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Risk and management factors: Participation options for small and medium sized bus transport operators in the tendering for contract system in South Africa

**Prof J Walters
Department of Transport Economics
Rand Afrikaans University
Johannesburg**

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Abstract

In this paper, an analysis is undertaken against the background of public transport policy changes in South Africa, of the role of small public transport enterprises in the tender for contract system. The analysis include the problems that small business in general experience to access public transport opportunities, an analysis of the tender risk elements from the perspective of different role players and potential initiatives to accommodate small business. Emphasis is placed on the potential of franchising and subcontracting as ways to accommodate small business and deal with the risk factors as perceived by the different role players.

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1. Introduction

Small, medium and micro-enterprises (SMME's) represent an important way to address the challenges of job creation, economic growth and equity in South Africa. Throughout the world small business is playing a critical role in absorbing labour, opening up new markets and generally expanding economies. The ability of the business sector (big business, multi-nationals, parastatals) in South Africa to absorb job seekers is extremely limited and renewed emphasis will have to be placed on the growth of the small business sector. This sector has however historically found it difficult to fulfil its rightful role in the economy due to a number of circumstances which are described in section 2 of this paper. In the 1995 White Paper on National Strategy for the Development and Promotion of Small Business in South Africa it has been estimated that there are about 800 000 SMME's in the country absorbing about a quarter of the labour force of 15 million people. A concerted effort through enabling policies and programmes will have to be embarked upon in this country to grow this sector.

1.1 Overview of public transport reforms in South Africa

Public transport policy in South Africa is undergoing fundamental change. Historically the bus and rail systems transported the bulk of urban commuters. These modes were protected from intra-and inter-modal competition through an extensive regulatory system. In 1985 the White Paper on Transport Policy formally sanctioned the introduction of the 16 seat minibus to operate taxi type services in the country. The immediate effect of the decision was an enormous and uncontrolled growth in these vehicles which in turn resulted in significant modal shifts between the bus, taxi and rail service operators. Today it is estimated that the taxi industry transports between 50% and 60% of all commuters with the remaining market share more or less evenly divided between the bus and rail industries.

The 1985 White Paper on National Transport Policy also introduced competitive tendering of bus services and resulted in a number of demonstration projects where bus services were put out to tender. Only a limited number of services were however put to tender in the ensuing ten years.

In 1996 the new government introduced its White Paper on National Transport Policy with the following goal relevant to this paper:

" In order to broaden economic participation in transport service provision, the Department of Transport will identify how ownership and participation, including jobs, organization, and bidding processes, influence participation in the various

transportation sectors and how these will be enhanced through the proposed policies. The Department of Transport will carry out its functions in a way which promotes small, medium, and micro enterprises"

With regard to the strategic objectives of land passenger transport the White Paper states the following:

"To empower and assist disadvantaged operators to participate meaningfully in the land passenger transport system"

The White Paper also states that the government recognises public passenger transport as a basic need but wishes to ensure that it is provided efficiently so that public resources are used in an optimal manner. The public transport system will be based on regulated competition and where public transport services require government funding support competition will take the form of tendered contracts and competition on the routes and networks will then be precluded. Competition will therefore be for the route or network and not on the route or network.

Contracts will also only be awarded by the transport authority to registered operators on the basis of a passenger transport plan. Contracts will also only be awarded to a recognised route entity, co-operative, association, close corporation, company or a legal person.

Where public transport can be rendered as profitable commercial services, "on the road" competition will be encouraged with competition being regulated through the issuing of operating rights based on capacity management in terms of the supply policies of the provincial or local passenger transport plans.

From the above it is clear that there is a major emphasis on small business development in public transport in South Africa. This paper focuses on the potential ways in which SMME businesses can participate in the tendering and contracting system in public transport in South Africa. It is also intended to stimulate discussion on this topic and draw on the experience of other countries and policies in this regard. The paper recognises that many small businesses are involved in especially the taxi industry in this country and that that industry and its participants have done extremely well in growing the small business sector. Small businesses in the public transport industry in this country however all face more or less similar problems when wishing to participate in the "tender for contract" system.

2. Problems that small business in the public transport industry face in South Africa

Small business in the transport, storage and communications sector is classified by the National Small Business Act as follows:

Size or class	Total fulltime equivalent of paid employees	Total annual turnover	Total gross asset value (excl. fixed property)
Medium sized	< 100	< R 20 m	< R 5 m
Small	< 50	< R 10 m	< R 2.5 m
Very small	< 10	< R 2 m	< R 0.50 m

From the above, and taking into account the characteristics of public transport investments and operations, it is evident that small bus transport enterprises, operating two or more buses, will mostly fall under the "medium sized" and "small" categories.

Small public transport businesses generally have cost advantages when compared to larger public transport businesses. These costs are manifested in lower overheads, salaries and wages, infrastructure and often in capital equipment. This characteristic enables such operators to operate lower density routes and still be profitable when compared to larger operators.

These types of business have however a number of problems in accessing public transport opportunities in the South African market. Examples of such problems are as follows:

- (i) The legacy of apartheid policies constitute an important factor in the inability of black-owned or controlled small business to face business development constraints. The following illustrates the point:
 - a) Poor education restricted opportunities for the acquisition of technical and professional skills by black people.
 - b) An absence of entrepreneurial education or sensitising for young people.
 - c) Apartheid confined the majority of black people to homeland areas which not only were the poorest in terms of living standards but also lacked a dynamic business environment.
 - d) Apartheid made it virtually impossible for would-be black entrepreneurs to participate in business apprenticeships and partnerships with more established enterprises.
 - e) Racially segregated residential areas uprooted millions of people and businesses and also led to large capital losses and virtually destroyed small black business.
 - f) Segregation of black residential and work areas thus increasing the cost and risk of doing business.
 - g) Dramatic curtailment of property ownership rights for blacks made it virtually impossible to acquire assets that could serve as collateral for loan financing.

These factors have given rise to the major focus of government policies on black economic empowerment in particular.

- (ii) Access to finance. Although this is generally a universal problem facing small business throughout the world, the problems facing small business in South Africa are somewhat different. The following illustrates some of these difficulties as mentioned by finance institutions:
 - a) A lack of credit history of many small businesses.
 - b) Poor preparation of business plans and loan applications.
 - c) Lack of entrepreneurial and management skills.
 - d) A lack of proper financial records of many small businesses.
 - e) The perception that small businesses constitute substantial financial risk when compared to large businesses.
 - f) Lack of collateral to secure loans.
 - g) The amounts of capital required in the public transport sector for a start-up business and the financial and operational risks associated with that industry.
 - h) Poor financial track record of many individuals wishing to embark upon new business ventures.
- (iii) Complexity of the tendering system. The tender system imposes several onerous requirements on operators - especially small business:
 - (a) Vehicles age and size specifications - small operators often operate vehicles that are older than the required age.
 - (b) Tenders specifications include routes to be operated, frequency of services, and timetable requirements. The service provision is then monitored by a monitoring company, appointed by the transport authority. Small operators often find these requirements onerous.
 - (c) Operators have to be "formalised" in order to participate in the tendering system - proof must be given of registration with the IRS. Many small operators are not registered.
 - (d) Expensive electronic ticket machines must be fitted and operated.
 - (e) Operators must have sufficient public liability insurance.
 - (f) The revenue risk is with the operator as contracts are "net contracts".
- (iv) Access to business premises. In the public transport industry this would include maintenance facilities, offices etc.
- (v) The acquisition of skills and managerial experience. Due to the size of the business and the complexity of involvement in especially the "tender for contract" system in public transport, small businesses find it difficult to compete with knowledgeable larger businesses for such contracts.
- (vi) Legal and regulatory environment - understanding of and compliance with legal requirements when rendering public transport on contract.
- (vii) Often unreasonable expectations about "getting rich quick".

Annexure 1 summarises some of the risk elements from the perspective of different role players in public transport.

To summarise, small businesses face particular problems should they wish to participate in the tender for contracting system. These are:

- A general lack of skills and management expertise in order to participate in the tender for contract system.
- Lack of financial systems, collateral, credit records and therefore access to capital.
- Lack of facilities such as maintenance facilities, depots etc.
- Lack of appropriate buses to participate in the tender system - based on the specifications of the tender documents.
- Lack of knowledge about operating under contract conditions and specifications.

Initiatives to address the problems of small operators will have to address these issues holistically.

A number of ways do however exist to meet the needs of the small business sector. In many instances a single method will not provide all the answers but offer some solutions to the problems alluded to above. The issue of management capacity and proficiency in SMME businesses will however not be solved over the short to medium term. In public transport in South Africa the empowerment of small business will need a concerted effort, probably co-ordinated by the National Department of Transport and in conjunction with the Industry Training Boards.

3. Initiatives to accommodate small business.

Government, through legislation and tender specifications, can advance the role of small business in public transport. Initiatives include set-asides for small business, the specification of routes and operating areas in such a way that it becomes easier for small businesses to tender, non-discriminatory public sector procurement rules and incentives for big business subcontracting to and embarking on joint ventures with small enterprises. Tender requirements for small services could also be relaxed (e.g. vehicle age profile) and a price preference given to SMME operators.

3.1 Contracting with special conditions that favour the participation of small business

A business responds to a request for services through a public tender and should it be successful contracts with the contracting authority for the rendering of services. In order to contract, the business needs access to capital (working capital, finance for vehicles, insurance cover, surety capital (4% of contract value)) as well as the necessary expertise to execute the contract according to the contract conditions and stipulations. Knowledge of tenders, tender procedures and operating requirements are essential to tender.

In order to ensure the participation of small business, tenders are specified in such a manner that small operators can tender for a contract which specifies a small number of buses, often varying in size to accommodate low density routes and the typical equipment that such operators require. Established operators are also often precluded from such tenders. In the tender evaluation process such companies are also given preference above other larger and established companies.

As many small businesses are informal and are often not managed according to accepted administrative procedures, the additional administrative burden of financial management systems, information management systems (ticket machines), the submission of subsidy claims and the administration thereof etc. could be overbearing. The benefits of tendering outright are however more rewarding when compared to joint ventures and subcontracting. The operator is in control of his own business, work ethics and market. He develops experience and provided he operates according to the tender specifications, he is assured of an income and a cost escalation factor. He can also develop the market further to his direct benefit. Such an operator ought to be better positioned than operators opting for the joint venture and subcontracting route when the contract expires and is advertised again.

At this point in time the complexities of the tender system, the inability to source adequate funding etc. linked to the disadvantages mentioned under section two, mitigate strongly against the emerging small entrepreneur.

The needs of small and medium business is however so complex that even a range of support mechanisms, including finance arrangements, are insufficient to encourage the participation of the small business sector in the tendering for contract system. Quite often the willingness to participate is present but the pre-requisites and tender requirements are so onerous that it is often not considered worthwhile. Other initiatives are necessary in addition to the measures highlighted above. These initiatives could depend on the role of established businesses in empowering small business and can be grouped under the following main headings:

3.2 Joint ventures

Several types of joint ventures are found:

- Two (or more) SMME's
- A large established operator and a SMME
- A consortium of operators
- A franchise-type operation

The profit sharing arrangements will depend on investments and expertise contribution. The management arrangements could be proportionate or dependent on the specific arrangements of the joint venture agreement.

(a) Two (or more) SMME's and the consortium approach to empowerment

Should SMME's (two or more) get together and jointly bid for services they have to possess most of the characteristics of an institution involved in straightforward tendering. The benefit of such a joint venture could be that the companies compliment each other - the one's weakness is the others' strength and vice versa, e.g. financial resources vs. managerial skills.

(b) Joint venture between a SMME operator and a large operator

This is a business venture between an established local or international business and another (emerging) company. The established company could make available the necessary capital, provide expertise, vehicles, facilities, etc. Joint ventures are often found where larger investments (transport services and infrastructure to support transport networks) are required.

There are numerous ways in which such a joint venture could be put together. The agreement could for instance be limited to the provision and maintenance of vehicles and /or be expanded to include administrative arrangements, finance arrangements, insurance cover etc. The advantages of a full joint venture between the parties can be summarised as follows:

- The SMME can draw on the expertise of the larger operator (for development, managerial strength, financial growth, exposure to authorities, banks, suppliers and the community)
- Finance muscle of the larger operator (to guarantee loans of the SMME, optimal finance rate)
- Bulk purchasing advantages of diesel, spares etc.
- Potentially lower insurance costs.
- Lower overheads, especially if some of the SMME's administrative functions are provided by the larger operator.
- Access to facilities, premises, training programmes etc.
- Structured introduction and exposure to the tender system.

(c) Joint venture franchising

The International Franchise Association defines a franchise as a "continuing relationship in which the franchiser provides a licensed privilege to do business, plus assistance in organising, training, merchandising and management in return for a consideration from the franchisee" It is a legal agreement that allows one organisation that possesses the product to grant certain rights and information about operating a business to an independent business owner.

Generally, franchising is embarked upon to expand business, attract capital, reduce risk, and explore business skills of the franchisees. An example of franchising of a bus business is to be found at National Express in England - a company that has about 46 franchisees in the long distance/inter-city market in England and Europe. The franchiser will typically ensure that the livery is maintained, information technology is provided, vehicle specifications are provided, market the service/s, negotiate packages with hotels etc. In return the franchisee will pay the franchiser an agreed rate per kilometre and finance its own vehicles. The operator works under the name of the franchising company which ensures market exposure and a "good name". The franchiser therefore has no vehicles as assets - these are owned by the franchisee/s.

Clearly these criteria do not necessarily meet the requirements of empowering small transport businesses in South Africa as such small businesses often do not meet these criteria, for the reasons mentioned above. The franchising of public transport services in South Africa will therefore have to be a hybrid approach between the traditional franchise and its objectives and the objectives of empowering small business in the country.

In pursuit of the empowerment of small public transport business through franchising two basic approaches could be followed;

- (i) An established operator forms a company that owns infrastructure and provides management expertise and systems support. It then provides a range of services such as administrative support, management and driver training, maintenance and repair of vehicles, depots for the safe parking of vehicles, etc. to small business on a cost recovery basis. Under this alternative the franchiser provides a standard range of support services to operating SMME's and can either withdraw as an operating entity or operate services in conjunction with such SMME's.
- (ii) This type of arrangement could go one step further to allow the franchiser to manage the entire route network on behalf of the franchisees thus scheduling such operators to meet the network requirements of integrated and co-ordinated services.

A characteristic of this type of joint venture is that the franchising company will provide a comprehensive training programme to prepare the franchisee for business ownership. It will also make available experienced operational staff and support personnel to provide ongoing advice and assistance.

Why would an established public transport operator want to pursue this option? Several reasons come to mind.

- It is government policy to grow the SMME sector.
- More rapid expansion is possible - lack of capital and a dearth of skilled employees can slow business expansion. The franchiser could provide both when services are franchised, provided the franchisee has access to capital.
- A higher level of motivation can be achieved. Each manager is an owner and has a high level of motivation for success.
- Operating costs could be lower as franchisees often have lower cost structures than larger businesses.
- The use of infrastructure facilities could be improved thus lowering costs.
- The operator can, through a continuous training programme, ensure that franchisees render high quality services.
- Franchisees are often closer to the communities they serve which could have a positive influence on passenger base loads and community acceptance.

Disadvantages for the franchiser include:

- Potential fragmentation of network services if co-ordination and integration objectives are not met.
- The way in which business was historically conducted, changes fundamentally for the franchiser.
- New skills and operating philosophy is required.
- Relations between the franchiser and the franchisees must be carefully managed.
- Giving up a single service operation to a multiplicity of smaller operators. The relationship between such operators and the franchiser would have to be carefully managed.
- Potential competition. Franchising a business has the potential of training competitors. Franchisees may learn how a business operates and then decide to replicate the operation under another name. In the spirit of growing SMME businesses in South Africa this could however be one of the objectives of franchising business.

From the franchisee's perspective (the SMME company) the following benefits can be cited:

- Lower risks. A franchise business generally has a lower risk of failure than a new start-up business.
- The experience of the franchiser's management team increases the potential for business.
- The franchisee would be able to source lower cost equipment and spares through the purchasing power of the franchiser. This would provide a cost-competitive edge when compared to contracting.
- Efficiency of operation. Franchisers often discover operating and management efficiencies that benefit franchisees. Operational standards set in place by the franchiser also control quality and uniformity among franchisees.
- Management assistance. A franchiser provides management assistance to franchisees. This includes accounting procedures, personnel management etc. Small business is often not geared or knowledgeable enough to manage these functions.
- Business plan. Most franchisers help franchisees develop a business plan. Many elements of the plan are standard operating procedures established by the franchiser. This may help the franchisee to obtain financial support from the financial institutions.
- Start-up assistance. The most problematic part of any small business is probably the start-up. Even experienced managers find this difficult because they are only involved a few times in setting up business from scratch. A franchiser however has a great deal of experience in setting up business to the benefit of the new entrant.
- Assistance in financing. It is possible to receive assistance in financing a new franchise through the franchiser. A franchiser will often make arrangements with a financial institution to lend money to a franchisee. The franchisee must still accept personal responsibility for the loan but the franchiser's involvement usually increases the likelihood that a loan will be approved.
- Payment of a franchise fee and royalties. Depending on how a franchise is conceptualised these fees may not necessarily be included in a franchise of a public

transport service as the franchiser may not have the exclusive right to the operation. Services and facilities are franchised. The fees may therefore not be applicable in this case which eases the entrance to the market. Franchisee's will however have to pay for the services rendered by the franchiser.

3.3 Subcontracting

Transport Authorities can either specify a tender to include a set-aside for small operators or specify the tender in such a way that certain services are " reserved" for small operators.

In the first option a contracting party (main contractor) subcontracts a portion of the service to another service provider - based on the tender requirements. The main contractor remains responsible for the execution of the contract and concludes a contract with the subcontractor for the rendering of the subcontracted services. The advantages of this approach for the smaller operator are numerous:

- Little tender expertise is required.
- The contract governing the subcontracted services could be quite simple.
- Less up front financial expertise required.
- Experience is gained with little financial and operating risk.
- Vehicles and/or standby vehicles could possibly be obtained from the main operator - at an agreed rate.
- There is a guaranteed cash flow. Operators are mostly remunerated on a revenue kilometre basis at an agreed rate per kilometre.
- Training and technical assistance could be made available.
- Potential for fewer labour problems.
- Administrative workload is much less when compared to outright tendering.
- Own markets can be developed.
- Lower costs can be realised when compared to outright tendering as many services are " outsourced" to the main contractor.

Disadvantages of subcontracting are cited as:

- Small operators claim that large operators exploit them financially.
- Less exposure to harsh business realities when compared to outright tendering.
- It is sometimes seen as window dressing by a larger operator in order to comply with the legal requirements of the tender.
- Intimidation of the subcontractor by the workforce of the main contractor as they perceive that the small operator could be jeopardising their jobs.
- Potential labour conflict as the SMME operators' workforce is often not unionised.
- Potential competition could be encouraged. Subcontractors may learn how a business operates and then decide to "go it alone" when the service comes up for tender again.
- When subcontractors sell tickets, the revenue risk resides with the main contractor.

Numerous examples of subcontracting exist today. Some of the services are subcontracts where the operator operates own vehicles, maintains the vehicles and manages the company as he sees fit. Other examples exist where the operators make use of the maintenance facilities of the larger operator, training programmes, administrative support programmes, financial guarantees etc. An example exists where a new company (Great Opportunity Bus Service in Pretoria) was established through an existing larger company subcontracting a portion of the contract kilometres to the new company. The buses are loaned by and maintained at an agreed fee by the larger company. The employees of the new company were originally the employees of the larger company. The larger company is represented on the board of the new entity and is actively involved in assisting the new company with managerial advice and support.

Despite the drawbacks of subcontracting, mentioned above, subcontracting is growing in South Africa. Most state tenders today include a portion of services to be subcontracted. Subcontracting is often seen as the only way in which SMME businesses can, at least at the beginning of the tendering process in South Africa, participate in the tendering programme. It overcomes many of the issues and problems of the financial institutions as well as SMME's through the involvement of the established company.

4. Conclusions

In this paper it was shown that SMME-type operators have particular problems, in many cases unique to this country, when wishing to participate in the tender for contract system. Although there are many examples of SMME operators tendering outright for services, experience thus far has shown that many small operators are opting for joint ventures and subcontracting in the initial stages of the tendering process. Although this paper differentiates between the two methods of empowerment, each method can be developed to suit a wide range of particular needs and is not necessarily to the exclusion of the other.

The franchising of services was discussed and put forward as a joint venture option. The traditional franchising concept, and the objectives thereof, will however have to be amended to suit franchisers and franchisees - at least at the beginning of the tendering process in the country. The principles underpinning the concept have however been proven in the franchising of National Express' tourist/inter-city bus services in England and Europe.

One of the concerns of established business is that they are empowering small business that could somewhere in future compete for their services. Any public transport service will however have some larger "core operations" involving larger numbers of vehicles and smaller services that require fewer vehicles. Empowering small operators through joint ventures and subcontracting would therefore not necessarily pose a threat to larger operators. It could however over time ensure that smaller operators, through better knowledge of real costs and safe operations, tender more realistic prices that would ensure long term sustainability of their businesses.

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