SMEs and Global Value Chains in the South African Auto Sector

*Experiences from firms in KwaZulu-Natal Province, South Africa**

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Auto production in South Africa

1970s & 1980s

Import substitution provided protected environment for expanding domestic vehicle production

Early 1990s

Trade liberalisation starts to increase competitive pressures and import competition grows

Mid 1990s – to early 2000s

Industry and government re-design policy response to facilitate OEM and supplier shift from domestic market to export focus. FDI flows in and exports increase.

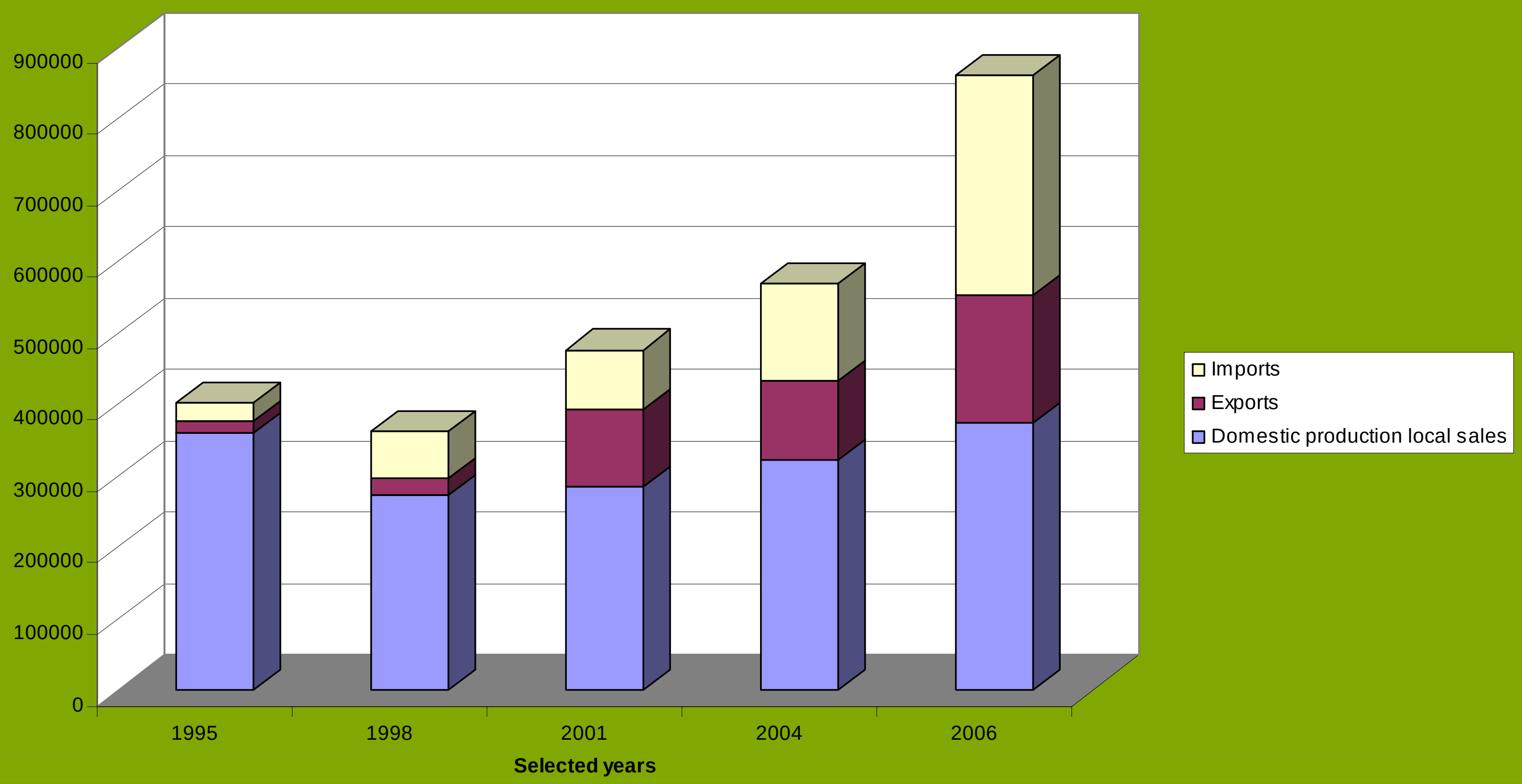
Mid 2000s

Accelerated global integration by domestic OEMs responding to strategic pressures in European producers and markets and supported by strong domestic demand

Auto production and imports in SA

- SA's auto industry is now connected with the global arena:
  - Since 1995 exports experienced a 9-fold increase from R4.2 to R39.2 bn in 2004
  - SA's share of global auto production was 0.61% in 2000 and grew to 0.79% in 2006
  - Total vehicle production in 2006 was 621 900 units – more than double the units produced in 1999

Combined Car and LCV figures (domestic production local sales, exports and imports)



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SMEs in South Africa's auto sector

- Prior to the restructuring of the early 1990s SA SME suppliers were:
  - Diversified operations supplying the auto sector as just one of their markets
  - Relatively responsive in a context of multiple short order runs
  - Producing products of low value and low technical specifications
  - Able to work directly with OEM purchasing and engineering functions at the South African plants
  - Operating licensed technology - much of it quite outdated
  - Reliant on personal and relatively informal trust relations rather than formal contracts
  - Often kept in the dark about OEMs strategy and price was the dominant aspect in many procurement decisions
  - Weak performers in relation to international benchmarks

SMEs in South Africa's auto sector

- Since the early 1990s SME suppliers have:
  - Needed to restructure their relationships with domestic OEMs who have in-turn slotted in into global supply relationships
  - Acquired complex standard and quality certifications as qualifying criteria for contracts
  - Either had to forgo the automotive market or to remain part of it:
    - As an aftermarket producer for models being phased out
    - As scaled up volume suppliers of components to the OEMs or to their suppliers
  - Required major capital investment, re-skilling and re-organisation of production systems to maintain a foothold in automotive supply
  - Participated in emerging networks of collaboration, partially supported by government, between SME suppliers and the OEMs to deal with common problems
  - And have been supported by the Government's Motor Industry Development Programme (MIDP) which has created some mutual dependence between OEMs and SME suppliers and catalysed some level of collaborative restructuring

What was SA's SME policy response?

- South Africa has sought to develop industrial policy and SME support systems favourable to:
  - reducing the bias against SMEs in the large-firm dominated economy, and
  - responding to growing international competition
- However, the bulk of SME support has been geared to relatively recently established micro-enterprises
- Some automotive component firms did qualify for some limited support such as that offered through manufacturing advisory centres
- National auto sector strategies identified the imperative of supporting the role of SMEs but tended not to translate into meaningful action as far as the SMEs were concerned
- Government at the national, provincial and local level did, for a time, support nascent regional clusters of firms engaging in networking activities
- The combination of these inclusive local collaborative processes with the industrial policy framework of the Motor Industry Development Programme, created scope for the persistence of SME supply in times of major upheaval

What can we learn from the case study?

- The case of Toyota South Africa and its SME suppliers:
  - In the late 1990s
    - TSA produced 80 000 units across seven model platforms
    - Almost exclusively for the South African market
    - It had 154 suppliers
    - 28% of suppliers to TSA could be characterised as global sourcing partners
  - In 2007
    - TSA will produce over 200 000 units mainly across two models
    - 65% of production will be for export to Europe
    - The firm will have 78 suppliers (to be reduced in the next few years to 62)
    - 82% of suppliers which will be what TSA refers to as global sourcing partners
  - Global sourcing had seen South African costs for the production of the Corolla reduced by 32% in the past 5 years
  - Between 2003 and 2006 the proportion of supply into TSA from suppliers not party to global sourcing arrangements dropped from 41% of total sourcing to 18%
  - The value of local purchasing has increased in this period from R2.3 billion to R5.4 billion. Today 70% of the Hilux is sourced locally up from 60% five years ago.

SMEs in South Africa's auto sector

- Some reflections by the SMEs on GVC participation:
  - Positive
    - Improved growth potential for firms on basis of increased volume orders allowing for scaling up
    - Investment and technical support
    - Access to knowledge networks of intermediary supplier firms
    - Greater strategic engagement on new model platforms
  - Negative
    - Threat to risk-diversifying non-auto activities – the need to specialise
    - Profit margins shrinking despite adoption of required standards
    - Inability to leverage many auto-supply systems and standards to other markets (no scope to recover investment through increased premiums)
    - Uncertainty about character of MNC suppliers acting as intermediaries with OEMs

Issues requiring policy consideration

- Supporting improved access of SMEs to GVCs must be combined with enhancing benefits to SME firms. This requires the examining of:
  - Global trade compacts, investment protocols and industrial policy frameworks
  - Continuous upgrading support for firms around manufacturing performance benchmarks (quality, delivery reliability, etc)
- Countries need to continue to attend to basics of infrastructure quality, services costs and other operating environment factors
  - Failure to address these weakens the country links to chains of production
- The importance of physical proximity for local suppliers is being challenged by the growing importance of networked supply at key GVC nodal points – often via first tier suppliers …
  - Therefore SME support frameworks need to accommodate globalisation of firms and be flexible in relation to new geographies of firm activities
- SMEs also continue to emphasise enhanced local networking with OEMs and their first and second tier follow suppliers
- Support for quality benchmarking has been critical to South African auto SMEs

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