National Industrial Participation in South Africa

DENTONS

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1. Introduction

This contribution considers the regulatory framework of National Industrial Participation (NIP) in South Africa, and specifically sets out the National Industrial Participation Programme (NIPP) and the NIP Revised Guidelines of 2013 (Guidelines). Examining the regulatory framework of NIP serves multiple functions. First, an examination of the framework is of particular interest to prospective participants in the programme. Secondly, understanding the framework may better explain the shortcomings or succeeding criticisms of the programme. Thirdly, in understanding the shortcomings of the regulatory framework, specific aspects of the framework can be identified which must be improved.

The National Industrial Participation Programme is set for review. Although well conceived, the NIPP can be criticised for being poorly implemented, displaying a lack of contract management skills, suffering from enforcement challenges, displaying a lack of commitment by obligors, and not delivering the promised local employment opportunities.

2. Public procurement in South Africa

In South Africa, public procurement is fundamentally governed by section 217 of the Constitution of the Republic of South Africa 1996 (Constitution). Section 217(1) provides the standard by which all public procurement in South Africa is measured, and requires that it be fair, equitable, transparent, competitive and cost-effective. The Council of Ministers in South Africa (Cabinet), approved a four-tier system of public procurement in December 2012, which consists of the Preferential Procurement Policy Framework Act 5 of 2000 (PPPFA), the Competitive Supplier Development Programme (CSDP), direct NIP, and indirect NIP (direct and indirect NIP are explained in paragraph 4).

3. The National Industrial Participation Programme

As the Constitution does not provide for industry-specific regulation of government procurement, the NIPP was created to address industrial participation. The NIPP, as governed by the South African Department of Trade and Industry (DTI), aims to advance the South African economy by promoting industrial development and expanding industrial capabilities (particularly in value-adding and tradable manufacturing sectors). According to the National Treasury in South Africa, the NIPP became effective in September 1996 and the general NIP policy and Guidelines were fully endorsed by Cabinet in April 1997.

In simple terms, according to the NIPP 2004 Report, the NIPP comes into operation when the South African government makes purchases abroad worth more than US$10 million, in which case the suppliers incur an obligation to reinvest a portion of the costs in South Africa. In more exact terms, as provided by the DTI and the Guidelines, the

NIPP applies to (and therefore places an NIP obligation on) all government and parastatal purchases or lease contracts pertaining to goods or services with an imported content equal to or exceeding US$10 million or equivalent value (also referred to as “the NIP threshold”).

According to the DTI, the benefit of the NIPP should be twofold. First, the South African economy should benefit through the fostering of new relationships in its export sector, job creation, technology transfer, and skills training for the population. Secondly, the foreign supplier should benefit by being exposed to a new market and being allowed to participate in the South African economy.

4. The NIPP Guidelines

The Guidelines (revised in 2013) set out the core obligations and principles of the NIPP, whilst also setting out to align the programme with other procurement instruments. These Guidelines are binding on all government departments, spheres of government and State Owned Companies (SOCs) in South Africa, unless exempted by the DTI.

The Guidelines distinguish between direct NIP and indirect NIP. Direct NIP is the preferred method of fulfilling industrial procurement obligations. As defined by the Guidelines, direct NIP refers to local manufacture, value-addition and related services projects that are directly related to the sector or industry from which the public sector procurement contract originates. Indirect NIP refers to local manufacture and services projects unrelated to the sector or industry from which the public procurement contract originates. The Guidelines stipulate that indirect NIP can only be used in certain circumstances and should only be applied in the sectors of public procurement for which there is significant expenditure, but where there is neither the capacity nor the capability present (or the reasonable expectation that the capacity or capability can be created) to support long-term industrial development.

The official objectives of the NIP, as set out by the Guidelines, include:

- sustainable economic growth (with emphasis on value-adding, labour-intensive and strategic manufacturing sectors of the economy);
- establishment of new trading partners and facilitating access to new markets;
- encouragement of foreign direct investment into South Africa (with emphasis on strategic productive sectors of the economy);
- ensuring technology transfer to South Africa;
- encouraging research and development collaboration between South Africa and other countries;
- support to South African manufacturers in the export of South African “value-added” goods and services and enabling South African manufacturers to enter the global supply value chains (GVCs) of major Original Equipment Manufacturers (OEMs);
- sustainable job creation and/or retention; and
- support of broad-based black economic empowerment and contribution to the advancement of previously disadvantaged communities.

5. Application process for participation

The DTI submits that the turnaround time for approval of an application to participate in the NIPP is four weeks.

As per instruction by the DTI, the process of application for participation in the NIPP involves the following steps:

- make contact with the DTI;
- submit the Business Concept for consideration;
- upon approval of the Business Concept, submit the detailed Business Plan outlining the Business Concept;
- sign an agreement with the DTI (there are two main types of NIP agreements, namely the Obligation Agreement and the Strategic Partnership Agreement (SPA), as discussed in paragraph 7);
- implement the Business Plan; and
- submit bi-annual progress reports on the approved Business Plan.

6. Understanding the Business Concept and the Business Plan

6.1 The Business Concept

According to the Guidelines, the criteria by which the Business Concept is evaluated are based on the four following principles: “additionality”, “causality”, “no increase in the purchase price” and “sustainability”. “Additionality” means that all NIP projects must reflect new or incremental business. “Causality” means that the NIP project must result directly from a NIP obligation, which arises from a government purchase contract, and would not have occurred had it not been for the NIPP (except in the case of SPAs). “No increase in purchase price” means that the NIP obligation must not result in an increase in the price of the purchase contract. “Sustainability” means that all NIP projects must be economically and operationally sustainable.

The Business Concept serves to provide a brief overview (in less than five pages) of the proposed project. Section 8.5 of the Guidelines sets out exactly what the Business Concept must contain. The Industrial Participation Secretariat (IPS) uses the Business Concept in deciding whether the Business Concept fulfils the NIP criteria. Once the Business Concept is approved, the prospective participant can prepare a more detailed Business Plan.

6.2 The Business Plan

The Business Plan sets out in greater detail what is already introduced in the Business Concept.

The Business Plan, according to section 8.6 of the Guidelines, should expressly set out inter alia the purpose, direction, growth potential, deliverables, timelines and resource allocation of the NIP project. At the same time, the Business Plan should set out the role and commitment of the NIP obligor and the local partners to the NIP project. Should the project involve other participating companies, the Business Plan must also contain bona fide letters from those companies, indicating their support and binding commitment to participate in the NIP project.

7. Types of NIP Agreements

7.1 The Obligation Agreement

Obligors are required to sign an Obligation Agreement with the DTI within a month of signing the main purchase agreement with the procuring entity. An Obligation Agreement is conditional upon the award of the tender and is linked to a single tender. The NIP obligation, in terms of the Obligation Agreement, arises when the tender is awarded.

The Obligation Agreement is always supplemented by a performance guarantee to the value of 5 per cent of the NIP obligation. Obligors are required to provide the DTI with an acceptable performance guarantee within 90 days of the effective date of the Obligation Agreement. Accepted performance guarantees include a bank guarantee and a company guarantee, of which a bank guarantee is always preferred.

According to the Guidelines, the Obligation Agreement should govern the relationship between the DTI and the supplier/contractor and set out: the NIP obligation value(s), the requirements to fulfill the NIP obligation, the performance milestones (as discussed below), the performance monitoring processes and the NIP credit allocation criteria.

The NIP obligation is calculated as an equivalent of 30 per cent of the imported portion of the purchase contract. According to the Guidelines, this obligation can be fulfilled through a number of local economic activities, which are selected on the basis that they can promote the objectives of the NIPP. These activities include inter alia: investment to raise production capacity and competitiveness in strategic sectors of the economy, export promotion or sales, research and development collaboration, technology transfer, and transformation of the domestic economy with special emphasis on the manufacturing sector.

Generally, obligations must be discharged over a period of seven years. The Guidelines provide for so-called "performance milestones" which obligors must observe within this time period. There are three milestones which obligors must observe – at the three-year, five-year and seven-year marks.

7.2 The Strategic Partnership Agreement

An SPA is a proactive agreement allowing potential obligors to initiate NIP projects and save accruing NIP credits for use in discharging future obligations. Upon signature of the SPA, the agreement will remain valid until the parties agree to terminate it. SPAs are long-term agreements between government and suppliers and are not linked to any tender, which means that an SPA can accommodate multiple tenders. Projects linked to an SPA will carry a lifespan of 10 years. NIP credits carry a limited lifespan of five years from the date of award, and credits that are not used within this period will automatically lapse.

8. Qualifying NIP projects

The Guidelines designate certain projects as "NIP projects". These projects involve investment, licensed production, export promotion, subcontracting, technology transfer and research and development.

9. General compliance and performance review procedure

9.1 General compliance procedure

Section 8 of the Guidelines describes the general NIPP compliance procedure. The most prominent features of section 8 have been included in the preceding paragraphs of this contribution.

At present, there exists no legislation dedicated to issues of NIP compliance/non-compliance.

No practical information in regard to compliance/non-compliance to the NIPP is available from the DTI at this point.

9.2 General performance review procedure

In order to ensure the success of the NIP, accurate monitoring and evaluation is crucial. Furthermore, overall compliance must be ensured to prevent import leakage. Once the purchaser and seller/contractor have confirmed the obligation values, the obligation is monitored by the IPS. Section 10 of the Guidelines and other DTI documentation submit that performance is monitored through six-monthly reports, annual review meetings, set performance milestone achievement evaluations (as discussed in paragraph 7), as well as regular project site visits by IPS personnel and by DTI industry experts.

Penalties are calculated upon signature of the purchase agreement and calculated from amounts reflected in the final purchase agreement. The penalty is therefore derived from the imported content value as per the purchase contract signed between the purchaser and the seller. The monetary value of a penalty is calculated as 5 per cent of the outstanding NIP obligation.

10. Conclusion

The preceding paragraphs have set out the regulatory framework of NIP, focusing specifically on the aspects of the NIPP and the Guidelines which are of particular interest to prospective participants in the NIPP.

In the course of this examination, shortcomings of the NIPP were detected. Even though the Guidelines set out the compliance and review procedures of the NIPP, the absence of Guidelines, national legislation and public information (supplied by the DTI) in regard to the practical effect of non-compliance makes it difficult to predict the practical outcome of non-compliance for participants in the NIPP. The lack of regulation in the context of non-compliance and enforcement may account for the main perceived failures of the programme. It can be argued that the creation of regulations, addressing non-compliance and enforcement, may also cure various corollary criticisms of the programme, such as the lack of commitment by obligors, the lack of job creation and other implementation challenges currently faced by the NIPP.

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