply primary commodities to world markets in return for manufactured goods produced in industrialised countries. In order to grow they need to diversify their economies and it is generally expected that diversification will come from industrialisation. The high weight/volume to value ratio of construction goods provides a start for industrial development in the absence of alternatives.

A developed local construction industry, embodying enhanced knowledge and skills, is also essential for the maintenance of infrastructure assets. Maintenance is a long neglected issue. A recent study estimates the investment needed to maintain existing assets in sub-Saharan Africa (at 4% of GDP) is almost as high as the investment needed for new infrastructure projects to meet the UN Millennium Development Goals<sup>9 10</sup>.

Reliance on foreign enterprises to design and construct facilities often means they are not sustainable as the expertise may no longer be available once the construction is complete.

## 3. Why is it necessary to use procurement to achieve this?

While there may be widespread agreement with

a policy of supporting the participation of local producers in the supply of infrastructure assets, questions are raised as to whether procurement is the best way to do it. The view is often expressed that assistance to local industries should be on the supply side and that procurement policies should be 'neutral' in terms of promoting development. However, current demand-side policies are not neutral and as a consequence the playing field is not level.

### a. Creating a level playing field

To create a level playing field where the local construction industry can compete on equal terms with foreign competitors a number of policy issues have to be resolved:

- **The continued tying of bi-lateral assistance to developing countries to the purchase of goods and services from the donor country<sup>11</sup>.**

This is despite the recommendation from the Organisation for Economic Cooperation and Development's Development Assistance Committee (OECD/DAC) to untie aid in 2001 and the efforts of some donors to promote this as a key objective under the Paris Declaration. Even when aid is not tied, donor country





firms involved in the provision of design services often specify their own national suppliers and products<sup>12</sup>. UNCTAD<sup>13</sup> suggests that using procurement to promote local content and technology transfer to developing countries could be one way of offsetting the adverse effects of tied aid.

- **The difficulties encountered by local enterprises (many of which are small) in accessing the public procurement market.**

These include the high fixed costs of access (regulation and prequalification costs), the high costs of tender information, the policy of 'bundling' contracts which favours large firms and financial constraints<sup>14</sup>. The most critical constraint to local construction firms winning contracts is lack of access to capital, particularly working capital. One of the key advantages of Chinese contractors in construction markets in Africa in recent years is their ready access to cheap finance from state owned banks<sup>15</sup>.

- **Fiscal policies which disadvantage local suppliers.**

For example, foreign companies often get tax concessions on imported materials and equipment, concessions which are denied to domestic contractors, particularly in construction. In a recent study in Ghana contractors complained of having to pay import duties and VAT on metal formwork imported from Spain, while foreign contractors can bring in such items duty free<sup>16</sup>.

The above factors combine to ensure that providers of construction services from the least developed countries are often unable to compete for

## “Buying locally in developing countries is a procurement goal of the UN system.”

projects in their own home markets<sup>17 18</sup>. While supply side assistance is also needed, the fact remains that lack of access to the market is the most critical factor inhibiting the development and growth of many small producers.

### b. Tilting the playing field to favour the weaker side

Until the above issues are satisfactorily addressed, enterprises from developing countries are at a disadvantage against international competitors. It has been argued that when one side is seriously weaker than the other, the playing field needs to be tilted to favour the weaker side<sup>19</sup>. In implicit recognition of this fact, many international agencies support the idea of using procurement as a tool to develop local industries through the offer of special incentives to local enterprises – in effect tilting the playing field.

For example, United Nations agencies have advocated increased sourcing of goods and services from developing countries in order to reduce poverty and secure maximum development impact. They have also introduced a number of capacity building initiatives to bring this about. There is general agreement on the idea of increased sourcing from the very countries the aid agencies are there to assist.

“By sourcing locally or regionally the procurement function itself is able to become a mechanism of development assistance, in that it provides institutional investment in local or regional businesses by contracting with them.”<sup>20</sup>

In support of this policy the United Nations Commission on International Trade Law (UNCITRAL) Model Law (upon which many developing countries are basing their procurement laws) allows the use of procurement as an industrial policy instrument and preferences at the evaluation stage for industrial development purposes are within the rules<sup>21</sup>. The guidance on the Model Law states:

“The Model Law recognises that enacting states may wish in some cases to restrict foreign participation with a view in particular to protecting certain vital economic sectors of their national industrial capacity against deleterious effects of foreign competition”<sup>22</sup>.

The Multi-lateral Development Banks (MDBs) also appear to support this approach. Four basic principles guide their procurement requirements:

1. Economy and efficiency in the procurement of goods, works and services
2. Fairness: giving eligible tenderers a fair opportunity to compete
3. Development: encouraging the development of suppliers in borrowing countries

## “Encouraging development of suppliers in borrowing countries is one of four principles of MDB procurement.”



#### 4. Transparency in the procurement process<sup>23</sup>

The most significant for our purposes is principle 3. To encourage the development of domestic industries the MDBs permit borrowers to give preference to tenders offering goods manufactured within the borrowing country; and countries below a specified threshold of per capita GDP are allowed to give preference to bids for works contracts from eligible domestic contractors.

The WTO/Government Procurement Agreement (GPA), whose objective is to achieve greater liberalisation and expansion of world trade, also recognises the need for developing countries to promote the establishment or development of domestic industries, including the development of small-scale and cottage industries, as well as economic development of other sectors of the economy<sup>24</sup>. Special terms allow developing countries to enter the GPA while retaining this right.

“Many countries have used public purchasing to support strategic industries (including construction).”

#### c. Historical evidence of tilting the playing field

The use of public purchasing to support strategic industries (including construction) has been consistently pursued by most developed countries and a good number of developing countries. The best known example is the ‘Buy America’ policy of the US. Under the ‘Buy America’ Act (1933) and subsequent legislation, the basic legal requirement on federal purchasers is that materials, supplies, articles or (since 1990) services that are acquired for public use should be substantially American<sup>25</sup>. In 2005, 94% of payments made by the Federal Government went to companies located in the US<sup>26</sup>.

Among developing countries, India stands out as having promoted local, small and public sector enterprises in its procurement policies over many years<sup>27</sup>. These policies have resulted in a high local content in the procurement of infrastructure. It is estimated that 100% of the inputs to water and rural road projects and 75% of the inputs to power projects are local<sup>28</sup>. In China also, procurement regulations require that government shall buy nationally unless the required goods, construction or services are not available or cannot be acquired on reasonable commercial terms and conditions<sup>29</sup>. The example of Singapore (box 2) demonstrates the importance of access to public procurement markets in the development of a national construction industry.

“While supply side assistance is also needed, lack of access to market is the most critical factor inhibiting the development and growth of many small producers.”

#### Box 2: The role of public clients in developing the construction industry in Singapore

Thirty years ago the local construction industry in Singapore was seriously underdeveloped, but now local firms are now represented in all classes and are fully competitive in their own home market, as well as winning a substantial number of projects overseas.

A recent investigation of the factors that have been responsible for the development of Singaporean contractors found that public sector clients played a key role. For many years the Housing and Development Board has offered bidding preferences to firms with good performance records, as well as a pre-financing loans scheme.

Contractors were asked to rank 10 factors in order of importance in furthering their development. Top in the overall ranking was ‘government’s attempt to improve the industry’s operating environment’ and this was followed by ‘public sector client’s help’ and ‘Government’s financial incentives’.

In fifth place was ranked ‘private client’s help’. This shows very clearly the importance of demand side issues for developing construction industries.

Source: George Ofori and Chan Swee Lean, Factors influencing development of construction enterprises in Singapore, *Construction Management and Economics*, 2001, 19, pp. 145-154



## 4. The key challenges

### a. Tension between conflicting interests

In low-income countries a high proportion of infrastructure investment is donor funded. A major challenge to the promotion of local content in procurement is the need to resolve conflicts of interest that may occur within and/or between donor and beneficiary governments. Governments play many roles, as clients, regulators, policy makers. While the agreed long-term policy goal may be to increase local sourcing, the preference of clients for expensive, imported products, and the desire of donor governments to promote their own exports, as well as a tendency to rely on standard engineering solutions, can lead to over-designed systems that local industries are unable to build or maintain<sup>30</sup>. In this example the short-term interests of clients and donors come into conflict with the longer term development objective.

### b. Failure to balance objectives

The MDBs play a key role in the funding of infrastructure projects in low income-countries. Despite recognising the need to balance local development with other procurement objectives, the MDB procedures for the appointment of contractors generally insist on International Competitive Bidding (ICB) and acceptance of the lowest evaluated tender. These are very different from the criteria for the appointment of consultants which is based primarily on quality.

In the appointment of contractors the World Bank specifically does not allow any evaluation criteria other than price and the capability and resources of the bidders to undertake the contract<sup>31</sup>. With the tender process led by price, the technical component of the bid is often weak and objectives such as developing the local economy are overlooked. The Bank also prohibits any mandatory requirement that foreign firms enter into joint venture with local firms and any restrictions on the sources of labour and materials except for unskilled labour in the contracting country<sup>32</sup>. This is a further indication that, in practice, the other procurement objectives listed on page 9 take precedence over the objective of promoting development.

Many low-income countries are currently reforming their procurement regulations and procedures under the direction of the World Bank. The requirements of the MDBs for open tender in the appointment of contractors and acceptance of the lowest evaluated price bid have been passed on, together with many other restrictions, as a central plank of these procurement reforms.

While recognising the desire to enforce strict rules where previously few existed, the insistence that developing countries fully open their markets may restrict their ability to take advantage of opportunities to use procurement as an industrial

policy instrument. It also weakens their bargaining position in multi-lateral trade talks<sup>33</sup>.

### c. Knowledge issues

A further challenge lies in the fact that the procurement of works is generally regulated and implemented alongside the procurement of goods. Yet the processes are very different. The procurement of works involves very long pre-tender and post tender stages crossing several technical areas. These include project preparation (pre-tender) and contract management (post-tender), both of which are within the body of knowledge of built environment professionals.

A strong case may be made for dealing with the two areas of procurement separately. At the very least it is important to recognise that different skill sets are needed for procuring construction services to those needed for procuring goods and that expertise is needed in both.

Procurement officials may also not be aware of social or economic development needs. Procurement is often still seen as an administrative function in which compliance with regulations is the most valued performance criterion. For this reason, it may be appropriate for governments to develop and disseminate guidelines on how to incorporate local content policies into procurement decisions. Some suggestions are presented in Part II.

**“Developing a strategy for operation and maintenance at the initial planning stage is critically important, as it is likely to result in the greater use of local products, enterprises and skills.”**



## Conclusion

Currently much of the funding invested in infrastructure in low income countries does not benefit contractors, suppliers and workers from these countries. Increasing local content in the construction and maintenance of infrastructure would generate income and employment locally and contribute to economic growth and poverty reduction. The use of procurement to achieve this objective is supported by international agencies and has been practised by a number of countries over many years.

But the ability of some of the poorest countries to use procurement to support

development is currently constrained by conflicting interests amongst donor and beneficiary governments, the failure of international agencies to balance objectives and lack of knowledge among procurement officials.

The current focus of donors is on strengthening country procurement systems. At the same time, donors should recognise that building local capacity is a valid objective and support countries that are seriously trying to do this.

Donors and/or their developing country partners may wish to explore opportunities to deliver more positive development outcomes, while still observing fairness, transparency, economy and efficiency in procurement.

While recognising that there are very real capacity constraints, we show in Part II that there are a number of ways to promote the objectives of generating local employment, promoting local enterprises and developing the capacity of the local supply chain, without necessarily sacrificing on cost or quality. We also show that this can be done without any major changes in procurement policies. The suggestions include actions at earlier stages of the procurement cycle.





# Part II – Practical steps to promote local content in infrastructure projects

We have argued in Part I that there is room within existing procurement systems to do more to promote local content in infrastructure projects. We show below the kinds of actions that can be taken to achieve specific policy objectives. The specific policy objectives are:

- Increasing employment opportunities throughout the construction supply chain
- Creating opportunities for local consultants
- Increasing work for local contractors
- Creating market openings for locally produced materials and components

The proposed actions are at the level of the project and are subject to the discretion of individual clients. But they can be developed into a series of guidelines for governments to disseminate to clients, as called for above.

We consider the actions that should be taken to deliver a 'local content policy' within the context of the construction sector as they occur at each stage of the procurement cycle under the traditional system for the procurement of works.

Actions are identified at seven stages:

1. Project identification and initial planning
2. Appointment of consultants
3. Detailed design and specification
4. Procurement strategy
5. Strategy for selecting a contractor
6. Contract agreement, monitoring and enforcement
7. Handover, operation and maintenance

**“The active participation of users and affected communities in project identification and planning can help tailor projects to local circumstances while also promoting ownership and accountability.”**

## 1. Project identification and initial planning

This is the key stage to consider how to meet the identified need while building local capacity to construct, operate and maintain the asset(s). The key issues to address are what type of facility and related service will best meet the need and how to ensure that it will be maintained. Steps to define a project in the context of local content objectives should include:

- Consultation with users and affected communities to help tailor projects to local circumstances. Well designed surveys of intended beneficiaries should reveal what kind of asset/service is sustainable. Involvement of beneficiaries at planning stage can also promote ownership and accountability.
- A feasibility study that evaluates (in addition to costs and benefits) the impact of alternative solutions on employment and local enterprises and the chance to build the capacity of the supply chain<sup>35</sup>.
- A Social Impact Assessment

(SIA) that is expanded to cover social opportunities related to the local content objectives, such as employment generation and the use of local enterprises and products.

- A plan for carrying the results of the SIA (which often get lost) through to procurement strategy and detailed design.
- A strategy for operation and maintenance as this will ensure that the asset has a long life and is also likely to result in greater use of local products, enterprises and skills.

## 2. Appointment of consultant(s)

a. Clients should appoint consultants familiar with the local context and sympathetic to the implementation of local content objectives. The services of consultants are used throughout the development of an investment project, including pre-investment (e.g. feasibility studies), planning, design and construction.

The specification of materials to be used and technological processes to be followed are all determined by the planning and design consultants.

**“Consultants play a major role, including specification of materials and technologies. Client’s local content objectives must be set out in the terms of reference and consultants pre-qualified on the basis of their track record in these areas and knowledge of the country and local resources.”**



## “Consultants’ technical bids should be scored in terms of quality criteria framed around their proposed approach to promote local content on the project and their written plan for the transfer of technology and building of skills.”

“In practice this may influence significantly the ability of developing countries to provide services under the specific project.”<sup>36</sup>

b. Procurement regulations for the appointment of consultants generally require some form of prequalification and quality based selection with the weighting for quality higher than price. This gives scope for the appointment of consultants who are experienced in and committed to the use of local resources. The following steps are recommended:

- Clients specify local content objectives in the calls for expressions of interest or terms of reference and introduce prequalification criteria framed around track record and local knowledge around such objectives
- Qualified national firms to be included on the shortlist<sup>37</sup>
- Submissions to demonstrate involvement of local enterprises and labour on the project and to include a written plan for the transfer of technology and building of skills and these issues to be given high priority in the criteria for evaluation of quality
- Evaluation of quality to include points for the percentage of nationals in the total key staff time proposed and for the transfer of technology to local enterprises and staff, as permitted in World Bank guidelines<sup>38</sup>
- Evaluation at both prequalification and tender stage is based as far as possible on objective criteria that can be verified

c. Consideration should also be given to the appointment of universities and

research centres as these are often repositories of local knowledge<sup>39</sup>. The benefits that may be derived from this approach are illustrated in the case study in box 6.

### 3. Detailed design and specification

a. The detailed design and drafting of technical specifications can have a huge impact on the ability of local suppliers to participate in a project.

Where appropriate, project designs should require technologies and methods of work that are within the capability of local contractors. Such technologies will generally also be within the capability of foreign contractors, thus ensuring there is no discrimination. When the playing field is levelled, more firms will be technically qualified to bid and competition should increase.

## “Designs should, where appropriate, specify technologies and methods of work that are within the capability of local contractors.”

b. Clients are also encouraged to standardise designs which will allow local contractors to build their skills and increase their efficiency thus enabling them to win further contracts in future (see case study in box 8)

c. Local sourcing of materials, components and equipment can create opportunities for local suppliers and generate employment in these supply industries. Up to 15%

preference to local enterprises is allowed in the MDB rules for the procurement of goods. However, clients are often unable to exercise this preference because materials, components and equipment used in the construction industry are usually purchased by the contractor<sup>40</sup>.

d. Instead, clients could adopt a procurement strategy whereby they purchase materials and engage contractors on a labour-only basis. Alternatively, they can specify locally produced materials. However, brand names should not be used in specifications and the words ‘or equivalent’ should be included so as to avoid discrimination and ensure that alternatives are available if local producers cannot deliver<sup>41</sup>.

e. Finding ways at the design stage to further increase employment in the construction, operation and maintenance of the facility is very important. Construction is one sector

where it is often technically feasible and cost-effective to increase employment by using technologies that requires a more intensive use of labour in place of machines<sup>42</sup>. Some examples of this approach are shown in box 3.

f. An additional benefit of labour-based approaches is that local enterprises are more likely to win contracts for the works. If local contractor capacity is lacking it is important to support the creation of micro enterprises for routine maintenance work. These may be privately owned or the form of cooperatives. Some examples of alternative approaches are provided in boxes 4 and 5.

## “Standardising designs allows local contractors to build their skills and increase their efficiency.”



## “Labour-based approaches can create employment, lower cost and save on foreign exchange. ”

### Box 3: Labour-based approaches to road construction

1. Gravel roads are particularly suited to labour-based approaches. They use local materials and low cost technology to build and simple maintenance techniques which can create regular off-farm employment for local labour. A review of experience with labour-based techniques for gravel road construction in a large number of low-income and low-wage economies found the labour-based option to be 25% to 30% cheaper than the capital intensive alternative, while creating up to 5 times the employment for the same investment. The employment effects of shifting to locally produce materials were also found to be very considerable.

Source: Willem Keddeman, Of nets and assets: Effects and impacts of employment-intensive programmes, ILO, employment intensive infrastructure programme. SETP No. 1, 1998 <http://www.ilo.org/public/english/employment/recon/eiip/download/setp/setp01.pdf>

2. Another example of road construction technologies suited to a labour-based approach is the use of concrete pavers. An urban road construction project in Mozambique shunned the conventional asphalt approach recommended by international engineers in favour of concrete pavers. The concrete solution took longer to build but used more labour inputs and only local materials (sand and cement). It required minimal maintenance and hence proved to be the most appropriate technology in the local context.

Source: World Bank, Infrastructure at the crossroads: Lessons from 20 years of World Bank experience, 2006

3. Rubble Masonry Concrete is suited to the construction of small- to medium-size arch dams and multiple arch-buttress dams. It has significantly lower construction costs on a site with a good foundation and where suitable rock is available,, than any other dam type. It is also less sensitive than most dam types to extreme flooding. The Huriah Dam in Afghanistan was completed at a total cost of US\$120 000, with 80% of that amount being returned into the community and only cement, a mortar mixer and a generator being brought in for the work. Rubble Masonry Concrete has provided Afghanistan with a simple design and construction technology that can easily be adopted, empowering engineers to develop dams where this was not previously possible.

Source: The Structural Engineer, 21 August 2007, pages 24 and 25

## “Specifying locally produced materials, components and equipment can generate employment and business opportunities in the supply industries.”

### Box 4: Cooperative micro-enterprises for road maintenance in Latin America

Contracting out of road maintenance became obligatory in many countries of Latin America in the early 1990s. Columbia (which was one of the first to go down this path) also pioneered the formation of both private and cooperative micro-enterprises for road maintenance, in the process creating jobs for people with little education or training living alongside the roads.

The cooperatives generally produced a better quality of work than the private micro-enterprises and this was attributed to equality among members, good training and the fact that the members were drawn from the area close to the road and developed a sense of ownership of ‘their’ road. Cooperative micro enterprises had between 11 and 15 members and were contracted directly with each given a yearly contract to manage an average of 40 kms of paved roads.

Cooperatives are now increasingly being remunerated on a performance basis. The contract lists the maintenance activities together with the performance indicators for each activity. Payment is in the form of a fixed fee, which is paid in monthly instalments. Penalties for non-compliance (if necessary) are deducted from monthly payment. Contracts are for one year and they are usually extended if performance is satisfactory.

The Columbian success with cooperatives was followed in Nicaragua, Venezuela, Honduras, Ecuador and Bolivia, while single owner micro-enterprises became more common in Guatemala and Peru.

Source: Dr. Gunter Zietlow, [www.zietlow.com](http://www.zietlow.com)



## 4. Procurement strategy

a. Clients should choose the most appropriate procurement strategy to deliver the project and the local content objectives. The key is allocating risk according to the capabilities of the participants to manage the risk.

b. The biggest single factor restricting the access of local contractors to public procurement markets is the difficulty in securing finance, particularly working capital. Even when banks are willing to lend, interest rates are prohibitive. The client can do much to ease this problem by:

- Waiving or lowering the requirement for performance bonds
- Lowering the cost of accessing tender information by either charging for the cost of reproducing the documents or supplying the documents free of charge (as is done in India)
- Waiving 'capacity building' or training levies for local firms on the grounds that it is local firms that such levies are designed to assist<sup>43</sup>
- Introducing a prompt payment regime (see below)
- Providing cash advances

c. Clients should also consider separating the purchase of materials from the provision of labour services as this may give better outcomes in terms of utilising local contractors and suppliers. It would open up the public procurement market to the large number of labour contractors who do not have the capital and are not willing to take the risk of supplying materials. At the same time it would give the client greater control

**“It is important to consider the most appropriate procurement strategy to deliver the objectives of the project. Involving communities may benefit local enterprises, generate ownership and increase the chance of the facility being maintained.”**

over the source and quality of materials. This approach, however, requires strict controls on the purchasing, storing and issuing of materials and may require the appointment of a materials manager to establish and manage a store.

d. Other measures that could increase the ability of local contractors to access the public tender market include:

- simplifying tender procedures
- where appropriate, issuing tender documents in local languages
- alerting enterprises to tender opportunities by SMS, and
- offering training through tender workshops (as is done in South Africa)<sup>44</sup>

e. Approaches that involve communities in the letting of contracts, or as participants in the actual construction work, can increase the involvement of local enterprises and create work for local labour. In some instances, community contracts have delivered better quality outcomes. They are also more likely to generate 'ownership' and increase the chance of the facilities being maintained. However, while community contracts are valuable they will

not deliver at scale.

f. On large projects clients may wish to consider more integrated procurement methods that have been developed in the industrialised countries (such as design and build, turnkey projects etc) as evidence suggests that this leads to improved project outcomes. But this would probably prohibit an inexperienced local firm from acting as the main contractor due to capacity constraints (particularly financial) and an inability to carry the additional risks. However, they can still be used as subcontractors and suppliers. A practical way of encouraging or requiring contractors to subcontract sections of the work to local enterprises (or procure supplies from local enterprises) is suggested in below under the umbrella of 'Targeted Procurement'.

g. Another innovative way of creating opportunities for small contractors on a sizeable project is to employ a consultant (or contractor) as management contractor, as demonstrated by the example from Zambia in box 5. Joint ventures between foreign and local enterprises may also have potential when entered into voluntarily.

**“Clients can do much to ease the financial constraints facing local contractors by waiving the requirement for bonds and introducing prompt payment regimes.”**



h. Output or performance based contracts are another way of promoting local content in so far as they expand the range of acceptable solutions and permit the inclusion of indigenous technologies. They are also seen as having potential to reduce

corruption<sup>45</sup>. One such procurement strategy that has recently been introduced by the World Bank in African countries on an experimental basis is 'Performance-based Management and Maintenance

of Roads'. But care has to be taken over the size of contracts if local firms are to be involved<sup>46</sup>.

#### Box 5: Smallholder Enterprise Development and Marketing Programme (SHEMP) - access road component, Zambia

The SHEMP programme was funded by the International Fund for Agricultural Development (IFAD) and implemented through the Ministry of Agriculture and Cooperatives of the Government of Zambia between 2001 and 2007.

An innovative management approach was used to deliver the access road component. A hybrid consultant/management contractor called an 'Implementing Engineering Firm' (IEF) was appointed to execute and supervise the work, with supervision assistance from the district councils. The IEF signed a contract for the works with the tender board and then contracted small scale labour-based contractors to carry out the work. A total of 47 labour based contractors were employed on the project and together they built 700km of gravel roads in five years at a cost of around \$7,000/km.

Source: Information provided by Adam Andreski of Intermediate Technology Transport (ITT), UK

## 5. Strategy for selecting a contractor

Within the MDB procurement guidelines there is scope to ensure that local contractors have a fairer chance of obtaining construction contracts. In this section we consider a number of options to increase the chance of local contractors winning contracts while minimising the risk to the delivery of the project. The client should evaluate which is appropriate to the primary purpose of delivering the asset and the local content object

### a. Preferencing:

Giving preferences on price to local tenderers in the award of contracts is generally allowed in public procurement legislation and is the most common means of implementing local content policies. A preference of 7.5% for works contracts is the amount allowed by the World

Bank. This means that if the tender of a local contractor is less than 7.5% above the lowest tender, the contract can be awarded to the local firm. The advantages of this approach are that it provides direct assistance to local enterprises in securing contracts and the additional cost of engaging local enterprises is known. The disadvantage is that local enterprises may be able to use the subsidy provided by the preference to charge higher than market prices, hence it may enable inefficient firms to survive.<sup>47</sup>

In practice very few contracts have been awarded to local contractors as a result of the application of a price preference. The Asian Development Bank reported only eight works contracts in the six years from 2000 to 2006 where the outcome was affected by domestic preference. In 2000 the World Bank reported less than 1% of works contracts awarded to local firms under the price

preference scheme.<sup>48</sup> However, in combination with other measures the exercise of a price preference in favour of local firms can tip the balance, as shown in the case study in box 6.

### b. Unbundling:

The failure of local firms to benefit from price preferencing often occurs because contracts are too large for them to bid. There are strong pressures from donors and businesses to combine requirements into larger and fewer contracts in order to benefit from economies of scale and lower administration costs. But letting contracts in smaller packages can increase competition and give lower prices as it allows a greater number of local contractors to bid. Unbundling is allowed by the World Bank (as well as in many countries' procurement regulations) so long as it can be shown that increasing local content is the objective.



Breaking contracts into smaller packages is relatively easy on road construction or housing projects, as shown in the case study in box 6. Even on very large projects, it is possible to let out sections of the contract, or specific tasks, separately from the main contract. However, this approach can increase the number of administrative tasks, financial transactions and supervisory roles for the client organisation. Therefore a policy of unbundling must clearly strike a balance: contracts which are too small will impose a high administrative burden, while contracts which are too large will exclude local firms.

In fact a range of contract sizes is needed in order to allow contractors to grow. The World Bank suggests a 'slicing and packaging' mechanism whereby

contracts are drafted in size and scope to allow local firms to compete and can be let either singly or five to 10 packages at a time.

An alternative way of creating a range of contract sizes, while avoiding the high administrative costs involved in unbundling, is to pass on the responsibility for 'slicing and packaging' to prime contractors. This has been implemented in South Africa under the umbrella of 'Targeted Procurement' (see box 11) under which clearly defined objectives (e.g. for local content) are set out in the project specification, together with how they are to be measured and how they are to be achieved.

An example of how this was done, using the NEC3 Contracts of the Institution of Civil Engineers,

on a large project in South Africa is presented in box 7. However, other countries dependent on donor funding should note that the World Bank prohibits any restrictions in contracts on the sources of materials or labour, except for unskilled labour from the contracting country (see page 11).

c. Pre-qualification using graded registers:

Pre-qualification can be costly and time consuming and often effectively discourages local firms from tendering. However, clients can use the prequalification process to ensure that local contractors with the right expertise and experience have a chance of winning the contract.

Costs can be minimised by keeping and maintaining

#### Box 6: Kiseke low-cost housing project, Tanzania

A project for the construction of 1,140 low cost housing units at Kiseke in the city of Mwanza, Tanzania by the Parastatal Pension Fund (PPF) demonstrates the successful use of many of the suggestions contained in this briefing note.

The objectives of the project were to provide houses at low-cost for PPF members, while building the capacity of local contractors and enhancing the socio-economic development of the local community. This was achieved through the specification of locally burnt bricks as walling materials, by unbundling the contract into a number of parcels (each phase was divided into six lots of 40-50 houses each) and by affording a 7.5% preference to local firms.

The tender process was open to local and foreign contractors in order to attract as many bids as possible. A large (foreign) contractor offered a substantial discount if all six lots were awarded to him but this was refused because the discount was less than the preference of 7.5% to local contractors as well as the desire of the client to involve as many local firms as possible.

Pre-award negotiations involved standardising the construction costs for the best evaluated bidders so that similar house units had similar costs. To ease the financial burden on the contractors, interim payments were effected within 14 days. The client also accepted the offer of performance bonds from insurance companies.

Contractors performed well and as a result of participating in the project all have been upgraded by at least two stages. Several public sector organisations were involved in the project: Ardhi University was awarded the contract for design and supervision; Misungwi Rural Housing Centre was involved in setting standards for the burned bricks and supervision of production in more than 70 villages around the city; and the Contractors Registration Board (CRB) was involved in on-site monitoring and training of contractors.

Sources: The Contractor, Newsletter of the Contractors Registration Board –Tanzania, July-Sept 2005 and personal correspondence with Athanas Mwageni, PPF Pensions Fund, Dar es Salaam, Tanzania



robust registers of contractors, graded according to ability. The case studies in boxes 6 and 8 both took advantage of local classified registers to invite contractors of appropriate size to bid. The key to success in both cases was well maintained registers and integrity of the professionals involved.

d. Serial contracts or framework agreements:

Construction is an easy industry to enter. But intense competition amongst the many

small contractors and selection on the basis of price makes it very difficult to get continuous work. Ways have to be found of nurturing the most promising contractors by providing them with regular work in order to give them an opportunity to consolidate and expand their business.

Regular clients with on-going construction programmes can create such opportunities through the use of serial contracts (using the same contractor for subsequent

similar projects) or through framework agreements when a programme of work is not well defined. While these kinds of contracts do restrict access and limit competition by increasing the intervals between bidding, they are a way of offering continuous work to contractors who perform well. Further benefits include

- Considerable savings to the client in administrative costs and professional fees as fewer contracts will need to be tendered and managed.

#### Box 7: Large scale contract for the replacement of Durban's secondary water mains

eThekweni Water and Sanitation maintains some 13,000km of water mains in the Durban area of which about 2,500km are aging asbestos cement pipes and require replacing. eThekweni adopted a delivery model which allows the target cost associated with each water district to be established once the scope of work and socio-economic deliverables have been finalized.

A project team comprising a programme manager, four design consultants and four contractors were appointed on 1 July 2007, for a three year period and were engaged on the NEC3 Engineering and Construction Target Cost Contract (Option C). In drawing up the contract, use was made of the Construction Industry Development Board's (cidb) Specification for Social and Economic Deliverables in Construction Works Contracts (see [www.cidb.org.za/cidb\\_toolbox\\_website/docs/cidbdocs](http://www.cidb.org.za/cidb_toolbox_website/docs/cidbdocs))

Expenditure on this project up to 1 September 2008 was approximately £27 million. Currently up to 80 km of water mains are being replaced each month. Approximately 3,800 temporary workers (unemployed persons) are employed on the programme to excavate trenches and are rotated every four months to allow others to financially benefit from the construction activities. The total amount of money paid to such workers is about 21% of total project expenditure. 16 subcontractors or co-contractors have been offered work opportunities. These contractors who have turnovers ranging from well below £50,000 to £375,000, are currently undertaking 10% of the construction work but are being developed to undertake 20%.

A full time mentor has been engaged to assist the co-contractors in establishing business systems in order to improve their sustainability and grow their business. Key performance assessments of these contractors are undertaken by the mentor at regular intervals to monitor their progress. Their expected annual turnover by the end of the contract is expected to be between £70,000 and £700,000.

Selected workers are provided with training in pipe laying. All workers received HIV/AIDS training. Work place experience is provided by the design consultants to enable eThekweni staff members to gain suitable experience to facilitate their registration as built environment professionals.

Sources: eThekweni project team, Watermeyer, R.B., Larkin, D. and van Huyssteen, S. (2007) A model for the delivery of large scale employment intensive works using a programme management approach. Prioritising Employment Creation in Government Policies, Programmes and Investments, 12th ILO Regional Seminar for Labour-based Practitioners, Durban, South Africa, 8-12 October.



- Contractors also save from not having to tender repeatedly for the same client. These savings can be considerable and should be passed on to the client in the form of lower prices<sup>49</sup>.
- Contractors are able to develop their relationships with subcontractors and suppliers, as well as to purchase plant and equipment and write off the costs against on-going programmes.
- It opens up the possibility of more stable employment and skills development<sup>50</sup>.

So long as competition (when it occurs) is open to all and the procedure is transparent, there is no reason why such an approach should fall foul of regulations or the strict standards imposed by donors.

Some examples from the UK which satisfy the requirement of the EU Procurement Directive are shown in box 9.

## “Prequalification and local registers can be used to ensure that local contractors with the right experience are awarded work, while serial contracts can ensure continuous work for promising contractors”

### e. Reservation/set asides:

It is possible to restrict access to tender lists in order to favour local enterprises. As an alternative to offering preferences on price, the whole or a proportion of the contract value may be ‘set aside’ for implementation by local contractors. The attraction of ‘set aside’ is that it can produce the quickest, most visible gains to the entry of local firms into public procurement markets<sup>51</sup>.

The entry of new firms into the market at the lowest end can also boost competition and result in lower prices. In fact the three requirements of economy, fairness and transparency may all be met, provided that there

are a sufficient number of local firms competing for work, which is generally the case with small contracts.

In national procurement regulations ‘set aside’ is often allowed but only on very small projects. Clients are advised to take advantage of this opportunity. A strong case may also be made for setting aside some medium sized contracts for local firms, in order to allow firms to grow while overcoming the problem of large (usually foreign) firms ‘down-sizing’ in times of recession.

### Box 8: Local content in school building projects in Malawi

A programme of primary school construction in Malawi, funded by the UK Department for International Development, used small contractors selected from a local graded register with three classes. Contractors have by law to be registered with the National Construction Industry Council and the register has been approved by both the Ministries of Health and Education for use on their infrastructure programmes.

By giving firms the chance to bid for several jobs each year and allowing only five to six firms to bid for each job, the successful contractors picked up regular work and retained skills. Designs were also standardised so that contractors learned how to construct the schools efficiently. To ensure the firms could make a profit, bids were only accepted that were within a set percentage of the estimated price it and bonus clauses were introduced for timely completion. The end result was an estimated cost saving of 40% over using international or large national contractors and the development of a thriving local contracting industry that other clients were able to use. Two or three of the largest Malawian building contractors started by building just one primary school under the scheme.

Contractors have confidence in the system because the procurement process is transparent and they are encouraged to challenge tender evaluations and contract awards. The authors conclude that so long as there is sufficient competition in the market place and an absence of cartels there is no reason why a select tender list system operating from a strong register of contractors cannot work without corruption.

Source: Andrew MacLean a-maclean@dfid.gov.uk and Jim Craigie j-craigie@dfid.gov.uk

**Box 9: Innovative contracts led by clients in the housing sector in the UK**

A UK National Audit Office Report (2001) has endorsed public sector moves away from adversarial forms of contract and tender evaluation based solely on price, towards newer forms of procurement that encourage partnering. Two examples, both client-led, show the possibilities for integrating small firms into the supply chain:

1. A local council in the UK developed a framework agreement, based on the partnering concept, to construct primary schools. Three contractor partners were appointed for a three year period. It used to be the case that small companies were rejected because of inadequate turnover, but turnover is not now considered at tender stage but only after selection, when each contractor is allocated work equivalent to 25% of their annual turnover. Another innovation is the move to a quality-price mechanism (70% for quality and 30% for price) in tender evaluation.

2. A second example is of a group of local authorities and registered social landlords in the north west of England who have formed an organisation to procure on behalf of the partners involved in social housing renewal in the region. They have bundled the present and future demands of different client organisations and put them into the market to get the best price in return for certainty of continuous workflow. The organisation has two separate agreements, one with contractors to supply labour only and the other with suppliers and manufacturers to supply products and materials only.

The whole procurement is 'open book', with the power to select the product and allocate the profit margin shifted from contractors to clients. One of the great benefits of this approach is continuous workload for contractors and subcontractors, which means continuous employment for their workforces, and cost savings from not having to tender for periods of 3-5 years. Other benefits are prompt payment (one week) and better relationships between suppliers and contractors as no money passes between them. Now more and more SMEs are collaborating and offering their services as a package.

Source: Khalfan, M.M.A. and P. McDermott (2006) 'Once un-thought, now the best practice within the construction sector' *Journal of Construction Procurement*, Vol. 12, No. 1, pp. 23 - 37.





## 6. Contract agreement, monitoring and enforcement

a. Many standard forms of contract and associated documents are complex and written in unfamiliar language that small local contractors have difficulty understanding. Clients should adopt contracts and specifications that are appropriate to the size, nature and location of the project with risk apportioned in accordance with the ability to manage it. Wherever practicable the contract and specification should be available in local languages

b. Clients should adopt a prompt payment regime to assist all contractors but particularly local firms that have great difficulty in accessing working capital. It is common for payment to be required within 30 days but sometimes it is 90 days which would severely stretch many small enterprises. Extended payment periods and delayed payment do not just incur short-term finance costs. Poor payers may experience higher tenders, with surcharges being imposed by both lead contractors and their supply chains that place a very high

**“Clients should ensure contracts are appropriate to the size, nature and location of the project, available in local languages and require that unskilled labour be locally sourced.”**

value on ‘payment certainty’<sup>52</sup>. A 15 day payment regime is strongly recommended and this was achieved in the project in box 6.

c. Consultants’ contracts should allow time and funds for the training of local employees. Provision for training and the transfer of technology can also be included in contracts with foreign contractors, with funds set aside for the purpose. But arrangements must be in place to monitor and enforce any such contractual obligations.

**“Contracts may make provision for training and technology transfer, provided funds are set aside for the purpose and provision is made to monitor and enforce the contractual obligations.”**

d. Contracts may include targets for the participation of local enterprises as subcontractors or materials suppliers. To be effective, such targets must be realistic, clearly defined, quantifiable, comply with national or donor procurement regulations and contractually enforceable. This has been achieved under Targeted

Procurement in South Africa, whereby key performance indicators (KPIs) - in this instance contract participation goals for targeted enterprises and targeted labour - are set and measured. Contractors can then be required to deliver against these KPIs as part of their contractual obligation, penalised if they fail to do so and offered incentives if they exceed the target. How this can be done using NEC3 Contracts is shown in box 10. The various procedures associated with

Targeted Procurement are set out in box 11.

e. The specification is the most appropriate place to define goals associated with promoting local content, as this sets out the client’s requirements, including the tasks to be undertaken and any constraints in undertaking the tasks.

### Box 10: NEC3 Contracts of the Institution of Civil Engineers

NEC3 Contracts provide an option for contractors to be paid an amount stated in an incentive schedule if the target stated for a KPI is achieved. The Incentive Schedule should provide details of the performance that the KPI is intended to measure, how it is to be measured, the target that is to be achieved and the amount to be paid to the contractor if it is achieved.

Source: Cousins P, Nicholson T, Read C (2005); NEC3 Engineering and Construction Contract Guidance Notes, Thomas Telford Ltd.

The South African Construction Industry Development Board has developed generic deliverable specification templates which promote a standard approach to their delivery<sup>53</sup>.

f. Clients in other countries will need to consider whether and how the above process can be best adapted to their context

## “Clients should strive to introduce a prompt payment regime.”

and their capacity to implement such a system. As the case with other contractual deliverables, social and economic deliverables need to be monitored and compliance with requirements confirmed. Monitoring and enforcement of contractual

obligations is weak in many developing countries. It is likely that an agreement with suitable incentives to enforce from within the project team will be required.<sup>54</sup>

## “Clients should take up opportunities within existing guidelines to ‘set aside’ contracts for local firms.”

### Box 11: Targeted Procurement Procedures

Targeted procurement procedures were developed in South Africa to address social development objectives including black economic empowerment, local economic development and poverty alleviation. The system facilitates the participation of targeted enterprises and targeted labour.

There are a number of techniques and mechanisms associated with targeted procurement procedures, all of which are designed to promote or attain the participation of targeted enterprises and targeted labour in contracts. These procedures relate to the:

- measurement and quantification of the participation of target groups
- definition and identification of target groups
- unbundling of contracts
- granting of preferences
- provision of incentives for the attainment of key performance indicators (KPIs) in the performance of contract
- creation of contractual obligations to engage target groups in the performance of the contract
- provision of third party management support; and
- evaluation of procurement outcomes

These procedures are all documented in South African national standards.

Sources: Construction Industry Development Board Inform Practice Note 10 Attaining social and economic deliverables, [www.cidb.org.za](http://www.cidb.org.za) (August 2006) and South African standards for construction procurement. The Structural Engineer. 15 February 2005, pages 15 to 18

## 7. Handover, operation and maintenance

A clear strategy is needed for integrating the project delivery stage with the operating stage. The norm will be for the contractor to hand over responsibility for operation

and maintenance to the client’s in-house team or to a new contractor. If the task is to be contracted out, the measures suggested above apply equally to the appointment of the operation and maintenance contractors.

Whichever option is chosen, the contractor who built the facility should be contracted to

provide guidance to the team responsible for operation and maintenance for a specified period of time. Such guidance may include:

- skills training
- knowledge sharing events
- mentoring
- procurement of supplies



# Summary of recommendations

## 1. Initial planning

The decisions taken at the project identification and initial planning stage of a project can have the biggest impact on the achievement of local content objectives. Essential steps are:

- consulting with local users and affected communities
- developing an operation and maintenance strategy for each new project
- evaluating alternative solutions and designs for the opportunities presented to build local capacity

## 2. Detailed design

Detailed designs should, where appropriate, specify technologies and methods of work that are within the capability of local contractors. Standardising designs allows local contractors to build their skills and increase their efficiency, while specifying locally produced materials, components and equipment can generate employment and business opportunities in the supply industries. Designing for labour-based approaches can create additional employment opportunities, often at lower cost and saving on foreign exchange.

## 3. Appointment of consultants

The important role that consultants can play in promoting local content through design and specification suggests the need for careful evaluation of their track record and their proposals in these areas prior to appointment. Clients should set out their requirements clearly in the terms of reference or scope of works and consultants' technical submissions should contain suggestions for the promotion of local content on the project and a written plan for the transfer of technology to local consultants and building of skills.

## 4. Procurement strategy

It is important to consider the most appropriate procurement strategy to deliver the objectives of the project. Clients can do much to ease the financial constraints facing local contractors by waiving the requirement for bonds, introducing a prompt payment regime, or separating the procurement of materials and labour. Involving communities in procurement may benefit local enterprises, generate ownership and increase the chance of the facility being maintained

## 5. Appointment of contractor

Prequalification and local registers can be used to ensure that local contractors with the right experience are awarded work, while serial contracts can ensure continuous work for promising contractors. Unbundling contracts into different sized packages can both increase the number of submissions from the local contracting community and allow contractors to grow. Clients' procuring entities should also take advantage of the opportunities within existing guidelines to 'set aside' contracts for local firms.

## 6. Contract agreement

Contracts should be appropriate to the size, nature and location of the project and available in local languages. They may require that unskilled labour be locally sourced. While any of the recommendations presented above may be adopted on any individual projects, together they constitute the elements of a national policy for promoting local content in public infrastructure procurement.

They could be turned into a series of guidelines for public sector clients to consider.

Some of the more experienced and innovative clients may be willing to take the lead in piloting the guidelines on a range of projects. Monitoring

and evaluation of the pilots will reveal what works and provide more information on the trade-offs. Revised guidelines could then be disseminated throughout the public sector.

As a relatively easy first step, government might consider actions to assist local enterprises with access to capital at reasonable rates of interest. Donors, for their part, should recognise that building local capacity is a valid objective and support countries that are seriously trying to do this.

## 7. Handover, operation and maintenance

The contractor who built the facility should be contracted to provide guidance to the team responsible for operation and maintenance (O&M) for a specified period of time. If O&M is contracted out, the measures suggested above apply equally to the appointment of the O&M contractor.

Recommended actions to achieve each of the four specific objectives are summarised in figure 3.

The recommendations presented above could be turned into a series of guidelines for public sector clients to consider. Some innovative clients may be willing to take the lead in piloting the guidelines on a range of projects. Monitoring and evaluation of the pilots will reveal what works and provide more information on the trade-offs. Revised guidelines could then be disseminated throughout the public sector.

As a relatively easy first step, government might consider actions to assist local enterprises with access to capital at reasonable rates of interest. Donors, for their part, should recognise that building local capacity is a valid objective and support countries that are seriously trying to do this.

### Promoting employment

- Evaluate employment impacts of alternative solutions
- Design for technologies that maximise employment
- Specify locally produced materials to create jobs in the supply industries
- Use the contract agreement to require unskilled labour to be locally sourced

### Creating opportunities for local consultants

- Evaluate bids on basis of local knowledge
- Short list to include local consultants
- Points for % of nationals in key staff time
- Points to foreign firms with plans to transfer technology to local enterprises and staff
- Make training a contractual requirement

### Core actions to promote local content

- Consult with users and local communities
- Develop an Operations and Maintenance strategy for each new project
- Evaluate alternative solutions and designs for opportunities to build local capacity
- Evaluate planning and design consultants on the basis of their track record and plans for promotion of local content and transfer of skills

### Increased work for local contractors

- Design for technologies suitable for local contractors
- Standardise designs so contractors can build skills
- Reduce the cost of accessing public contracts
- Set up and maintain graded registers
- Use price preferences, framework agreements, serial tenders to provide continuous work for promising contractors
- Provide a range of contract sizes by unbundling or getting main contractor to unbundle
- Reserve some contracts for local enterprises
- Introduce prompt payment regime
- Make training a contractual requirement

### Market openings for local suppliers

- Evaluate impact on Balance of Payment of alternative solutions
- Design for technologies that maximise the use of local materials
- Specify locally produced materials

Figure 3: Core common framework for promoting local content

# Appendix

Table 1: The main approaches to defining 'local content'

Source	Enterprise approach	Value added approach
World Bank: qualification for domestic preference in procurement of works	Percentage of local ownership of the firm	
World Bank: definition of 'local' in rules for procurement of consultants' services	Place where the firm is registered	
South Africa: Construction Industry Development Board rules for contractors tendering for works	Place where the firm is registered and where it pays taxes, rent and service charges	
Trinidad & Tobago: policy for local content in procurement of works	Place where the firm is registered and local ownership	
African Development Bank (AfDB): qualification for domestic preference in procurement or works	Place the firm is: registered and undertakes most of its activities; majority of board members & key personnel are nationals, of shares held by nationals and profits and other benefits accrue to nationals	
AfDB: qualification of domestic preference in procurement of goods		At least 20% of ex-factory price is local value-added
World Bank: qualification for domestic preference in procurement of goods		At least 30% of ex works price (before tax) to include local labour and materials
India: preferences in purchase of goods		Raw materials produced or goods manufactured in India from raw materials produced in India
United States: local content requirements for goods in the 'Buy America' Act of 1933		Raw and semi-processed materials produced in the US; manufactured goods with 50% local content



# Endnotes

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- <sup>12</sup> On the historical effects of AID on the development of African construction industries, see Hillebrandt, P.M. "The construction industry and its resources: A research agenda", *Journal of Construction in Developing Countries*, vol.11 no. 1, 2006, Penerbit Universiti Sains Malaysia
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