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Harnessing the Informal and Formal SMME Construction Sectors to Resolve the South African Construction Skills Shortage

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ABSTRACT

As the accelerated and shared growth initiative of South Africa (ASGISA) unfolds, there is speculation that expansionary investment in infrastructure will be hampered by a skills shortage. Economic planners advice that there is little scope for importation of skilled people from the international community because the cost associated with securing requisite skills is set to rise due to robust demand. Consequently, it is plausible that some construction businesses will find it difficult to secure suitably qualified staff to enable them complete projects within prescribed cost, time and quality requirements. To keep skills related costs from rising, construction businesses may have to look to less traditional areas of labour supply.

This paper argues, through a review of literature, that there are latent skills in the informal and formal, small, medium and micro enterprises which go largely untapped. It concludes that harnessing these latent resources could assist in resolving the speculated shortage and augment *Construction for Development.*

KEYWORDS: Harnessing, Informal and Formal Sectors, Infrastructure Investment, Skills Shortage, SMMEs.

1. INTRODUCTION

The South African construction industry employs over 1 million people comprised of 864,000 in the formal sector (StatsSA, 2006). The industry's total output is about R100 billion and contributes 17.9% to the Gross Domestic Product (GDP) and about 14.5% to Gross Fixed Capital Formation (GFCF) (SARB, 2006). The industry comprises over 23,000 enterprises most of which are Small, Medium and Micro Enterprises (SMMEs). About 8,000 SMMEs are registered members of the Construction Industry Development Board (CIDB) Emerging Contractor Development Programme – a scheme which supports new contractors in South Africa who wish to undertake work in the public sector.

The government in partnership with parastatals has committed itself to a 5 year investment plan in transport, energy, civic and sports infrastructure. The current estimated total expenditure for the period 2005 to 2009 is around R320 – R400 billion (Cheetham and Mabuntana, 2006). This ambitious government economic expansionary agenda is driven through the Accelerated and Shared Growth Initiative of South Africa (ASGISA) set of interventions (DTI, 2006; Robert, 2006). Among other things, ASGISA calls for significant investment in infrastructure and assistance to strategic sectors of the economy.

For the construction industry, the implication of this government expansionary agenda is that the industry has to double its current output of R100 billion a year by 2010 (Creamer, 2005; Mowson, 2005; RICS, 2005; Creamer, 2006). This expected high level of investment in infrastructure and project delivery means that the construction industry would have to grow by at least 10% between 2006 and 2010 (le Roux, 2005). This is a great challenge for the industry given that the development of skilled workers, particularly artisans and foremen has to match the growth in investment in the industry (Loxton, 2005; World Bank, 2005; Creamer, 2006). According to Milford, the industry would need an additional 25 000 qualified artisans by 2010 (cited in Creamer, 2006).

As is, the country is currently experiencing severe stress on infrastructure delivery (Creamer, 2006). It needs to increase the productive capacity of its existing construction stock and create new ones. It could be argued that as delivery capacity is used up, small, medium and micro enterprises (SMMEs) can enter and assist in this regard. Against this background it is contended that a significant increase in the number of large scale projects will result in a supply gap at the lower end of the market where most small municipal infrastructure projects are found (Creamer, 2005; Mowson, 2005; Campbell, 2005). This lower end of the construction market consists of small, medium and micro enterprises [SMMEs] (Hauptfleisch, *et al*., 2005) which are the focus of this paper. As one of the ASGISA set of interventions is to support and promote SMMEs [including black and women owned enterprises], entry of small enterprises

into the construction market is amenable to this intervention (Creamer, 2005; Mbachu and Folose, 2005).

The overwhelming demand generated by the massive investment in infrastructure is likely to exacerbate the skills shortage highlighted above (World Bank, 2005). Considering the difficulties associated with skills, it's likely that some construction enterprises may not be able to deliver on time and within prescribed standards and timeframes (Creamer, 2005). As a way of addressing the problem, the Joint Initiative for Priority Skills Acquisition (JIPSA) a component of ASGISA, in consultation with the CIDB and government, is considering short-term measures to source qualified people to work in the industry including importation from overseas among others (Creamer, 2006; DTI, 2006). However, Shakantu *et al.* (2006) note that while importation of manpower would offer a quick short-term solution, robust international demand is likely to raise the cost of acquiring these resources. In addition, importing skills may reduce the incentive to train local manpower, which may not augur well with government intentions of encouraging training and development.

To mitigate the likely increasing costs resulting from skills related problems, less traditional areas of labour supply may offer some potential solutions. The main argument of this paper is that there are latent skills within both the informal and formal SMMEs which remain largely untapped and if harnessed could assist resolve the construction capacity gap. Therefore, the purpose of this paper is to report part of the findings of a research project that is exploring ways of harnessing these resources in the informal and formal SMME sectors in order to address the skills shortage. The paper is based on a review of literature.

2. THE INFORMAL SMME SECTOR

The construction industry has two specific characteristics that have a major bearing on its employment and training patterns. These are the project based nature of construction and the cyclical nature of the industry (boom and bust). The cyclical nature of the industry indicates a high variability of demand. In the 22 years prior to 1999, the South African construction industry had been experiencing diminishing and volatile demand resulting in employers being unable to retain excess labour, train or offer opportunities to young trainees (Rebello, 2005; CIDB, 2006). As a result, many former construction employees were 'forced' into the informal sector which seems to have been benefiting from the misfortunes of the formal sector.

The informal construction sector basically comprises people who are unemployed due to lack of construction work and/or downsizing in the formal private and parastatal sectors (Shakantu *et al*., 2006). Contrary to popular belief, the informal sector comprises not only of people with limited skills but, also some very skilled and experienced artisans and managers

who have chosen to either work for themselves or their families as a result of the cyclical nature of construction, or who have 'leaked out' of the construction industry into other sectors e.g. the taxi industry. This provides a reasonably wide pool from which many of those skilled people could be attracted back into the construction industry.

Alternatively, entrepreneurs with limited skills could be offered skills development support and attracted back so that they can contribute to the expansionary fiscal framework. This way, when the level of demand in the formal sector goes down, these entrepreneurs could continue to operate within the informal sector.

3. THE FORMAL SMME SECTOR

The promotion of SMMEs has been a particular focus of government mainly as a means through which social economic objectives such as job creation could be achieved. With the government's expansionary fiscal framework centered on infrastructure development, it is expected that as the order books of large contractors get filled, the demand will trickle down to SMMEs (Mohammed, 2005).

The SMME sector in South Africa can be classified into 4 broad classes namely; survivalist, micro, small and medium enterprises.

- Survivalist enterprises are at the lowest level of entry into the SMME sector and that's where the largest number of enterprises is found. Survivalist enterprises mainly undertake 'survival-type' construction activities which consist mainly of small types of work. These types of construction activities are typically undertaken by unemployed people in an effort to earn a living. Most of these activities take place outside the formal setting. Survivalist enterprises mostly employ family labour and seldom employ more than five people (Rebello, 2005). In terms of skills, survivalists do possess minimum skills required to do the work at hand.
- Micro enterprises are very small businesses which usually involve the owner, some family members and at most not more than 5 paid employees (DTI 1995; DTI, 2007). They often operate in the informal sector as they usually lack 'formality' in terms of business licenses, VAT registration, formal business premises, operating permits and accounting procedures (DTI, 1995). However, micro enterprises do have the potential to operate in the formal sector. In large part they are run by owners who have some skills in the particular business area in which they operate. According to the White Paper on Small Businesses, "most of them have a limited capital base and only rudimentary technical or business skills among their operators (DTI, 1995: par 2.1.3). Many micro enterprises do advance into viable small businesses (DTI, 1995).

The average annual turnover of micro enterprises varies widely up to one million rand [R1, 000, 000] (DTI, 2007).

- Small enterprises employ in the range of 6 - 60 people and generate between R1.1 to R12 million per annum (DTI, 2007). They are usually owner managed and are likely to operate from business or industrial premises, be tax registered and meet other formal registration requirements (DTI, 1995; Berry *et al*., 2002; Rebello, 2005; Jewell *et al.*, 2005). Small enterprises also employ skilled people to carry out the work required (Shakantu *et al.,* 2006).
- Medium enterprises constitute quite a wide range of enterprises. These can employ from about 61 to about 300 employees and generate between R12.1 to R60 million per annum (DTI, 2007). Medium enterprises are also still perceived as owner/manager controlled (DTI, 1995; Jewell *et al.,* 2005; Rebello, 2005). Like small enterprises, medium enterprises employ relatively skilled people.

4. TOWARDS INTEGRATING THE INFORMAL AND FORMAL SMME SECTORS

As earlier indicated in the paper, the SMME sector consists predominantly of family owned businesses employing relatively few or self employed people. This characteristic reflects the limited capacity inherent in SMMEs which is a hindrance to government's objectives of leveraging infrastructure investment to bolster economic growth, employment creation and poverty alleviation (Shakantu *et al.,* 2006). Besides, the government believes that investment in infrastructure will improve the social conditions of the majority of the population and narrow the gap between the formal and informal economies (le Roux, 2005).

With the above context in mind, it is imperative that ways in which infrastructure investment can translate into meaningful participation by people operating in the informal sector be sought. By so doing, the majority of people operating on the peripheries can be integrated into formal activities. This calls for development of technical solutions to assist SMMEs which may include integrating aspects of 'indigenous' construction skills. This kind of support towards developing technical solutions, if targeted at SMMEs could benefit the economy as well considering that SMMEs already cut across the formal and informal sectors/economies (le Roux, 2005). Arguably, SMMEs are better placed as vehicles for accessing untapped labour supply that can potentially be harnessed. The starting point in harnessing the potential of informal and formal SMMEs is to develop their management and entrepreneurial skills. Achieving this would assist the SMMEs become reasonably larger employment generators or at

least, the individuals operating them could be encouraged to seek employment in the formal sector (Rebello, 2006).

As was suggested earlier in this paper, SMMEs have potential to benefit from the trickledown effect of established contractors' full order books. By their nature, small businesses can be very flexible and innovative and are capable of handling many small labour intensive dispersed projects which are necessary for economic development and social upliftment within communities (UNCHS, 1996). Because SMMEs have great potential as vehicles for redistribution of wealth, creation of business and employment opportunities and poverty alleviation (Agumba, 2005), harnessing their potential would enable government achieve some of its socio-economic objectives.

Further, harnessing the potential of SMMEs also implies a proactive interventionist approach to addressing constraints faced by SMMEs that cannot be resolved through normal market forces and private-sector action (DTI, 1995). According to the government, assistance should be given to SMMEs in terms of capacity building, training, business advice and counselling as well as adequate access to technological and financial resources in order for them to realise their full potential (DTI, 1995). In the view of Shakantu *et al.* (2006), integrated efforts at the local, provincial and national levels are vital to the success of SMMEs' development and sustainability. Moreover, targeting support at the development of entrepreneurship through public and private partnerships would complement the efforts of the DTI. This is because the DTI aims to promote technological know-how within the SMME sector, through the deployment of skills, knowledge and innovation critical to improved productivity. To this end, developing entrepreneurs would enhance production competitiveness at the level of the enterprise (Shakantu *et al.,* 2006).

5. CONCLUSIONS

The construction industry is currently experiencing a boom fuelled by government's infrastructure investment plan and preparations for the 2010 FIFA World Cup. The implication of the boom is that the industry has to double its current R100 billion per annum output in order to match the public-private sector growth targets. However, it is speculated that unless dramatic measures are taken, the current skills shortage will be exacerbated which in turn might affect the industry's ability to meet demand and hamper the investment programme. Currently, there is a shortage of qualified manpower at both the managerial and artisanal levels. At the artisan level for example, estimates are that the industry would need 25 000 additional qualified staff by 2010.

Through the JIPSA, importation of manpower from overseas is one of the potential short-term measures for the government. However,

importing manpower is likely to increase the labour costs due to robust international demand and could also put a damper on training local people. Against this background, the paper has made a case for looking at ways of harnessing the potential that lies within the informal and formal SMMEs to complement measures of addressing skills shortage.

The paper highlights that because most of the small businesses already operate across the formal-informal divide, they provide an important latent resource pool from which to draw labour and equip it with skills, including entrepreneurial skills. As the order books of large contractors get filled, the demand may trickle down to the SMME sector which by undertaking the smaller projects will in effect be bridging the skills shortage especially at the level of small municipal infrastructure projects.

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