creamer media

REAL ECONOMY INSIGHT: AUTOMOTIVE

JUNE 2015

Picture by Duane Daws

Real Economy Insight: **Automotive**

Shona Kholer | Research Associate

South African automotive consumers are spoilt for choice, as they have the largest choice to market size ratio in the world. In 2014, there were more than 55 brands and more than 4 400 model derivatives available to South African consumers in the new-passenger-car market. In the light commercial vehicle (LCV) segment, there were 31 brands and 615 model derivatives from which to choose.

Figures from the National Association of Automobile Manufacturers of South Africa (Naamsa) show that 644 504 new vehicles were sold in the country in 2014, marking a slight year-on-year decline on the sales recorded in 2013. The 0.7% decline was the first recorded since 2009. Nevertheless, new-vehicle sales turnover grew by 9.8% in 2014 to R225-billion.

Factors contributing to fewer vehicles having been sold in 2014 include that the vehicle replacement cycle – in terms of which owners replace their vehicles, owing to age or mileage – seemingly reached its end in 2013. Sales were also subdued because of factors that negatively affected the affordability of and demand for vehicle finance, including the slowdown in the domestic economy, and two recent interest rate increases.

Further, new-vehicle price increases have been above inflation. Vehicle importers have been more affected by price increases, as they tend to move more aggressively on pricing, compared with local vehicle manufacturers, as the rand weakens. However, local manufacturers have also been affected by the devaluation of the rand, owing to significant cost increases in imported parts.

In 2014, South Africa's automotive industry produced 566 083 vehicles, including 277 491 passenger cars and 255 629 LCVs. Total vehicle production was 3.7% up on production in 2013, passenger car production increased by 4.7%, and LCV production by 2.9%.

The major car and LCV manufacturers active in South Africa include the local subsidiaries of seven global automotive companies – BMW, Ford, General Motors, Daimler (Mercedes-Benz), Nissan, Toyota and Volkswagen. Several dedicated truck assemblers, including Fuso, Freightliner, MAN, Tata, Isuzu Trucks, Hino, Volvo, Renault, Hyundai, FAW and UD Trucks, are also active in South Africa.

South Africa's automotive industry, including vehicle manufacturers and aftermarket participants, use a combination of locally manufactured and imported components. The local-components industry consists of about 500 companies, including 120 first-tier suppliers.

The National Association of Automotive Component and Allied Manufacturers (Naacam) estimates that South Africa's component manufacturing sector recorded turnover of about R78.4-billion in 2014 and undertook capital expenditure of R2.7-billion.

Revisions and expansions to sector support

Globally, it is the norm for governments to offer support to their automotive industries, with most countries offering a range of support measures to vehicle manufacturers. They do so because of the investment required to establish an automotive plant, the number of jobs an automotive industry creates and the multiplier effect on the broader economy.

South Africa has been supporting its automotive industry since 1961. Currently, this support comprises the Automotive Production and Development Programme (APDP), which entered full effect at the beginning of 2013 and will continue until 2020.

One of the four key elements of the APDP is the Automotive Investment Scheme (AIS). In 2012, the Department of Trade and Industry (DTI) released the People-Carrying Automotive Investment Scheme (P-AIS) as a subcomponent of the AIS, with a specific focus on the minibus and taxi segment. Further, in July 2014, Trade and Industry Minister Dr Rob Davies approved revised guidelines for the AIS and P-AIS. In October 2014, government released guidelines for the Medium and Heavy Commercial Vehicles Automotive Investment Scheme to stimulate investment in the production of these vehicles in South Africa.

Meanwhile, the APDP has undergone a review, the outcomes of which are expected in about mid-2015. The need for policy stability and certainty was critical in the review process, as demanded by international vehicle manufacturers, whose investments are based on the incentives available under the scheme as it currently stands.

The review also has to an assessment of the incentives available for automotive component manufacturers. Former Naacam executive director Roger Pitot, who also serves as an adviser to the DTI on the APDP, has noted that component manufacturers are generally 'not happy' with the APDP and that some have had to close down, owing to the reduced benefits available under the programme, compared with the benefits that were available under the previous incentive scheme.

Other competing demands that the review has to consider include union demands for jobs, international competitiveness concerns and the cost of the incentives to the national fiscus.

It is expected that beyond 2020, when the APDP is set to end, the DTI will continue to support the local automotive industry. Companies in the components industry contend that a post-2020 support programme will need to be substantially different from the APDP. Components company Metair Investments has indicated that a new programme will have to be proposed within the next 18 to 24 months.

This will provide the South African automotive industry with the certainty required to make investment decisions while allowing for adequate time to adjust to the new policy.

Competitiveness

The competitiveness of South Africa's automotive industry has been significantly boosted by the APDP. Ford Motor Company of Southern Africa, for example, has noted that the incentives provided by the programme have made South Africa an attractive investment destination for the industry.

Despite the benefits offered by the APDP, however, competitiveness remains a major challenge for companies operating in South Africa. Naacam president Mpueleng Pooe contends that competitiveness is "the biggest challenge facing the South African automotive industry" and that "[the lack of] competitiveness of the industry remains the key inhibitor to growth and is a growing concern, based on the shift towards vehicle manufacturing in low-cost countries". Pooe's statement is applies to the automotive assembly and components sectors.

Competitiveness concerns are evident in company assessments of future investments in South Africa. For example, Datsun global head Vincent Cobee has described South Africa as the "logical choice" when it comes to the establishment of vehicle manufacturing operations that target the African automotive market, but has cautioned that the country will first need to significantly overhaul its level of competitiveness.

Picture by Duane Daws

A particular challenge is South Africa's precarious electricity supply. Naamsa, in a review of business conditions in the first quarter of 2015, notes that the "key imponderable" regarding the outlook for the automotive industry relates to the "security and stability of electricity supply". For several years, South Africa has been experiencing electricity supply shortages, owing to insufficient electricity generation capacity, with these becoming particularly significant in early 2015.

While South Africa's electricity shortages represent an obstacle to production, companies active in the local automotive industry contend that a far more significant challenge is the country's labour force. Mercedes-Benz South Africa (MBSA), for example, has identified labour instability as the biggest challenge to its producing C-Class vehicles in the country.

This observation follows two years during which the automotive industry experienced several major disruptions, owing to labour action. During that time, up to 13 weeks of vehicle production was lost because of strikes, including at assembly plants and component manufacturers, and in related sectors such as metals and engineering and logistics.

Companies have decried the impact of labour action on their operations. Toyota South Africa Motors' president and CEO Dr Johan van Zyl has said: "There is no way we can do that again. That was an incredibly bad period." MBSA has said that another major strike in the industry "will have a more critical impact than what most people will even be able to contemplate – it is a very serious matter". Naamsa has noted that the disruptions to production caused by labour action have "severely dented the industry's reputation and track record as a reliable supplier to international markets". Vehicle manufacturers will take South Africa's labour situation into account when considering possible additional production opportunities in the country.

The industry is set to embark on new wage negotiations in 2016, when the current three-year wage deal comes to an end. However, by early 2015, Naamsa was involved in talks with the unions on how to approach the 2016 negotiations more productively.

The wages in the local automotive industry are higher than in other competing developing countries. However, it is expected that the 2016 wage settlement is unlikely to be at a level lower than the 8% to 10% a year increases agreed to in the 2013 wage deals in the retail, components and assembly sectors. Nissan SA president Mike Whitfield says the social imperative in South Africa to "close the wage gap" will probably result in future wage increases continuing to "run ahead of inflation".

Motor companies have expressed concern that the high wage increases in the South African automotive industry do not necessarily lead to increased productivity. South Africa's labour costs is relatively high when compared with those of other vehicle manufacturing countries; therefore, if an increase in wages is not mirrored by an in crease in productivity, high labour costs impact negatively on competitiveness.

Another labour-related challenge affecting the competitiveness of South Africa's automotive industry is the skills shortage at assembly plants and suppliers. BMW South Africa has identified this as one of the major challenges it faces in the production of vehicles in South Africa. Several automotive companies are involved in efforts to ensure that the required skills are available to them. For example, MBSA has announced that, through National Treasury's Jobs Fund, R130-million will be spent on building a learning academy in East London, in the Eastern Cape. The facility will address the MBSA plant's technical needs and those of the region by training electricians, fitters and mechanics, among other skills sets. The academy is expected to open towards the end of 2015.

The difficulties automotive companies face in achieving economies of scale also affects competitiveness. They have also noted logistics as an area in which improvements are required. Volkswagen Group South Africa MD David Powels stated in early in 2015 that the South African supply chain, including participants, such as port and rail authorities and logistics service providers, would do well to improve its efficiencies.

Pooe contends that the fate of South Africa's automotive industry lies in understanding the competitiveness challenge facing the country.

Contributing to such an understanding, Van Zyl has noted that while South Africa's automotive industry does have several strengths, the country's natural advantage lies neither in the design and development of new vehicles nor in manufacturing, logistics, vehicle sales or aftersales service. He contends that, instead, the only real competitive advantage the local automotive industry has in comparison to international competitors is the availability of natural resources, thus, "the beneficiation of our mineral resources is key". Van Zyl adds that, for example, South Africa uses its lead resources optimally in the production of car batteries. However, it does not use iron-ore, locally produced resin, or copper in the

Closure of any local assembly plant 'a disaster' – Van Zyl

In March 2015, Toyota South Africa Motors president and CEO Dr Johan van Zyl, who is also the president of the National Association of Automobile Manufacturers of South Africa, noted that the closure of any vehicle manufacturer's operations in South Africa would be a "total disaster".

He stated that South Africa's automotive manufacturing industry was "very much like" the industry in Australia, which was set to close down by 2018, owing to decreased government support, rising costs and shrinking volumes.

"We can't lose anyone. If one [manufacturer] leaves it would have a domino effect".

Van Zyl contended that it would be impossible to sustain the South African component supplier base, should vehicle production volumes deteriorate, owing to the departure of a manufacturer.

"Slowly, but surely, things will just die."

While vehicle manufacturers do not use the same wiring harness, for example, the number of manufacturers in South Africa ensure sufficient shared volume for a wiring-harness producer to set up shop locally.

Van Zyl emphasised that the closure of any local plant would not result in the remaining vehicle manufacturers gaining market share, as had been hinted at by some market commentators.

Source: *Engineering News*

same manner. To encourage this, it is necessary to sell and build more cars locally, and to invest in, and develop the skills and technology base needed to increase the local-parts content of vehicles built in South Africa. This, of course, requires reliable electricity supply and a stable labour force.

While South Africa is facing major challenges to its competitiveness, other African countries are increasingly welcoming investors. General Motors Africa president Mario Spangenberg has noted that these countries are working hard to become more investor friendly, and South Africa has to take note of this.

Nigeria is the first African country outside South Africa to produce a local vehicle- manufacturing plan, with Nissan becoming the first major manufacturer to build a car in that country, following the announcement of the Nigeria Automotive Policy. Ford Motor Company is also mulling vehicle assembly in Nigeria and is in talks with the Nigerian government about the content of its policy. Toyota has indicated that it will study the economic merits of manufacturing vehicles in Nigeria.

Nissan and Ford have indicated that a complementary relationship could exist between South African and Nigerian automotive plants. Nissan has shown this in practice, with its South African plant providing its Nigerian plant with kits to produce the NP300 pickup vehicle. Ford has noted that manufacturing facilities elsewhere in Africa could enable South African components companies to export their products to these locations.

However, the South African automotive industry has been cautioned that to "do nothing" in response to the rise of the Nigerian automotive industry would be very problematic. B&M Analysts MD Douglas Comrie has noted that a rival assembly industry could diminish South Africa to "an island", selling vehicles only to its own population, instead of exporting vehicles to the rest of Africa.

Prospects

Toyota South Africa Motors (TSAM) marketing and sales senior VP Calvyn Hamman noted in late 2014 that "[the automotive industry is] not in a downwards cycle. The market is more nervous than negative".

TSAM's Van Zyl echoed this sentiment, noting that "this is not doom and gloom". Naamsa is relatively upbeat regarding new-vehicle sales in 2015, with the association noting in March 2015 that it expected new-vehicle sales in South Africa to register marginal growth for the year, rising to 671 000.

Naamsa expects that vehicle production in South Africa will increase to 627 500 vehicles in 2015. Passenger car production for the year is expected to rise to 320 000 units, and LCV production is expected to reach 273 000 units.

Creamer Media, based in Johannesburg, South Africa, publishes occasional Research Briefs to supplement the information contained in the Research Reports available on the Research Channel Africa. The briefs are intended for use by subscribers to the Research Channel Africa, and are not to be reproduced or published for any other purpose. The information contained in this brief is believed to be reliable, but no warranty is made as to its accuracy.

This brief was compiled by Shona Kohler – Research Associate.

Creamer Media (Pty) Ltd
Tel +27 11 622 3744 | fax: +27 11 622 9350 | email: subscriptions@creamermedia.co.za