

JAPAN INTERNATIONAL COOPERATION AGENCY (JICA)

DEPARTMENT OF TRADE AND INDUSTRY (DTI),
THE REPUBLIC OF SOUTH AFRICA

DEPARTMENT OF ECONOMIC DEVELOPMENT AND TOURISM (DEDT),
KWAZULU-NATAL PROVINCE

**STUDY
ON
DEVELOPMENT OF SMALL AND MEDIUM ENTERPRISES
IN
KWAZULU-NATAL PROVINCE
THE REPUBLIC OF SOUTH AFRICA**

(SUMMARY)

MARCH 2002

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Abbreviations

ABET	Adult Basic Education and Training
AIDC	Automotive Industry Development Centre
ANC	African National Congress
BEBP	Bureau of Economic and Policy Analysis, DTI
CBU	Completely Built-Up
CKD	Completely Knocked Down
COD	Cost, quality, and delivery
CSBP	Centre for Small Business Promotion, DTI
CSIR	Council for Scientific and Industrial Research
DEDT	Department of Economic Development and Tourism (KwaZulu-Natal Province)
DTI	Department of Trade and Industries
DUMAC	Durban Manufacturing Advisory Centre
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross National Products
GEAR	Growth, Employment and Redistribution Strategy
GEIS	General Export Incentive Scheme
GGP	Gross Geographical Product
IDC	Industrial Development Corporation
IEC	Import-Export Complementation Scheme
JIT	Just-in-time
JV	Joint Venture
KHULA	Khula Enterprise Finance Limited
KMI	KwaZulu-Natal Marketing Initiative
KZN	KwaZulu-Natal (Province)
LBSC	Local Business Service Centre
LC	Local contents
LCP	Local Contents Program
LCR	Local Contents Regulations
MAC	Manufacturing Advisory Centre
MERSETA	Metal, Engineering and Related Industrial Sector Educational Training Authority
MIDP	Motor Industry Development Programme
NAACAM	National Association of Automotive Component and Allied Manufacturers
NAAMSA	National Association of Automotive Manufacturers of South Africa
NGO	Non-Governmental Organization
NPI	National Productivity Institute
NQF	National Qualification Framework
NSDS	The National Skills Development Strategy
NTSIKA	Ntsika Enterprise Promotion Agency
OEM	Original Equipment Manufacturer
OJT	On the job training
PDI	Previously Disadvantaged Individual

RDP	Reconstruction and Development Programme
REM	Replacement Equipment Manufacturing
RFI	Retail Financial Intermediary
SABS	South African Bureau of Standards
SADC	Southern African Development Community
SAQA	South African Qualification Authority
SETA	Sector Educational Training Authority
SME(s)	Small and medium enterprise(s)
SMME(s)	Small, medium and microenterprises
SPF	Service Providers Forum
Stats SA	Statistics South Africa
TAC	Tender Advice Centre

Table of Contents

Executive Summary

Summary

I	General Outline of the Study and Organization of the Report	S-1
1	Background, Objective and Scope of the Study	S-1
2	General Outline of the Study and Organization of the Final Report	S-4
II	Present Situation and Analysis.....	S-5
1	Socioeconomic Conditions in South Africa and KwaZulu-Natal, and Economic and Industrial Development Plans.....	S-5
2	The Manufacturing Sector; Machinery Industries, and Their Supporting Industries in South Africa and KwaZulu-Natal Province	S-11
3	Automotive and Automotive Parts Industry in South Africa and KwaZulu- Natal Province.....	S-15
4	SMEs in South Africa and KwaZulu-Natal Province.....	S-44
5	SME Promotion Policies, Programs, Institutions, and Activities	S-49
III	Conclusion and Recommendations.....	S-60
1	Conclusion	S-60
1.1	Rationale and Need for SME Promotion in KwaZulu-Natal Province.....	S-60
1.2	SME Promotion Policy.....	S-60
1.3	Institutional Setup for SME Promotion.....	S-66
2	Master Plan for SME Promotion in KwaZulu-Natal Province.....	S-68
2.1	Direction and Strategic Goal of SME Promotion	S-68
2.2	Policies and Measures Related to SME Promotion in General	S-71
2.3	Policies and Measures for Upgrading of Supporting Industries for the Machinery Industry.....	S-74
2.4	Policies and Measures for Promotion of PDI Enterprises	S-82
2.5	Policies and Measures for Development of the Supporting Environment for SMEs	S-88
2.6	Implementation Plan Proposal.....	S-92

3 Details of Action Plans S-94

 Strategic Goal 1: Upgrading of Supporting Industries for the Machinery
 Industry S-94

 Strategic Goal 2: Promotion of PDI Enterprises S-99

 Strategic Goal 3: Improvement of the Supporting Environment for SMEs S-99

Executive Summary

1 Direction and Strategic Goal of SME Promotion

Direction of SME promotion

On the basis of analysis of the current status of SMEs, the role of SMEs in socio-economic and industrial development, the direction of SME promotion is recommended as follows:

- To enable SMEs to play their expected social and economic roles
 - To make a contribution to improvement of competitiveness of industry in the country
 - To correct social and economic disparities through improved distribution of economic effects through SMEs' activities
- To assist SMEs in coping with their special, difficult situation
- To promote business startups by PDI

(1) To enable SMEs to play their expected social and economic roles

Promotion of SMEs in South Africa and KwaZulu-Natal Province is recommended firstly to undertake from the standpoint of enabling them to play the following social and economic roles that they are expected to fulfill.

1) To contribute to improvement of competitiveness of industry in the country

SMEs have a potential to serve as a major engine driving industrial diversification because they can be easily established in diverse fields. Also, they can be agile and creative enough to develop and provide products and services that large corporations cannot provide. Moreover, they are flexible, enabling them to meet highly customized production requirements, if the circumstances permit. Thus, improved competitiveness of SMEs will help develop and maintain the multi-tier industrial structure in which SMEs and large corporations supplement each other. In this way, the promotion of SMEs is justified for the sake of enabling them to contribute to raising international competitiveness of industry on the whole.

2) To correct social and economic disparities through improved distribution of economic effects through SMEs' activities

During the years apartheid was enforced, South Africa developed significant social

and economic disparities, which continue to exist, especially in the form of mass unemployment. This is a major problem that cannot be neglected in the country's social and economic development process. As SMEs generally use easily accessible technologies, and a high degree of manual work, they are inherently suitable for small scale production, are labor intensive in nature and have relatively large job creation effects. Also, SMEs can be easily established in response to business opportunities and in many geographic areas because of their small service area, so that they can contribute greatly to amelioration of regional and income disparities. It is therefore recommended to encourage the establishment of SMEs for the purpose of utilizing their potential power to equalize throughout the population the benefit of economic activities.

(2) To assist SMEs in coping with the difficult situation

Many SMEs are not endowed with managerial resources that maximize their strengths, and hence fail to take advantage of their potential. As a result, they are weak in resistance to competitive pressure from foreign companies under the government policy to promote liberalization of trade and investment and face many difficulties. If this problem is left unsolved, industrial diversification will be impeded, tending to increase reliance on imports and to erode the competitiveness of industry. Furthermore, under such conditions SMEs will be less able to absorb labor, and the jobless rate will rise. Clearly the problem cannot be mitigated or solved through the market mechanism alone, because SMEs are in a weak position because of having much smaller capital and weaker organization than large corporations. Thus, promotion of SMEs is recommended to assist them in overcoming problems and growing on a sustainable basis.

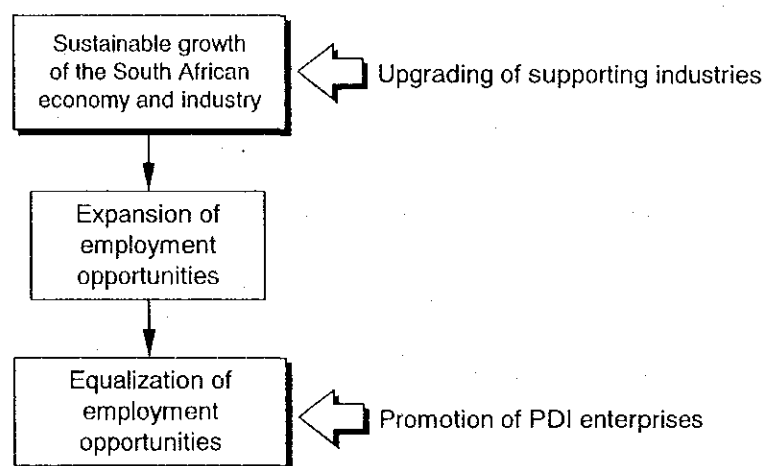
(3) To promote business startups by PDI

In South Africa, there is a clear difference in SME ownership among major population groups, which has been created by the historical racial discrimination policy. This most important social and economic problem can be resolved to a substantial extent by enabling SMEs to play a crucial role by creating employment opportunities in areas where the PDI population is high. Nevertheless, the problem should not be treated within a general framework of public support for SMEs' business startup alone. As the low rate of business startups by PDI is a product of various factors that are based on the long history and its aftermath, it cannot be simply improved by focusing on a single issue. In this sense, one of the several goals of SME promotion efforts should be directly focused on PDI's business startup.

“Reduction of unemployment” and “correction of racial inequality in employment” are

the most important challenges for social and economic development efforts in South Africa. To achieve these goals, employment opportunities must first be expanded, followed by equalization of expanded opportunities among all population groups.

Accordingly, in promotion of SMEs, two major indispensable goals should be tackled; i.e., the improvement of competitiveness of SMEs that are expected to serve as the foundation for “sustainable growth of the South African economy and industry” and equal distribution of economic benefits obtained from the resultant economic growth among all population groups.



As stated in the National Strategy for Small Business Development, these goals have been treated as inseparable to each other under the theme “promotion of SMEs.” However, these two goals are by no means suitable for every company, and rather, each should be established for different groups of companies from another. Accordingly, public policy designed to achieve each goal necessarily differs from each other in terms of its focal point on policy element, i.e., industrial policy, SME policy or social policy. As each goal has an important bearing on the future course of industrial and economic development in the country - with promotion of SMEs as core - programs to achieve each goal should be planned and implemented by taking into account the above differences among the goals.

Strategic goal

On the basis of the above discussion, the following strategic goals for promotion of SMEs in KwaZulu-Natal Province are recommended.

Strategic Goal of SME Promotion

- Promotion of upgrading of automotive parts manufacturers
To contribute to sustainable growth of the South African economy.
- Promotion of PDI enterprises
To promote equalization of economic benefits among different population groups.
- Development of the business environment to foster and support SMEs
To develop the environment where SMEs have a level playing field relative to large companies in a wide range of areas.

A set of policies and programs is recommended, as shown in Figure 1.

2 Policies and Measures Related to SME Promotion in General

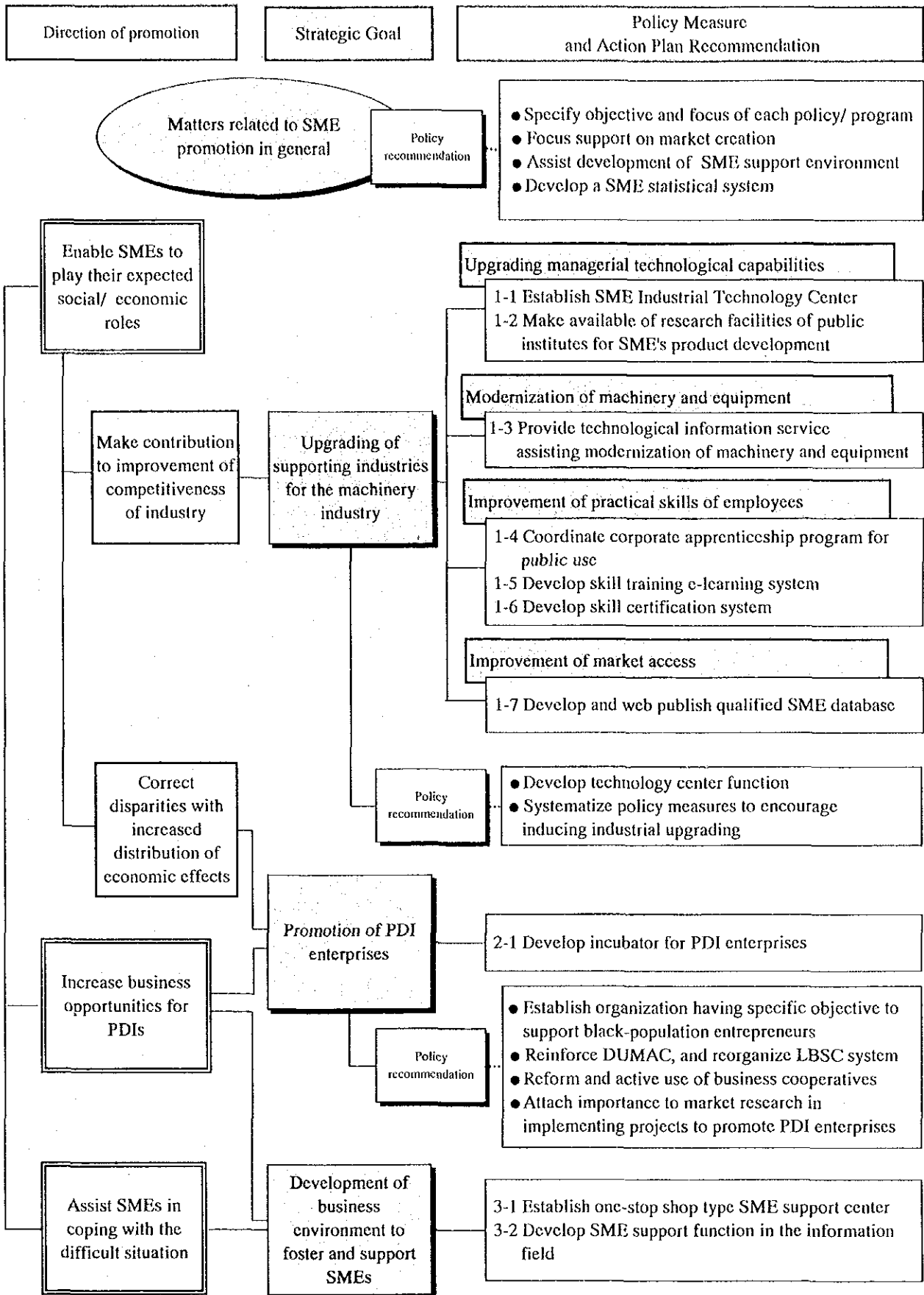
Recommendation 1: To specify the objective and focus of each policy and program

Major issues related to SMEs vary according to the target SMEs. This implies that each promotion policy and program is established by defining its objective and focus clearly.

Recommendation 2: To focus on support in the area of market creation

Government policy for SME promotion should focus on creation and improvement of the environment to foster SMEs through the creation of markets for SMEs, the development and strengthening of managerial and technological capabilities, and provision of a credit and loan system accessible to SMEs. In particular, support for market creation should be emphasized. A primary example is found in the use of government procurement projects that currently favor procurement from SMEs. Implementation of economic development projects targeting creation of projects dedicated for SMEs is also effective. Affirmative action by private companies is another example of creating business opportunities for SMEs.

Figure 1 Overall System of SME Development Master Plan



Recommendation 3: Need for further financial assistance of the Government to the development of the environment to support SMEs

To develop the environment to support SME promotion (as discussed below), continued financial assistance by the government is called for.

Particularly, for the establishment and operation of the following plans, the financial support of the Government is recommended:

- 1) To provide low-interest loans or grants-in-aid for interest payment for equipment purchase or R&D projects as part of the financial program for upgrading of automotive parts manufacturers; and
- 2) To provide subsidies for qualified SMEs to cover user charges or technical fees under the support program implemented by the SME Production Technology Center.

Raising initial investment funds required to build the environment to support SMEs is the most difficult task for implementing bodies, especially in the case of public projects. The government should therefore play a leading role by providing financial assistance for that purpose, especially by the provision of initial funds (or loans as the case may be) for the development of a system to support information access, market access, and the development of a management and technology support system.

Recommendation 4: Development of a statistical system covering SMEs

To ensure availability of appropriate statistical data on SMEs, the actions should be taken on an urgent basis.

3 Policies and Measures for Upgrading of Supporting Industries for the Machinery Industry

Upgrading of automotive parts manufacturers in the broad sense should be promoted in the following four areas: 1) improvement of managerial and technological capabilities; 2) modernization of production machinery and equipment; 3) upgrading of workers' skills; and 4) improvement of market access (Figure 2).

A proposed set of policy measures and action plans required to accomplish the strategic goal is summarized in Table 1.

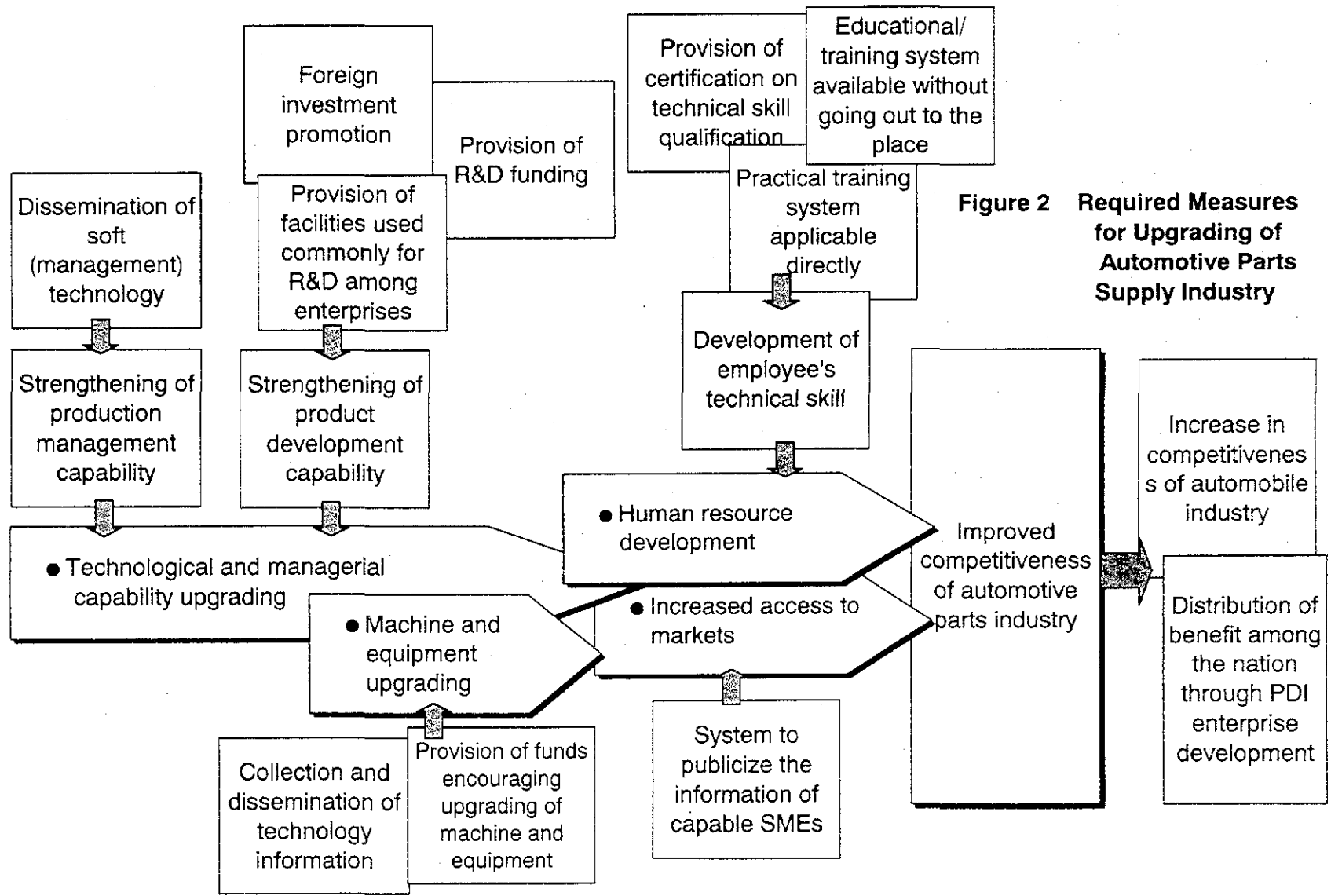


Figure 2 Required Measures for Upgrading of Automotive Parts Supply Industry

**Table 1 Upgrading of Supporting Industries for the Machinery Industry
(Mainly focus on automotive parts and related industry)**

Requirements	Recommended policy measures and action plans	Current status/relevant policy measures	
Technological and managerial capability upgrading	Production management technology		
	Production management technology, process technology, and production technology	<p>R-1: Development of technology center function (as the core for technological information in the province)</p> <p>A 1-1: Establishment of SME Industrial Technology Center for dissemination of production management technology mainly through field guidance</p>	<p>AIDC: remote location from KZN. Expensive service fee. <i>Work Place Challenge program: Production management technology is not included.</i> DUMAC Program: Insufficient experience in automotive parts manufacturing technologies.</p>
	Product development capability		
	Advanced technology		<p>Encouragement of foreign direct investment Policy to liberalize investment</p>
	Facility and equipment for R&D	<p>A 1-2: Open-use of testing and research facility of public institutes to encourage and assist R&D activity of SME</p>	Contract research program (CSIR)
Investment on R&D	<p>R-2: Systemized policy measures to encourage and help induce industrial modernization</p>	<p>SMEDP Program (by DTI): Grant on general investment. Applicable only to newly started projects. Khula: General-purpose loan programs</p>	
Machine and equipment upgrading	Technological information	<p>A 1-3: Provision of technical information to assist upgrading machine and equipment</p>	
		<p>Development of technology center function</p> <p>R-1: (as the core for technological information in the province)</p>	
	Funds for procurement of machine and equipment	<p>R-2: Systemized policy measures to encourage and help induce industrial modernization</p>	<p>SMEDP Program (by DTI): Grant on general investment. Applicable only to newly started projects. Khula: General-purpose loan programs</p>

Requirements		Recommended policy measures and action plans	Current status/relevant policy measures
Development of employee's technical skill	Practical training system applicable directly	A 1-4: Use of idle portion of corporate apprenticeship program for public training purpose	New educational and training system under NQF, prepared by MERSETA Many vocational training facilities, but lack of practical skill training (particularly for SME employees, and unemployed)
		A 1-5: Development of e-learning system using computer network, for comprehensive skill training of employees	
	Public certified system of education and training	A 1-6: Development of public certification system of skill	New educational and training system under NQF, prepared by MERSETA
Increased access to markets	Assisting measures to increase market access	A 1-7: Development and web publication of database of qualified SME	Preferential market access: EU, SADC, etc. SME Database developed and operated by DEDT: need for marketing function.

Notes: A: Action plan, R: Policy recommendation

In addition to the action plan proposals, following are the policy recommendations related to promotion of parts supply industry upgrading.

Recommendation 1: Need for a industrial technology center function that provides information on modernization and upgrading of management and technical capabilities, and that serves as the basis of promoting collaborative efforts of the public and private sectors to develop and share technical guidelines

It is important to have a mechanism to provide guidelines and suggestions as to how SMEs should work with equipment modernization. There is no organization that provides such information now and SMEs have to act without any guidelines. Thus, it is recommended to establish a function to provide SMEs with such technical guidelines.

Recommendation 2: Need for systematized policy measures to encourage and induce upgrading of the automotive parts industry

The current SME finance assistance programs are mainly for general purpose loan programs. There is a need to prepare a finance assistance program having the clear objective to contribute to encouraging SMEs for essential target of industrial policy and SME promotion policy.

4 Policies and Measures for Promotion of PDI Enterprises

Difficulties involved in startup and development of PDI enterprises can be summarized as follows, although detailed conditions vary among different business fields.

- 1) Difficulty in finding customers and markets;
- 2) For startups: Lack of business information, managerial knowledge and experience required, and difficulty in raising funds for initial investment and operation; and
- 3) For viable business operation: Difficulty in securing management skills, technology, and other skills required, and difficulty in obtaining credit and loans.

Thus, difficulties facing PDI enterprises are diverse in nature and extent. Meanwhile, a large number of programs to support PDI enterprises have been implemented but have failed to produce significant results. Here, the recommendation is to provide integrated measures for PDI enterprises and potential entrepreneurs, to meet the diversified requirements.

Figure 3 shows the factors which may contribute to promotion of PDI enterprises or potential entrepreneurs.

Table 2 summarizes proposed policy measures and action plans for attaining the goal.

In addition to the action plan proposal, following are the policy recommendations for the objective of promoting PDI enterprises.

Recommendation 1: Establishment of an organization having a specific objective of supporting black-population entrepreneurs

Organizations currently involved in SME promotion appear to give priority to support for PDI enterprises. However, actual programs do not have well-defined target SMEs in many cases. Furthermore, support for PDI enterprises is provided under the same program and by the same implementation organization that provides support for black-population entrepreneurs. As a result, urgency for black-population entrepreneur support is not effectively reflected in the programs, which should be the multi-faceted support.

Recommendation 2: Reinforcement of DUMAC and reorganization of LBSC

It is recommended to expand advisory functions of DUMAC to extend coverage beyond the manufacturing sector and include managerial support.

As for LBSCs, it is recommended to treat all LBSCs as an integrated organization and rearrange them in consideration of overall operating efficiency.

Recommendation 3: Reform and active use of business cooperatives

It is recommended to recognize the potential value of business cooperatives as the place for black-population entrepreneurs (or potential entrepreneurs) to acquire the knowledge and experience required for a business startup, viable operation, and expansion, and to use them effectively for promotion of black-owned enterprises by creating or modifying the legal framework and implementing a support program focusing on business cooperatives.

In addition, the proposal is made for the procurement of enterprises, which have difficulty in finding the successor of the current owners, for continued operation by PDI enterprise or business cooperative. The plan is to provide the PDI entrepreneurs with the business basis, succeeding the employees and customers.

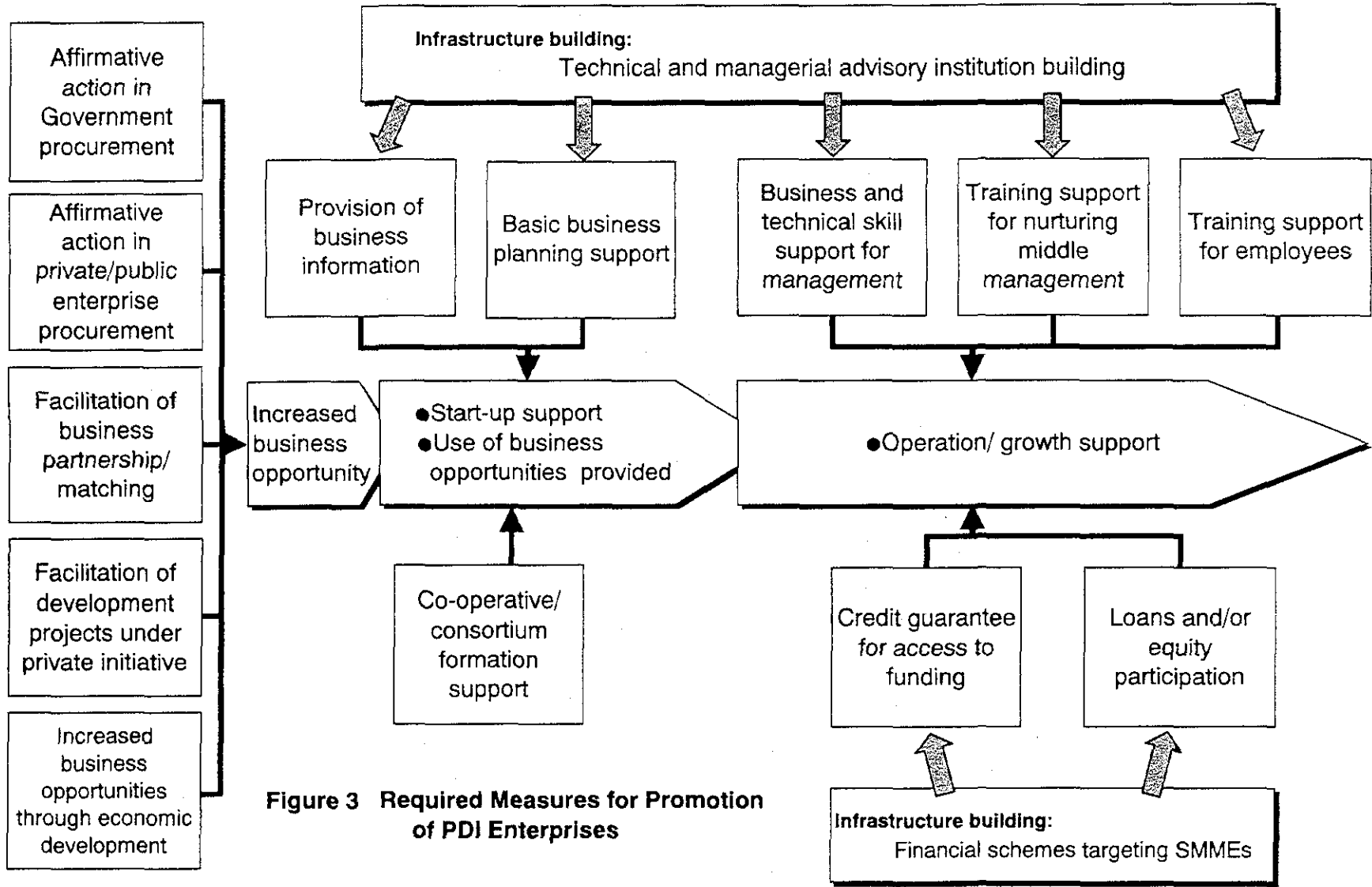


Figure 3 Required Measures for Promotion of PDI Enterprises

Table 2 Promotion of PDI Enterprises

Requirements	Recommended policy measures and action plans	Current status/relevant policy measures
Creation of business opportunities	<p>R-4: Attach importance to market research in implementing projects to promote PDI enterprises</p>	<p>Preferential treatment in Government procurement</p> <p>Affirmative actions by private companies</p>
Support for business startup and operation	<p>Establishment of incubator for PDI enterprise promotion</p> <p>A 2-1: (To provide integrated assistance to PDI enterprises)</p>	<p>Following assistance programs in respective field</p> <ul style="list-style-type: none"> - Training program by LBSC - Tender Advice Center program - Loan and credit guarantee scheme by Khula - The Thuso Mentorship program
	<p>R-1: Establishment of an organization having a specific objective of supporting black-population entrepreneurs</p>	<p>DEDT, LBSC, etc.</p>
	<p>R-2: Reinforcement of DUMAC and reorganization of LBSC</p>	
	<p>R-3: Reform and active use of business cooperatives</p>	

Notes: A: Action plan, R: Policy recommendation

Recommendation 4: Attach importance to market research and identification in implementing projects to promote PDI enterprises

Many projects designed to support business startups are conceived to develop a product or create a service that can be sold on the market. However, they do not give thought to marketing in many cases – what takes to actually find a customer. This is a major reason why many projects cannot be viable once support from a donor organization, be it domestic or foreign, is terminated. Any project that involves development of a product or service as a tangible outcome will not succeed unless the product is developed to meet the customer needs, which must be identified from market research and analysis.

A workable approach is therefore to conceive a project that serves as a core project to induce other projects or economic activities under joint planning (and possible investment)¹ by the government and private sectors. Then, projects that support SMEs are introduced around the core project, receiving a trickle-down from the core project.

Another approach is to procure enterprises, which have difficulty in finding the successor of present owners, and hand it over to PDI entrepreneurs. Thus, they can leverage on experienced employees and current customers.

5 Policies and Measures for Development of the Supporting Environment for SMEs

Support functions, which are needed for SME support, can be classified into the following four categories:

- 1) Management and technical support;
- 2) Information gathering and dissemination;
- 3) Financial support; and
- 4) Human resource development support.

Here, two action plans are proposed to cover the information gathering and dissemination function (Table 3).

¹ A typical example is a tourism development project in a specific area.

Table 3 Development of Supporting Environment for SME

Requirements	Recommended policy measures and action plans	Current status/relevant policy measures
Management and technical support	A 1-1: Establishment of SME Industrial Technology Center for dissemination of production management technology mainly through field guidance	Following organizations are available, but competitiveness development is not regarded as their major theme. - DUMAC - LBSC
Information gathering and dissemination	A 3-1: Establishment of One-stop shop type SME support center, with staff from relevant organizations	Following organization is available, but main focus is placed on PDI enterprise promotion. - LBSC
	A 3-2: Development of information center function	Following is available, but competitiveness development is not regarded as their major theme. - BRAIN
Financial support	R-2: Systemized policy measures to encourage and help induce industrial modernization	General loan program by Khula · SMEDP program (by DTI)
Human resource development support	A 1-4: Use of idle portion of corporate apprenticeship program for public training purpose	New educational and training system under NQF, prepared by MERSETA Many vocational training facilities, but lack of practical skill training (particularly for SME employees, and unemployed)
	A 1-5: Development of e-learning system using computer network, for comprehensive skill training of employees	
	A 1-6: Development of public certification system of skill	New educational and training system under NQF, prepared by MERSETA

Notes: A: Action plan, R: Policy recommendation

6 Details of Action Plans

Strategic Goal 1: Upgrading of Supporting Industries for the Machinery Industry

1-1 Establishment of SME Industrial Technology Center

To reinforce international competitiveness of the automobile and automotive parts industries, it is essential to establish a production and distribution system on the parts and components supplier side, which is integrated with the automobile assembly system. This action plan proposes the establishment of an Industrial Technology Center to disseminate three key technology elements to develop the integrated production chain, i.e., production management technology, process technology, and production technology.

Dissemination of information should preferably be conducted in the form of field (shop floor) guidance, rather than lectures. Thus, the center will primarily provide field guidance service, plus some educational functions where a classroom venue is appropriate.

In the initial stage, the center will serve companies engaged in production of automotive parts in order to meet their urgent needs. Then, the scope of service will gradually be expanded to other industries and companies that require these key technology capabilities.

1-2 Provision of an Open-type Testing and Research Center for Supporting Improvement of Automotive Parts Development Capabilities

The action plan is to establish a testing and research facility, which will provide equipment and instruments that must be used by but are not owned by automotive parts suppliers, to conduct testing and research activities for product improvement and other purposes.

The center's function should be established with the following scope as the first step, namely:

- To create a system that collects information on testing and R&D equipment owned by laboratories, research institutes and universities, and on their availability for public use, and to provide this information to individual companies upon request. In South Africa, a large number of networks have been created to establish this

type of collaboration in sharing resources, and the networked system can easily be established.

As the service needs are expected to emerge a few years later, the first step should be focused only on the scope described in the above.

In the future, the center will be able to help joint R&D projects of local companies and public organizations (including companies in different fields) by providing a laboratory space and equipment, while providing technical advice on joint projects, including general arrangements.

1-3 Dissemination of Information for Equipment Modernization and Upgrading for SMEs

The plan is designed to provide supporting industries in the machinery sector with information on the latest production machinery and equipment through computer networks.

The plan will involve recruiting the following organizations and companies as information sources to ensure periodical renewal of information published on the Web site: CSIR, SABS, NPI, universities, NAAMSA, NAACAM and their member companies, trade associations related to industrial machinery and member companies, and foreign companies in the related industries.

1-4 Use of the Unused Portion of Corporate Apprenticeship Program for Public Training Purposes

Various companies operate an apprenticeship program to train their employees, but there are often vacancies in some programs because of the small number of new employees. The plan will prepare a system, which is designed to provide training employees of SMEs by using vacancies in the apprenticeship program, with cooperation of relevant enterprises, thereby to provide them with an opportunity to receive systematic vocational training.

To initiate the plan, companies that have an apprenticeship program and those wishing to send their employees to participate in such program will be invited to form an ad-hoc organization to arrange use of vacancies in the program. Then, vacancy information will be obtained from members to arrange, through the intermediation process, apprenticeship training for those who wish to use them.

1-5 Development of the “E-Learning System” for Vocational Training Using Computer Networks

The objective is to build an “e-learning system” for vocational training using computer networks for the purpose of providing systematic vocational education and training for company employees or other persons.

The proposed system allows workers to receive systematic vocational education and training in the course of or after everyday work without leaving the workplace. Each company participating in the program will provide computers, space and time for employees, who receive education and training at their own pace and can obtain skill certification after completion.

1-6 Development of the Skill Certification System

The objective is to certify workers’ skills according to a specific standard and issue a certification. This will provide incentive for workers to learn various skills and establish the confidence of industry in vocational training. The action plan aims to build infrastructure for the certification system, including the establishment of certification methods and standards, and the securing of equipment required for skill certification and examiners.

1-7 Development and Web Publication of the Database on Qualified SMEs

The objective is to build a database containing automotive suppliers who are qualified under specific criteria and publish it on a Web site that can be accessed by potential customers for search.

The database will store vital data on each supplier that allow a potential customer to evaluate it accurately, including human resources, production machinery and equipment, and reputation or rating by existing customers. It will also be hyperlinked to the supplier’s Web site for advertisement purposes.

Strategic Goal 2: Promotion of PDI Enterprises

2-1 Incubator for PDI Enterprises (or PDI Business Cooperatives)

The plan is to provide proposed PDI enterprises (or PDI business cooperatives) or new PDI enterprises with a workspace and/or PC and other business machinery at a low cost, and provide comprehensive support required for smooth business startup and operation, including financial management, accounting, business consultation, and technical assistance.

The action plan design calls for construction of an incubator facility to provide the above support and assistance and develop an official support system, while facilitating collective operation of PDI enterprises in the incubator facility in the areas of physical distribution, sales and marketing.

Strategic Goal 3: Improvement of the supporting environment for SMEs

3-1 Establishment of the One-stop Shop Type SME Support Center

The objective is to make diverse SME support programs readily accessible to recipients and facilitate their use. Hence, the project will establish a center that combines related organizations for one-stop shopping service, to thereby promote active use of SME promotion programs.

It is important to appoint SME advisors in each department and organization responsible for SME promotion. The advisors should be senior personnel who have sufficient knowledge and experience in programs implemented by the department or organization they belong to and who can provide appropriate advice on use of such programs by SMEs.

3-2 Development of the Information-related SME Support Function

The objective is to establish an information center to collect and publish information related to SME promotion, focusing on improvement of competitiveness, and development of new businesses and markets. An information system will be developed and operated to serve as the nucleus of the regional SME information center to collect, compile, update and publish information useful for SME promotion purposes, including the following:

- 1) Technical information including processing, production management, process technology, new materials, and environmental preservation;
- 2) Results of relevant research and study, and case histories on technical guidance and consultation; and
- 3) Information on the business needs and seeds (including technologies and products in various industries); and
- 4) Software information (business application programs).

I General Outline of the Study and Organization of the Report

1 Background, Objective and Scope of the Study

Background of the Study

In 1994, South Africa entered a new era as the national reconciliation government was established after the first general election with participation by all population groups. The new government promptly launched new social and economic policies. At present, major policy objectives are to reinforce economic growth and to ensure social and economic development that helps achieve fair distribution of income and opportunities.

Under these circumstances, promotion of small and medium enterprises (SMEs) has significance from two viewpoints. Firstly, it helps build supporting industries having competitiveness in order to form a strong supplier base that can help ensure that large manufacturers improve and maintain competitiveness. Secondly, SME promotion is an effective means to correct economic disparities among different population groups, especially by focusing on job creation and income growth among those people who have been suffering from unfavorable conditions (PDIs).

Despite such efforts, little by way of visible results has been achieved in the area of job creation through SME promotion.

The Sequences of the Study

Against the background described above, JICA started to search for ways to provide assistance for South Africa in promotion of SMEs, and finally, it was confirmed that JICA would conduct a development study on SMEs with an emphasis on supporting industries.

This series of studies and discussions has led to a final decision in January 2000, to conduct the development study. In March 2000, JICA sent a preparatory study team to the country. Then in March 2001, the Scope of Work to define the content of the development study was agreed with DTI and the Department of Economic Development and Tourism (DEDT) of KZN.

Objective of the Study

Understanding the long-term objective that policy and institutional support for the SMEs to be recommended in the Study are to contribute to the reduction of unemployment in KwaZulu-Natal, the objectives of the Study are:

- 1) To formulate a SMEs development plan including concrete strategy and action plans/projects, especially for the existing and potential component suppliers to

- specific manufacturing industries (supporting industries),
- 2) To offer venues and opportunities where people in KwaZulu-Natal could share a common vision and direction and where government officials and people from the private sector could exchange their opinions and views regarding SMEs development through workshops to be organized in the course of the Study, and
 - 3) To promote the transfer of knowledge and methods to the counterpart's personnel.

Scope of the Study

The nature and scope of the study, as agreed by the two governments¹ in the Scope of Work (S/W), is outlined below.

Study items

- (1) Review of the present economic situation of the Republic of South Africa in general and KwaZulu-Natal Province in particular.
- (2) Review and analysis of current institutional arrangements for SME development, policy framework, and supporting measures available for SMEs including that offered by the private sector.
- (3) Analysis of the machine industry including the automobile and its supporting industries such as metal, plastic, and aluminum processing,² to understand the current situation and relevant development issues.
- (4) Survey on assemblers and foreign suppliers in KwaZulu-Natal, and screening and analysis of existing and potential SMEs in strategic sub-sectors through the interviews at and diagnosis of selected enterprises.
- (5) Hold workshops with participants from various organizations and enterprises in order to
 - 1) Identify existing problems and constraints which the existing and potential enterprises particularly in strategic sub-sectors are experiencing,
 - 2) Discuss the SME development plan to be drafted by the Study Team.
- (6) Formulate the promotion plan, including promotion strategy of SMEs, and the action plan/programs for existing and potential SMEs, which are supplying parts to specific manufacturing industries.

¹ Signed on March 10, 2001.

² At the start of Study, the strategic subsectors were agreed to be revised to metal pressing, other metalworking, and plastics molding.

Industries to be studied

Supporting industry for the machinery industries, which includes the automotive industry, primarily emphasizing the following industries as strategic subsectors:

1. Metal pressing
2. Other metalworking
3. Plastics molding

2 General Outline of the Study and Organization of the Final Report

General Outline of the Study

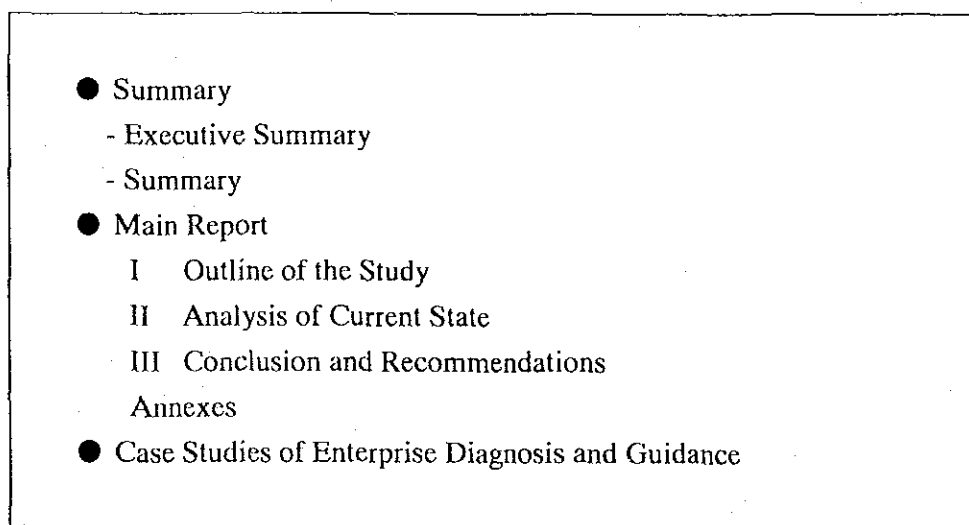
The study covers the following items.

- (1) Research and study to understand the current state of SMEs and development of SME promotion plans
 - 1) Surveys of selected enterprises to understand general profiles of SMEs and the machinery industry
 - 2) Detailed analysis of problems through enterprise diagnosis and guidance, and assessment of effectiveness of development plans to be proposed
 - 3) Delineation of problems through workshops and sector-based discussions, promotion of understanding of the SME promotion plan development process, and assessment of effectiveness of development plans to be proposed
- (2) Technology transfer to improve competitiveness of SMEs
 - 1) Transfer of knowledge and expertise to SMEs through enterprise diagnosis and seminars
 - 2) Transfer of management consulting techniques to the local counterpart and consultants through enterprise diagnosis and seminars

Organization of the Final Report

Figure I-2-1 shows the organization of the Final Report.

Figure I-2-1 Organization of Final Report



II Present Situation and Analysis

1 Socioeconomic Conditions in South Africa and KwaZulu-Natal, and Economic and Industrial Development Plans

1.1 Socioeconomic Conditions of South Africa and KwaZulu-Natal

Major socioeconomic indicators concerning South Africa and KwaZulu-Natal (KZN) are presented in Table II-1-1.

GDP amounts to R728 billion (US\$130 billion), the same level as that of Indonesia. GDP per capita is US\$3,000 on average, more or less the same level as Malaysia. However, there is a very large difference in income levels between the high income segment and the poverty segment, and there seems to be few people in the average income group. GGP in KZN amounts to R94 billion, accounting for 13% of GDP. GGP per capita is R11,000, which is equivalent to a third of that in Gauteng and is higher than that of Eastern Cape.

A major problem for South Africa is the high unemployment rate that reached 23% in 1999. The unemployment rate is highest among Africans, 29%. The situation is worse in KwaZulu-Natal, where the overall rate reaches 26%, and Africans who have an unemployment rate of 30%.

KwaZulu-Natal is second only to the province of Gauteng in terms of percentage contribution to South Africa's GDP.

The Gross Domestic Product of KwaZulu-Natal was R55 billion in 1996 with the manufacturing sector, at 36%, contributing the largest share, followed by commerce and tourism.

1.2 Economic Structure and Growth

By sector, the manufacturing sector is the largest and accounts for approximately one-fifth of South Africa's GDP, followed by finance 18%, government 15%, commerce 14%, and transportation 11%. Each sector has been growing year after year on a real basis (Table II-1-2).

**Table II-1-1 Major Social / Economic Indices of South Africa
and KZN Province**

	South Africa	KZN Province	(For reference)	
			Gauteng	Eastern Cape
Land areas (km ²)	1,219,090	92,100	17,010	169,580
Total population	40,583,573	8,417,021	7,348,423	6,302,525
African	31,127,631	6,880,652	5,147,444	5,448,495
White	4,434,697	558,182	1,702,343	330,294
Colored	3,600,446	117,951	278,692	468,532
Indian / Asian	1,045,596	790,813	161,289	19,356
Other	375,204	69,423	58,654	35,849
Population density	33.3	91.4	432.0	37.2
GDP / GGP (R mil.)	728,055	93,851	267,973	51,760
(Per capita, R)	17,940	11,150	36,467	8,213
GDP distribution (%)				
Agriculture	3.3	2.8	0.6	5.3
Mining	5.9	0.5	4.1	0.4
Manufacturing	16.6	28.8	19.4	20.2
Electricity & water	3.0	2.3	2.2	1.6
Construction	2.6	3.0	3.1	2.8
Trade	11.9	12.2	13.6	13.3
Transport	9.1	11.9	11.5	7.8
Finance	26.7	14.1	25.7	11.8
Community services	21.0	24.3	19.6	36.8
Unemployment ratio (%)	23.3	25.9	20.6	29.8

Sources: Statistics South Africa, "South African Statistics 2000"

IMF, "International Financial Statistics 2000"

WEFA, "Regional Economic Focus 1999"

Table II-1-2 Gross Domestic Product by Economic Activity (at Constant 1995 Prices) (1988 - 2000)

	1988		1989		1990		1991		1992		1993		1994		1995		1996		1997		1998		1999		2000	
	R million	%	R million	%	R million	%	R million	%	R million	%	R million	%	R million	%	R million	%	R million	%	R million	%	R million	%	R million	%	R million	%
13 Agriculture, forestry and fishing	22,283	4.7	25,559	5.3	23,735	4.9	24,795	5.2	18,036	3.9	22,366	4.7	24,125	5.0	19,317	3.9	23,950	4.6	24,313	4.6	22,539	4.2	23,304	4.2	24,200	4.3
14 Mining and quarrying	35,827	7.6	35,451	7.3	35,171	7.3	34,397	7.2	34,978	7.5	35,782	7.6	35,946	7.4	34,830	7.0	34,542	6.6	35,118	6.6	34,846	6.5	34,499	6.3	33,875	6.0
15 Manufacturing	105,851	22.4	107,828	22.2	105,405	21.9	100,590	21.1	97,291	20.9	97,114	20.6	99,706	20.5	106,180	21.2	107,648	20.7	110,249	20.7	108,447	20.2	108,282	19.7	112,198	19.8
16 Electricity, gas and water	14,350	3.0	14,881	3.1	15,141	3.1	15,436	3.2	15,520	3.3	16,133	3.4	17,069	3.5	17,408	3.5	18,403	3.5	19,206	3.6	19,317	3.6	19,688	3.6	20,598	3.6
17 Construction	16,242	3.4	17,611	3.6	17,774	3.7	16,942	3.6	15,889	3.4	14,804	3.1	15,233	3.1	15,774	3.2	16,092	3.1	16,572	3.1	16,777	3.1	16,135	2.9	15,987	2.8
18 Wholesale and retail trade, catering and accommodation	67,754	14.3	68,031	14.0	68,580	14.3	67,349	14.2	65,768	14.1	66,121	14.0	67,780	14.0	71,768	14.3	74,415	14.3	74,748	14.0	73,704	13.7	74,676	13.6	78,499	13.9
19 Transport, storage and communication	36,157	7.6	37,732	7.8	37,745	7.8	36,919	7.8	37,620	8.1	38,307	8.2	40,281	8.3	44,538	8.9	47,368	9.1	50,884	9.5	54,443	10.1	58,558	10.7	62,355	11.0
20 Financial intermediation, insurance, real estate and business services	73,172	15.5	74,546	15.4	74,720	15.5	75,875	16.0	76,199	16.4	76,580	16.2	79,378	16.3	82,162	16.4	87,668	16.8	91,454	17.1	96,602	18.0	102,721	18.7	107,679	19.0
21 General government services	73,537	15.5	75,337	15.5	76,552	15.9	78,286	16.5	79,161	17.0	79,366	16.8	80,157	16.5	80,832	16.2	82,422	15.8	82,860	15.5	82,458	15.3	81,879	14.9	80,930	14.3
22 Other services	10,521	2.2	10,728	2.2	10,880	2.3	11,035	2.3	11,198	2.4	11,341	2.4	12,420	2.6	13,690	2.7	14,210	2.7	13,971	2.6	13,902	2.6	14,186	2.6	14,517	2.6
23 Other producers	12,858	2.7	13,318	2.7	13,353	2.8	13,432	2.8	13,499	2.9	13,556	2.9	13,687	2.8	13,855	2.8	14,066	2.7	14,298	2.7	14,626	2.7	14,918	2.7	15,281	2.7
24 Gross value added at basic prices	473,121		484,728		481,077		475,697		465,159		471,670		485,782		500,354		520,785		533,673		537,662		548,846		566,119	
47 Gross domestic product per capita	15,128		15,167		14,806		14,357		13,749		13,621		13,759		13,884		14,150		14,196		13,979		13,847		n.a.	

Source: Statistics South Africa, "South African Statistics 2001"

South Africa has enjoyed a modest upturn in economic activity since late 1998. The economy experienced five quarters of progressively stronger growth with real GDP of over 4 percent (at an annualized rate) in the final quarter of 1999. Despite some adverse shocks during the first half of 2000, the pace of activity has regained momentum and, led by a healthy expansion in private investment, real GDP grew by over 3 percent in 2000 (Table II-1-3).

The ongoing liberalization of the South African financial and trade markets has exposed domestic markets to increased foreign competition. Mature industries have been restructured and many new ones have developed in reaction to the opening-up of the economy.

1.3 Economic Policy, and Economic and Industrial Development Plan

Economic policy is directed at reinforcing the economic growth that South Africa is experiencing and ensuring that social and economic development contribute to an improved distribution of income and opportunities. Some of the key areas of structural reform targeted by the Government are monetary policy, privatization, international trade and labor market reform.

Unemployment remains a serious problem in South Africa, particularly affecting school leavers and young work-seekers. Since 1994, the normally positive impact of economic growth or labor demand has been outweighed by a weakening in the capacity of the productive structure of the economy to absorb labor, while the labor supply continues to grow.

The Reconstruction and Development Program (RDP) remains the basic policy framework to achieve this objective. The Growth, Employment and Redistribution (GEAR) program is the associated macroeconomic strategy used. In order to make the *industrial strategy more explicit and accessible and to deal with changing conditions*, the Discussion Document; "Driving Competitiveness: An integrated industrial strategy for sustainable employment and growth" was drafted in May 2001.

Table II-1-3 Real Growth of GDP

Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP at Constant 1995 prices (R billion)					531.5	548.1	570.9	585.1	589.1	600.2	618.7
GDP (%)	-0.3	-1.0	-2.1	1.2	3.2	3.1	4.2	2.5	0.7	1.9	3.1

Source: 1990-1994; IMF, International Financial Statistics, 1995-2000; South African Statistics 2001.

Basic stances of the Industrial strategy

The above discussion document pointed out the following. It clearly indicates the basic stance of industrial strategy in this country.

1. With access to cheap raw materials and energy, which have been the major sources of export competitiveness in South Africa, being of declining significance, they will not be a firm foundation for a competitive position in the future.
2. Lowering the cost and increasing flexibility in relation to the unskilled and semi-skilled labor, leaving aside other considerations, will not provide a sustainable basis for the very large part of South African manufacturing industry.
3. The government is committed to the further liberalization of trade. Manufacturers will be faced with ever more competitive markets, both domestically and internationally.
4. South African manufacturing firms are generally characterized by low spending on innovation. Increasing innovation activities will be an important feature of policy.
5. There is a structural shift in the pattern of world trade away from commodity production and raw material-intensive simple manufactured goods and towards increasingly knowledge-intensive goods and services.

2 The Manufacturing Sector; Machinery Industries, and Their Supporting Industries in South Africa and KwaZulu-Natal Province

2.1 Manufacturing Sector

Manufacturing sector in South Africa

The manufacturing sector accounted for approximately 20% of the country's GDP in 1999, and is the largest industrial sector. The largest subsector in the manufacturing sector is metallic products, machinery and household appliances, accounting for approximately 25% of the total. The transportation equipment subsector, including automobiles, has an approximately 8% share³.

In terms of *industrial production by Province*, Gauteng has the largest share, 39%, followed by KZN with 20% and Western Cape with 16.5% (Table II-2-1). These states have a combined share of 75.5%.

Table II-2-1 GGP per Sector per Province

Sector	Gauteng	Western Cape	KwaZulu-Natal	Eastern Cape	Mpumalanga	North-West	Free State	Northern Province	Northern Cape
Agriculture	1,486.9	6,191.9	2,650.7	2,725.2	2,732.7	2,843.3	3,653.7	2,360.3	1,989.3
Mining	11,941.6	492.5	492.3	217.8	8,417.9	13,779.3	7,273.7	3,376.4	1,147.6
Manufacturing	51,910.4	21,928.8	27,063.0	10,431.5	11,368.8	3,583.3	4,107.2	1,506.0	741.1
Electricity & water	5,912.9	1,987.2	2,141.8	810.7	8,609.4	491.4	2,150.5	1,378.0	303.2
Construction	8,227.3	4,329.1	2,852.8	1,443.1	1,053.2	763.3	824.7	1,103.3	321.2
Trade	36,443.8	21,576.5	11,445.4	6,905.8	4,499.0	4,635.3	4,059.0	3,915.3	1,731.0
Transport	30,822.1	15,311.9	11,193.9	4,052.3	2,686.0	2,367.4	3,166.6	1,982.7	1,563.1
Finance	68,797.2	39,802.4	13,198.4	6,100.9	2,520.4	2,676.9	3,911.6	2,345.9	1,278.3
Community services	52,431.1	27,778.3	22,812.6	19,072.4	9,228.1	10,720.5	10,884.1	11,471.9	3,551.1
Total	267,973.3	139,398.6	93,850.6	51,759.7	51,115.6	41,860.6	40,031.0	29,439.7	12,625.9

Source: WEFA, Regional Economic Focus, 1999

Manufactured exports have consistently increased in importance. Exports have risen at more than double the rate of increase of the pre-1994 period and stronger export growth post-1994 has prevailed across almost all manufacturing sectors (The fastest growing sectors include chemicals, metals and metal products, machinery and motor vehicles and components. Food, clothing and footwear saw a decline in exports). Whereas in 1994, 15% of the output of the manufacturing sector was exported, in 2000 this had almost

³ Among automotive parts, plastics parts are classified in chemical products and metallic parts in metallic products, and not included in transportation equipment.

doubled to 28%.

Employment has declined steadily. Between 1994 and 1996, there was a marginal increase in employment, but over the last five years employment in manufacturing has declined by 11.5%.

Industrial sector in KwaZulu-Natal economy

The province of KwaZulu-Natal is the most manufacturing-intensive. Whereas the average proportion of GGP taken up by the manufacturing sector is 17%, 29% of KwaZulu-Natal's GGP is related to the manufacturing sector.

The sectors that were over-represented in terms of output were Textiles, clothing, leather goods; Wood & wood products, paper & paper products, publishing and printing. On the other hand, the province does not have a large capacity in terms of Electrical machinery and apparatus, and Radio, TV & communication equipment; medical, precision and optical instruments.

The two sectors with the largest output, each with slightly more than 18% of the total output, were Coke, refined petroleum products, chemicals, rubber & plastic products and Basic metals, fabricated metal products, machinery and equipment.

Within the province of KwaZulu-Natal, the sector that had the greatest number of establishments was Basic metals, fabricated metal products, machinery & equipment, accounting for almost a quarter of manufacturing establishments. Within this category, the largest component was other fabricated metal products; metalwork service activities.

Although the Basic metals, fabricated metal products, machinery and equipment had the largest number of establishments, it was only the second greatest employer, accounting only for 14.6% of total employment. The average number of employees per establishment in this category was 40.6, which is below the overall average of 64.4 employees per establishment. The largest employer was the Textiles, clothing and leather goods, which accounted for a third of total employment and employed an average of 103 employees per establishment.

During 1997/98, the province identified nine prime targets for inward investment. These are textiles, clothing, plastic products, chemicals, fabricated metal products, automotive components, wood and wood products, footwear, machinery and appliances.

2.2 Overview of Non-Automotive Machinery Industry and Its Supporting Industries

Non-automobile machinery sector

The industrial structure in South Africa has undergone major changes after the policy shift in 1994. Before that, the government intended to have within national borders all industries, in order to cope with economic sanctions. Extensive protectionist policy was adopted and all basic industries established themselves in the country.

The machinery industry was no exception to this. Manufacturers of mining equipment (to support diamond, gold and coal mining operations), sugar refinery equipment, shipbuilding and repair, automobile, and agricultural machinery emerged, together with parts industries and metal engineering. These industries established the heavy machinery and engineering industry.

Then, the policy shift in 1994 resulted in the lifting of economic sanctions, and at the same time, economic policy focused on market opening and deregulation. Many industries that were founded upon the protectionist policy were exposed to direct competition with imports and were forced to move swiftly in order to gain international competitiveness.

As a result, the machinery industry is in a process of rapid restructuring. In heavy machinery engineering and foundry industries, many companies have gone out of business.

The machinery industry in KwaZulu-Natal has been following more or less the same historical pattern as that in the country as a whole. The chamber of commerce and industry in Durban registers 65 machinery assemblers as members, of which 45 companies are classified as follows:

Agricultural machinery:	45
Hydraulic equipment:	15
Mechanical engineering:	11
Hoists, winches, and lifting equipment:	6
Boilers and heating equipment:	9

Many manufacturers in the machinery industry are capable of meeting diverse engineering service demands, but ship repairing and mechanical engineering demand is on the steady decline. While some manufacturers have successfully converted to automotive parts production, many have gone out of business.

Leading companies in the machinery industry excluding automobiles and automotive parts are Bell Equipment (agricultural machinery and construction equipment) and Defy

Appliances (household appliances).

Other than DEFY, there are several household appliance manufacturers that make small products.

Industrial subsector relating to machinery industries

South African metal industry is large, sophisticated and extremely versatile. It represents roughly a third of all manufacturing, encompassing more than 9,000 companies and employing 320,000 people.

A diverse range of products is manufactured, from stainless steel to electric toasters, catalytic converters, pipes, tubes, car bodies, engine blocks, alloy wheels, cable and wire, sheet metal and plate, cutlery and hollowware.

The SA plastics industry is dominated by the packaging sector. It consists of numerous small to medium size businesses producing moldings for a wide variety of end-uses. Manufacture of pipe and cable, irrigation fittings, crates, sheet and film, beverage and other containers and numerous injection molded items, is characterized by a high level of competition.

Currently there are approximately 1,018 companies in the industry, based mainly around Johannesburg, Durban and Cape Town.

3 Automotive and Automotive Parts Industry in South Africa and KwaZulu-Natal Province

3.1 Automotive Industry

Overview

The automotive industry is the largest component in the country's machinery industry.

The automotive industry in South Africa is characterized by the presence of seven major automakers that assemble passenger cars and commercial vehicles of varying sizes primarily for the small domestic market, where 300,000 – 400,000 vehicles are newly sold each year (Figure II-3-1). In addition, Man Truck operates a small assembly plant for buses and large trucks. Other major international automakers that do not have production facilities in the country import their own CBUs or contract with local assemblers to manufacture their own models using CKD components.

Industry Size

Automobile production in South Africa has ranged between 310,000 and 390,000 units annually. Table II-3-1 shows recent trends in automobile production, sales, exports and imports on a unit basis between 1995 and 2000. Table II-3-2 shows unit-based automobile sales and exports by vehicle type during the same period. The domestic market reached 420,000 units in 1996 and then continued to decline by more than 10% each year to 320,000 units in 1999. Meanwhile, exports grew steadily during the period and reached 66,000 units in 2000. Export growth helped domestic production make a moderate recovery to 357,000 units in 2000, although it is way below the historical high of 389,000 units in 1995.

Total revenues of the automobile and related industries have been growing steadily in recent years, as shown in Table II-3-3. Revenues from the domestic market soared from R63.3 billion in 1998 to R81.3 billion in 2000. While new vehicles are the largest factor, parts and accessories also make sizable contributions. Export revenues also surged, from R10 billion to R18.9 billion, during the same period. It is interesting to note that export revenues from automotive parts exceeded those from assembled cars.

Investment and Production Capacity

Investment made in the automotive industry has been growing year after year, and exceeded R1.5 billion in 1999 and 2000 (Table II-3-4). According to NAAMSA's forecast, investment in 2001 will exceed R2.7 billion. Priority has been placed on improvement of international competitiveness so as to increase exports, particularly in the

Figure II-3-1 Plant Locations of Automotive Assemblers

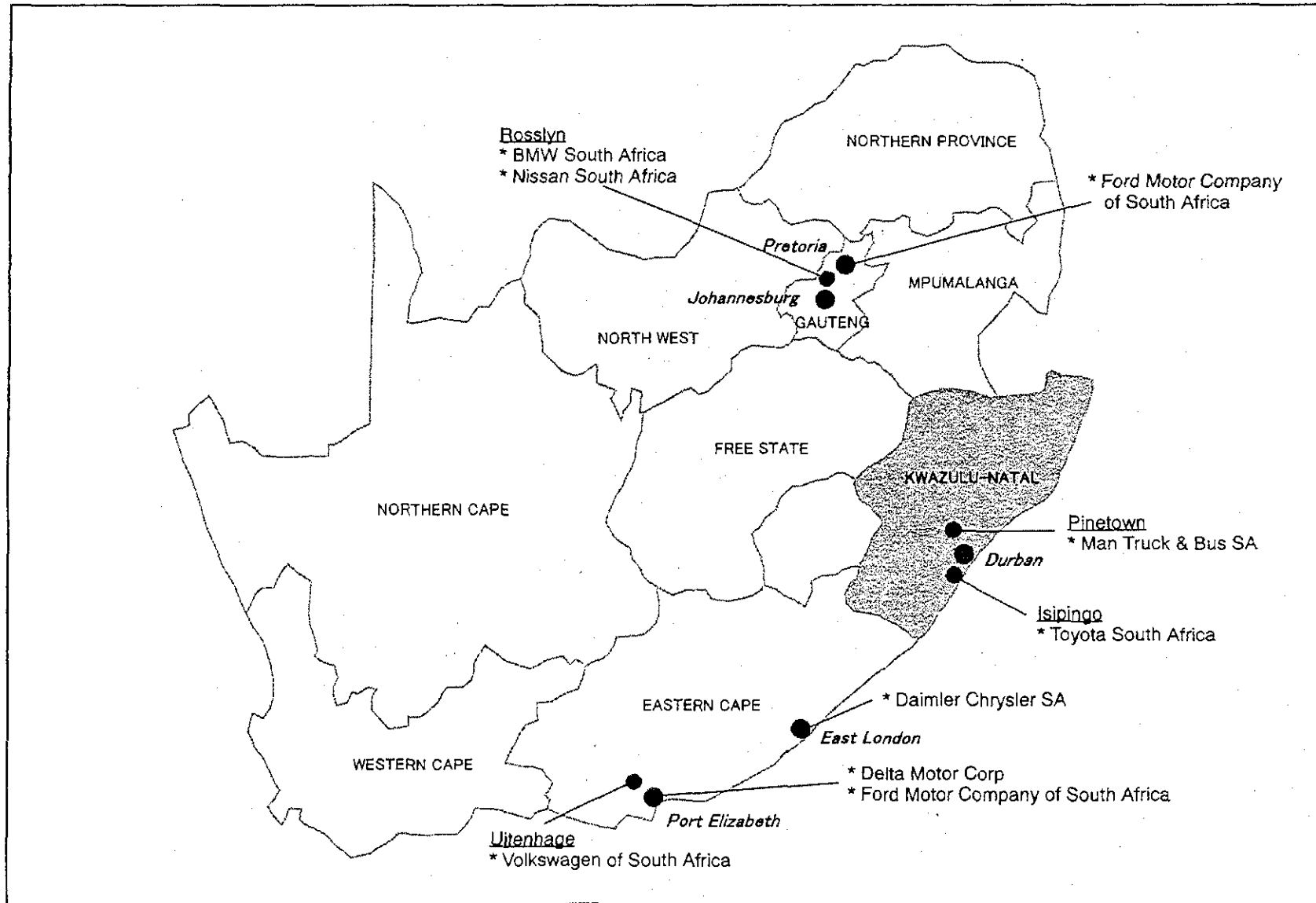


Table II-3-1 South African Vehicle Production and Sales Data: 1995 - 2000

	1995	1996	1997	1998	1999	2000
Sales of domestically produced vehicles	373,712	374,758	342,535	286,159	266,349	289,333
Exports	15,764	11,553	19,569	25,896	59,716	68,031
Total domestic production	389,476	386,311	362,104	312,055	326,065	357,364
Exports as percentage of domestic production	4.0%	3.0%	5.4%	8.3%	18.3%	19.0%
Imports	22,081	46,318	56,740	65,351	59,426	66,749
Total local market (including imports)	395,793	421,076	399,275	351,510	325,775	356,082
Imports as percentage of local market	5.5%	11.0%	14.2%	18.6%	18.2%	18.7%

Note: Domestically produced vehicles include cars, light, medium and heavy commercials.

Source: NAAMSA

**Table II-3-2 Annual New Vehicle Industry Sales Performance
by Sector and Industry Export Figures**

	1995	1996	1997	1998	1999	2000
<Domestic sales>						
Motor cars	236,584	249,838	239,762	203,821	189,370	224,122
Light commercials	128,397	129,575	114,354	99,078	96,169	105,235
Medium commercials	4,139	5,457	5,636	5,092	4,668	5,162
Trucks and buses	7,664	8,110	7,123	6,419	5,568	6,563
Total domestic sales	376,784	392,980	366,875	314,410	295,775	341,082
GDP growth rate (%)	3.4	3.2	1.7	0.1	1.2	3.1
<Exports>						
Cars	8,976	3,743	10,458	18,342	52,347	58,204
Light commercials	6,356	7,125	8,000	6,806	6,581	9,148
Trucks and buses	432	685	1,111	748	788	679
Total exports	15,764	11,553	19,569	25,898	59,716	68,031

Source: NAAMSA

Table II-3-3 Motor Industry Revenue by Major Sectors

(Unit: R million)

	1998	1999	2000
Domestic sales revenue			
New vehicles	24,200	24,900	32,650
Used vehicles	12,372	14,477	18,320
Workshop revenue	8,650	8,746	10,122
Spares, accessories & other trading revenue	18,064	17,671	20,190
Total	63,286	65,794	81,282
Export revenue			
Components	7,895	9,600	11,500
Built-up vehicle	2,100	5,200	7,400
Total	9,995	14,800	18,900
Total revenue	73,281	80,594	100,182

Source: NAAMSA

Table II-3-4 Capital Expenditure - New Vehicle Assembly Industry

(Unit: R million)

	1995	1996	1997	1998	1999	2000
Product, Local content and Export investments	388.5	586.1	729.7	734.5	1,170.4	1,108.7
Plant, Machinery and Production facilities	345.3	409.6	294.9	409.1	143.7	202.5
Land and Buildings	34.9	46.2	129.1	60.0	81.5	109.7
OEM support structure	78.1	129.4	111.6	138.5	115.4	140.6
Total	846.8	1,171.3	1,265.3	1,342.1	1,511.0	1,561.5

Source: NAAMSA

areas of product improvement, localization of parts and components, and development of export capabilities.

In contrast, investment in capacity expansion has been on the decline during the same period. This is because the present production capacity far exceeds demand. As shown in Table II-3-5, the capacity utilization rate for production of passenger cars remained at around 66% in 2000, while the international average was 76%.

Employment

As shown in Table II-3-6, employment in the automobile assembly industry totals approximately 32,000 persons. It declined from 38,600 in 1995 but increased slightly in 2000. The automobile and related industries including automotive parts production and automobile sales employ approximately 254,000 workers as of 2000, of which automobile sales account for the largest portion.

Market Outlook

Automobile demand in the country is expected to increase in the future for the following reasons, according to DTP's "Current Developments in the Automotive Industry" (September 2000).

Table II-3-7 shows NAAMSA's forecast for domestic automobile sales, exports and imports. The domestic market is expected to grow 8% in 2001 and 8.3% in 2002, reaching 274,000 units. Furthermore, imports will increase rapidly, 26.3% in 2001 and 20.5% in 2002. At the same time, exports will grow 63.2% and 10.5% respectively. As a result, domestic production will increase 17.1% and 5.6% and will reach 285,000 units in 2002.

Automotive Industry in KwaZulu-Natal Province

Toyota SA in Durban is the only automaker operating in KwaZulu-Natal Province. In addition, MAN Truck assembles trucks in Pinetown and Bell Equipment manufacturers dump trucks in Richards Bay.

Toyota SA holds a share of around 25% of national automobile sales. Its unit sales was more than 90,000 in 1997. However, production declined rapidly to the 70,000-unit level in 1998 and 1999. The company's recent production trends and plans are estimated as follows.

Toyota assembles seven models (as of 2000) in South Africa and annual production still remains at 40,000-unit level even in the case of most popular model, Corolla, while the annual production level is 70,000 units on the average in the case of world-class models.

Table II-3-5 Motor Vehicle Manufacturing Capacity Utilisation Levels

(Unit: %)

	Industry average capacity utilisation levels					
	1995	1996	1997	1998	1999	2000
Cars	84.3	78.9	77.3	64.3	64.6	66.1
Light commercials	81.7	75.9	70.6	59.1	57.5	60.2
Medium commercials	81.3	80.0	77.6	73.6	69.7	64.2
Heavy commercials	81.9	68.3	74.2	69.3	61.9	74.8

Source: NAAMSA

Table II-3-6 Industry Employment Levels: Average Monthly Figures

	1995	1996	1997	1998	1999	2000
Assembly industry	38,600	38,600	37,100	33,700	32,000	32,300
Component industry	47,000	45,000	44,000	40,000	39,000	38,500
Tyre industry	11,000	10,000	9,500	9,100	9,000	8,600
Motor trade	178,000	180,000	180,000	170,000	175,000	175,000
Total	274,600	272,600	270,600	252,800	255,000	254,400

Source: NAAMSA, Retail Motor Industry organisation (RMI), National Association of Automotive Component and Allied Manufacturers (NAACAM) and SA Tyre Manufacturers Conference (SATMC)

Table II-3-7 Projection of Vehicle Market Growth

	2000	2001	2002
Cars			
Domestically produced			
Local sales	172,373	175,000	180,000
Exports	58,204	95,000	105,000
Sub-total	230,577	270,000	285,000
CBU imports			
NAAMSA	51,749	64,000	94,000
Non-NAAMSA	10,000	14,000	-
Sub-total	61,749	78,000	94,000
Total local market	234,122	253,000	274,000
Light commercials			
Domestically Produced			
Local sales	105,235	113,500	123,000
Exports	9,148	9,000	10,100
Sub-total	114,383	122,500	133,100
CBU imports (Non-NAAMSA)	3,000	3,000	3,000
Total local market	108,235	116,500	126,000
Medium and heavy commercials			
NAAMSA sales	11,725	13,000	14,000
Exports	679	800	900
Imports (Non-NAAMSA)	2,000	2,200	2,400
MCV/HCV market	13,725	15,200	16,400
Total aggregate market	356,082	384,700	416,400
Total aggregate exports	68,031	104,800	116,000
GDP growth rate (%)	3.1	3.3	3.5

Source: NAAMSA

Thus, automakers operating in the country must improve and maintain international competitiveness in a small-lot, large variety production environment, and local parts suppliers are expected to meet customer demand to help achieve the goal.

Parts procurement

Extent and mode of automotive parts procurement varies among assemblers. Furthermore, local content rose steadily under the LCP and now undergoes a major change due to the Parts procurement. At present, local content ranges between 40% and 60%.

Figure II-3-2 shows the overview of parts procurement structure in South Africa.

Metalworking component

1) Stamped metal parts

Those assemblers which have their own large presswork lines, where large parts are made, purchase small- and medium-sized parts from local suppliers. Those which have no stamping plant, it imports key safety parts and procures other stamped parts from local sources.

2) Castings and forgings

Castings and forgings used for engines and underframes are primarily procured from local sources, with some imports, because no assembler has an in-house shop. The assemblers believe that these metalworking parts made by local suppliers have reached a near satisfactory quality level, with some improvement.

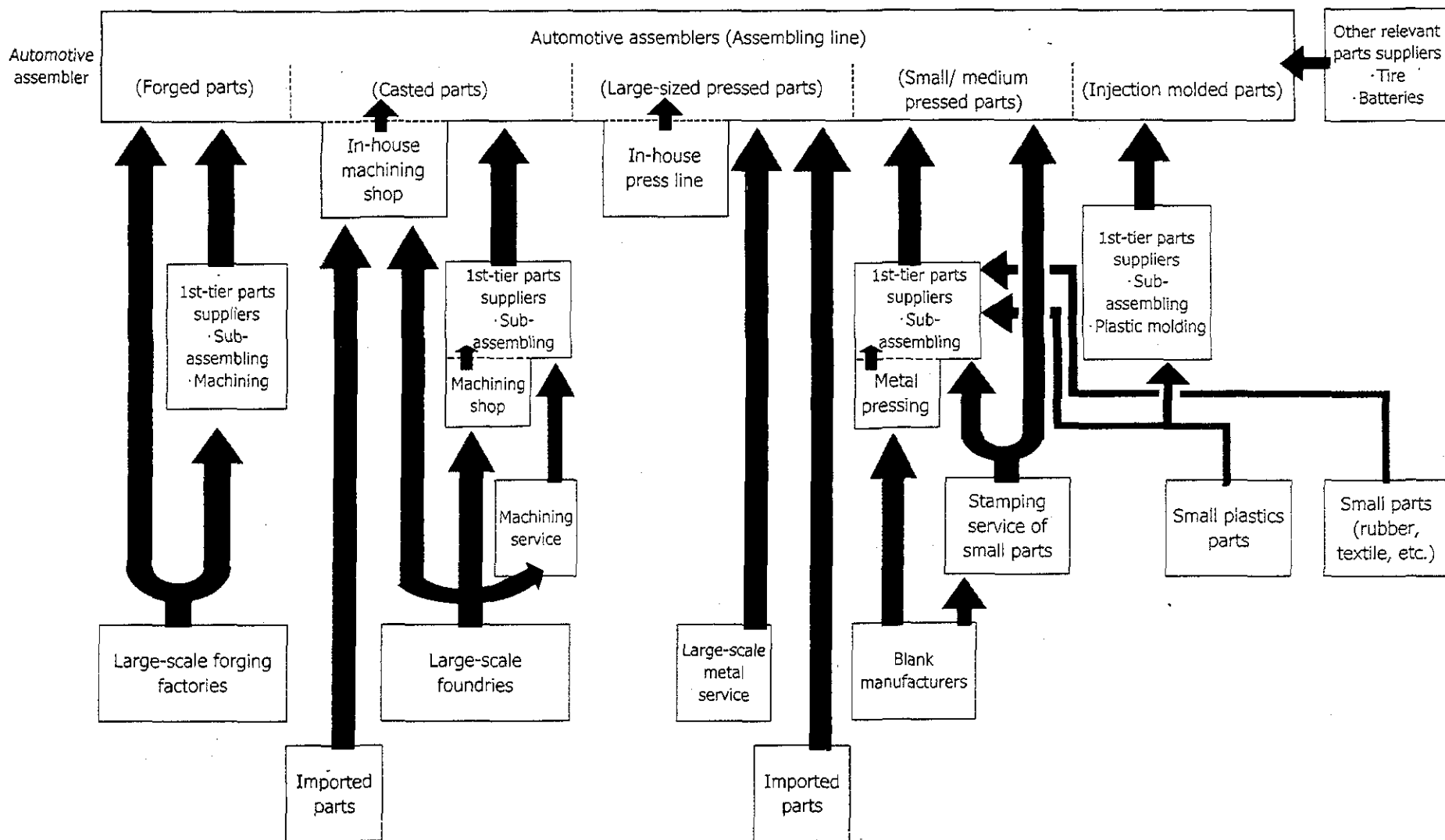
Plastic injection molded parts

Only a handful of manufacturers, less than 10 (mainly foreign companies), can make plastic injection molded automotive parts. In particular, most assemblers internally make or import large parts, such as bumpers and instrument panels. Some foreign manufacturers have started local production, but assemblers are not satisfied with local products in terms of quality, technology and/or cost.

Components

Assemblers show varying reactions to local procurement of components. German automakers (BMW, Volkswagen and DC) responded quickly to the MIDP and IEC programs and started the development of modular components and the establishment of the JIT delivery system earlier than others. They asked for cooperation of first tier suppliers, especially large European and American suppliers. As a result, foreign large suppliers started local production and joint ventures or licensing agreements with local suppliers were established, and local procurement of components is steadily on the rise.

Figure II-3-2 Product Flow of Automotive Components in South Africa



S - 26

Source: Field survey on automotive assemblers, and parts suppliers.

3.2 Automotive parts industry in South Africa

Overview

Localization of parts production progressed under the Local Contents Program (1961 -- 1995). Automotive parts with the highest level of local content are machined and metal components, including castings, forgings, stamped parts, and machined parts, as well as plastics molded products except injection molded ones.

Compared to other developing countries, South Africa has the following distinguishing characteristics related to supply of automotive parts.

- 1) A large number of European-based international suppliers are operating in the country, including those specialized in large casting and forging production (more than two in each category). There are press lines owned by automobile assemblers and large press shops. Specialized machining service companies provide advanced service. Thus, medium- and large-sized suppliers having high levels of production technology are present in the country.
- 2) Large company groups consisting of automotive parts suppliers have been formed by domestic interests (plus joint ventures with foreign companies). This reflects the fact that the advanced processes are already taken care of by large foreign suppliers or assemblers themselves.
- 3) Thus, automobile assemblers, large metalworking companies, and large automotive suppliers tend to keep production processes in-house, resulting in a low level of linkage with supporting industries (especially, there are few manufacturers specialized in automotive parts and related services). As an exception, a relative close linkage is observed in the sector making small and medium-sized stamped parts. In other categories, including plastics parts, the linkage is simply weak as assemblers and first-tier suppliers have installed most types of molding machines they need for in-house production, while procuring small parts from local suppliers.
- 4) Automobile assemblers and parts suppliers do not form vertical supply chains, in which suppliers form a pyramidal structure under each assembler. Instead, first-tier suppliers and large metalworking companies (e.g., foundries, forging and press shops) do not serve a specific assembler on an exclusive basis. They deal with multiple assemblers relatively freely. In fact, less and less second- and third-tier suppliers maintain close relationships with specific first-tier suppliers.

Companies related to the automotive parts industry can be broadly classified into the following types.

- 1) Those having large casting, forging, press work or machining capabilities and specialized in manufacture of large or special parts and components that require advanced production skills. They are often joint ventures with foreign companies or their affiliates. Many companies in joint ventures belong to one or another company group owned by local capital.
- 2) Specialized parts suppliers that constitute key elements of the first-tier supplier base. Unlike the companies in type 1), which are specialized in a certain field of technology (e.g., metalworking, a company of this type possesses proprietary technology (or a set of technologies) required to make diverse products in a specific category. For instance, this type of company manufacturers wire harnesses, front-end modules, door modules, and seat modules. Their major distinguishing factor is possession of subassembly capability and they will most likely adapt themselves to the modulation demand by European and American automakers. In addition, many of them belong to local company groups and have acquired technology, capital or both from foreign partners. Foreign suppliers operating in South Africa are often classified in this type. Another example is a local company developing its own electronic safety devices.
- 3) Suppliers that depend more on first-tier suppliers or assemblers and are specialized in manufacture of metalworking parts through stamping, machining, coating and/or surface treatment. Manufacturers of plastics parts are included, although they are small in number because most plastics parts are made by company groups in 2) that have large plants. Notably, suppliers of this type are primarily engaged in manufacture of automotive parts and are mostly SMEs.
- 4) Suppliers of non-critical parts or small parts (having simple designs) that are delivered to parts manufacturers. They are positioned as first-, second- or third-tier suppliers, depending on the their customer. Many are engaged in metalworking operation, such as stamping, metal-sheet work or machining, but some supply molded plastics, rubber or fabric parts. For suppliers of this type, automotive parts represent small portions of total production as other types of products are also made. They are classified in SMEs or MEs (micro enterprises).
- 5) Job shops that process semi-finished parts furnished by parts suppliers and are primarily specialized in metalworking operations, including coating, electroplating, heat treatment, and machining. Again, their major customers are in other industries and automotive parts account for a minor part of their business. Manufacturers that bring them semi-finished parts are first- or second-tier suppliers. Companies of this type are SMEs or MEs.

- 6) Suppliers of standard machine elements, such as blanks for stamping, tubes, partially processed steel wires, flanges, springs, bolts and nuts. There are a large number of companies in this category. They supply these products to automotive parts manufacturers and others as well. They should be considered to be distributors of basic industrial materials. Some companies have machining or other processing functions. Most companies are SMEs and MEs, while steel centers provide the same function.

In addition, automobile assemblers have their own shops for supply of a variety of parts. Originally, the parts that they made were large ones and components that were not suitable for importation, or were not available from local sources because special equipment was required for their manufacture. Now, these parts are increasingly available from local suppliers. In particular, European assemblers are promoting modularization of parts, a move which is accelerating outside sourcing. Thus, captive production has different meanings for different companies, including those that established in-house shops in response to the imposition local content standards and have continued to operate or even expand them.

Today, there are as many as 300 suppliers in the country, including second- and third-tier suppliers⁴. They include suppliers in 4) – 6), which receive orders of automotive parts supply, which represent the minor portion of their businesses. The members of NAACAM, which are classified in 1) through 3) and mainly represent the relatively large purchase orders from automotive parts manufacturers, totals 84 companies.

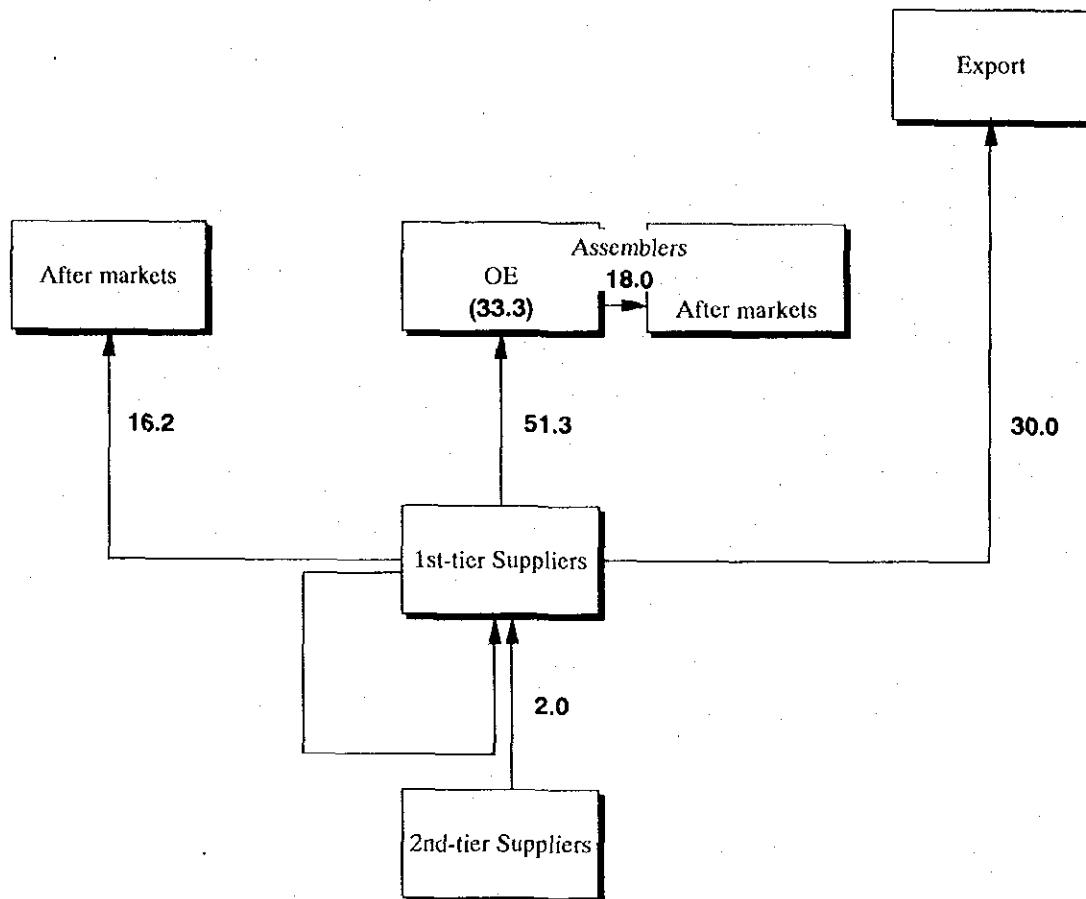
Size of industry

Employment in the auto parts sector continued to decline during the period, amounting to 38,500 as of 2000. The sales in 2000 recorded 11,623million Rands, increased by 37% compared to 1999, in the case of total of 84 NAACAM member companies. NAACAM estimates that its member companies account for nearly 50% of total sales. Thus, total sales in the country will be twice the NAACAM figures.

Figure II-3-3 shows the outline of automotive parts supply flow. Since the data in figure base on that of NAACAM members alone, the value of parts supplied from the second-tier suppliers appears to be smaller. Even if one considers this data limitation, the figure indicates that the development of supporting industry has not been progressed.

⁴ Estimated from the results of the interview surveys of automobile assemblers.

Figure II-3-3 Flow of Locally Produced Automotive Parts in South Africa



Notes: 1) Figures show the flow of parts, in terms of percentage of total local parts production in 1999 and 2000, on the average.

2) NAACAM members only.

Source: NAACAM

Component exports grew rapidly after the introduction of the MIDP and IEC schemes. DTI estimates that the value of exports in 2000 reached at least R12 billion.

In particular, catalytic converters and stitched leather components, both of which use natural resources available in the country, account for a high percentage of total exports. In addition, silencers, exhaust pipes and wheels (aluminum alloy) show rapid growth (Table II-3-8).

The major destination is the EU, which takes more than 70% of exports. Germany holds the largest share.

3.3 The Automotive Components Industry in KwaZulu-Natal Province

Overview

Toyota SA, which is virtually the only automobile assembler in KwaZulu-Natal Province, purchases raw materials, parts and services from more than 300 local suppliers, including some outside KwaZulu-Natal Province. Among them, suppliers of automotive parts total 108.

At the same time, Toyota SA has two internal shops making automotive parts: Toyota Stamping Division (TSD) that makes large parts; and Toyota Automotive Components (TAC) that makes assemblies, spare parts, and accessories. In addition, the company has large plastics molding machines to make bumpers.

In KwaZulu-Natal Province, there are 28 first-tier suppliers, of which 19 supply a variety of parts to Toyota SA. Toyota's local content has reached 48%, of which TAC accounted for 15%. Thus, the remaining 33% come from outside sources, and most castings and forgings as well as a high percentage of press parts are purchased from outside of the province.

On the other hand, 11 out of 28 first-tier suppliers in KwaZulu-Natal Province deliver parts to automobile assemblers outside the province, two companies export products to foreign assemblers and 12 ship to the overseas aftermarket.

Then, there are 12 first-tier suppliers that are primarily engaged in production of automotive parts and supply them to first-tier suppliers. By type of product, 5 companies are specialized in machining and surface treatment (mainly stamping), 3 plastics molding, 2 die casting, and 2 others. All except one company (a large manufacturer supplying aluminum extruded pipes) are small- or medium-size companies.

Table II-3-8 Major Component Exports

(Unit: R million)

	1995	1996	1997	1998	1999	% of total (1999)
Catalytic converters	388	485	835	1,520	2,569	29.6
Stitched leather components	1,019	1,259	1,408	1,854	1,888	19.5
Tyres	219	296	342	498	639	6.6
Silencers/ exhaust pipes	76	170	151	493	598	6.2
Road wheels and parts	175	227	325	446	518	5.4
Engine parts	112	137	285	390	383	4.0
Wiring harnesses	41	92	136	207	304	3.1
Automotive tooling	259	279	309	256	264	2.7
Glass	49	71	105	112	147	1.5
Radiators	77	107	93	108	111	1.1
Ignition/ starting equipment	4	16	30	47	94	1.0
Transmission shafts and cranks	29	38	7	62	85	0.9
Filters	13	42	55	72	85	0.9
Brake parts	23	29	38	76	79	0.8
Shock absorbers	38	53	56	63	77	0.8
Body parts/ panels	18	39	39	30	75	0.8
Car radios	7	4	29	47	73	0.7
Batteries	53	60	88	79	68	0.7
Gauges/ instruments/ parts	18	28	29	30	59	0.6
Clutches/ shaft couplings	16	21	33	51	54	0.6
Other components	684	598	722	1,454	1,504	15.5
Total component exports	3,318	4,051	5,115	7,895	9,674	100.0

Note: Complete disaggregation of customs data is not always possible and certain categories, such as tooling, may contain a small percentage of non-automotive exports.

Source: DTI

In addition to the 40 suppliers, there are a number of companies that make the following automotive-related parts in KwaZulu-Natal Province. Note that they make automotive parts together with other parts and do not always made automotive parts.

Classification of parts supplied		No. of companies (estimate)
Small metallic parts	Machined parts	3 +
	Stamping parts	7 +
	Assemblies / accessories	10 +
Small plastics parts		5 +
Preliminary processing and supply of blanks, tubes, wires, flanges and other metalworking products		18 +
Metalworking service such as coating, electroplating and machining		7 +
Other small parts	Rubber parts	2 +
	Leather parts	1 +
	Other parts and accessories	4 +

(Note) "+" indicates that the actual number of companies can be slightly larger than the figure shown.

In addition, there are 50 – 60 companies specialized in supply of hardware (bolts, nuts and screws) and metalworking and engineering services, which serve as would-be suppliers of automotive parts. It should be noted, however, that these companies include trading agents.

Finally, there are suppliers of basic materials used by the automotive industry, including steel materials, fuels and chemicals.

In the following section, the leading 40 automotive parts manufacturers (including first-tier and second-tier suppliers) are statistically analyzed⁵. They are established manufacturers specialized in automotive parts in KwaZulu-Natal. Their location and size classification are summarized in Table II-3-9.

⁵ Data on the 40 companies were obtained from KZN Benchmarking c.c.'s database on automotive parts manufacturers.

Table II-3-9 Location of Automotive Component Activity in KZN (n=40)

Location	% of firms	Large firms (employ <200)	Medium firms (employ <100, >=200)	Small firms (employ >=100)
Southern Durban Industrial Basin ¹⁾ (n=13)	32.5	<ul style="list-style-type: none"> • Aunde TAP • Federal Mogul Friction • Feltex Foam Mouldings • GUD Filters • Rockham • Wayne Rubber (n=6)	<ul style="list-style-type: none"> • Fascor • Feltex Automotive Trim • Venture SA (n=3)	<ul style="list-style-type: none"> • Commercial Elastic • Grupo Antolin • L&J Tools • SAI Automotive Autoplastic (n=4)
Central Durban ²⁾ (n=3)	7.5	<ul style="list-style-type: none"> • Aunde Cartrim • PFK Electronics (n=2)		<ul style="list-style-type: none"> • Sabex Manufacturing (n=1)
Pinetown ³⁾ (n=16)	40.0	<ul style="list-style-type: none"> • Behr Engine Cooling • Federal Mogul Engine Bearings • Midlands Trim • Smiths Manufacturing (n=4)	<ul style="list-style-type: none"> • Duys Component Manufacturers • Federal Mogul Valves • Microfinish • Natal Die Casting (n=4)	<ul style="list-style-type: none"> • Automould • Braceable • era-Beier • Component Technologies • Triple C • Houghton Plastics • Sondor • Technique (n=8)
Pietermaritzburg (n=7)	17.5	<ul style="list-style-type: none"> • Filpro • Shurlok International • Ramsay Engineering (n=3)	<ul style="list-style-type: none"> • Pressure Die Castings (n=1)	<ul style="list-style-type: none"> • Kaymac Rotomoulders • Stronga Exhausts • Webroy (n=3)
Other ⁴⁾ (n=1)	2.5	<ul style="list-style-type: none"> • Hesto Harnesses (n=1)		

Notes: 1) Including Mobeni, Jacobs, Prospecton, Rosburgh and Umbogintwini

2) Including Umbito and Springfield Park

3) Including Westmead and New Germany

4) Areas outside of metropolitan locations

Source: KZN Benchmarking cc

Location of the automotive components industry

The industry is concentrated in five distinct areas, namely, the Southern Durban Industrial Basin (Prospecton, Jacobs and Mobeni), Pinetown (including New Germany and Westmead), Central Durban (including Springfield Park), Pietermaritzburg (principally Willowton) and Rest of KZN (primarily Isithebe and Stanger).

The most important location for automotive component manufacturers in KwaZulu-Natal is Pinetown, where 40.0% of firms are located, followed by the Southern Durban Industrial Basin with 32.5%. The Southern Durban Industrial Basin's importance is largely a result of the location of Toyota SA in the area, whilst Pinetown's importance stems from favorable industrial ratings that were made available to industrial investments in that area in the past, as well as the availability of land and excellent infrastructure linkages to the Durban harbor, Gauteng province and Southern Durban Industrial Basin (for supply to Toyota).

Employment

The Southern Durban Industrial Basin is the more important locality from an employment point of view. Of the 9,722 persons employed at the 40 automotive component firms, 3,263 or 33.6% of total employment, are located in the Southern Durban Industrial Basin.

The majority of employment is moreover concentrated amongst the larger automotive component manufacturers employing 201 employees or more. More than 78% of employees are employed in large automotive component manufacturers, with 12% employed in medium size operations (101 to 200 employees) and 10% in small firms employing 100 or less persons.

Manufacturing activities and outputs

Both first and second tier automotive component activities are evident in KwaZulu-Natal Province.

	First tier	% of total	Second tier	% of total	Total
Number of component manufacturers	28	70.0	12	30.0	40

Output level in the province's industry is approximately R3.15 billion. The most important automotive localities in the province in terms of output level are Pinetown (R1.135 billion worth of output, representing 36.1% of the provincial industry), followed by the Southern Durban Industrial Basin (R945 million, or 30.3% of the provincial industry) and Central Durban (R590 million, or 18.7% of the provincial industry).

The most important creators of output in the industry are the large automotive component manufacturers employing more than 200 persons. The 16 firms that fall into this category have a combined turnover of R2.7 billion, which is six times the aggregated turnover levels of the medium and small size firms, thus constituting 85.7% of the provincial industry's total output.

The principle manufacturing activities in the province are metal forming, metal pressing and assembly (each representing 17.5% of principle manufacturing activities in the province⁶), while molding is also important with 15.9% of principle manufacturing activities. The molding, here, is primarily plastic injection molding, although roto-molding and rubber molding is also evident. Metal forming and metal pressing are, for example, over-represented among the small automotive component manufacturers.

The South Durban Industrial Basin have a significant number of firms performing molding, and assembly operations, while the Pinetown region has a propensity for metal pressing, metal forming and molding activities.

Market

The single most important market for the Southern Durban Industrial Basin KwaZulu-Natal based automotive component manufacturers is Toyota South Africa. Other OEMs, the independent aftermarket and the export market are also, however, important markets for the firms. Not all of the large automotive component firms supply Toyota, with MAN Truck and Bus (located in Pinetown) and Bell Equipment (in Richards Bay) also important KwaZulu-Natal based purchasers of automotive components.

Toyota plays a significant role in the South Durban Industrial Basin, with the firms based in this region indicating that Toyota was by far the most important market for them. These firms also show a very low level of export focus in the aftermarket and none

⁶ Note that the number of principle manufacturing activities (n=71) exceeds the number of firms (n=40) as a number of firms have two or even three principle manufacturing activities

whatsoever to international OEMs. The Pinetown firms have a very different focus from those in the South Durban Industrial Basin in that although Toyota still forms a significant part of their market, their prime market is made up of the first tier suppliers. This is largely the result of the number of second tier suppliers located in the greater Pinetown area.

Exports

Given the increasingly strong international aftermarket presence of a number of KwaZulu-Natal based automotive component manufacturers, as well as the establishment of two large leather seat manufacturers in the greater Durban area, levels of exporting from the province's industry are relatively high. Roughly R1.3 billion was generated from automotive component exports in 2000. This equates to 40.6% of the 40 firms' automotive output. This exporting is concentrated in two areas – the greater Pinetown area and Central Durban, with the Southern Industrial Basin firms exporting significantly less.

3.4 Positioning of the Automotive Industry and Future Outlook for Procurement of Automotive Parts

Industrial policy related to the automotive industry and the industry's reaction

While the Local Contents Program (LCP), which was started in 1961 and continued until 1995, promoted localization of the automotive industry, it made the industry lag behind the wave of globalization. In particular, the small market is crowded, with seven assemblers, who expanded production models to 34 (after 1993) and increased production costs thereby.

The government decided to promote liberalization of the automotive industry that had been protected by the import substitution policy, and to help the industry attain international competitiveness, and this led to introduction of the first MIDP (1995 – 2002) in 1995. Under the MIDP, all local contents regulations are terminated and tariff rates on CBU and CKD components will be reduced to 40% and 30%, respectively, by 2002.

At the same time, the Import-Export Complementation Scheme (IEC) was started. By introducing the duty rebate system, it successfully stimulated exports and imports by assemblers and suppliers. The MIDP will be extended until 2007. Tariff rates on CBU and CKD components will be lowered to 30% and 25%, respectively, by 2007.

Automobile assemblers have been reacting to these programs as follows.

- 1) First of all, they have been rationalizing (reducing) production models. At the same time, assemblers have promoted rationalization of their production systems, including procurement from multinational suppliers (not insisting on local sourcing), development of modular parts, and delivery based on the JIT system.
- 2) Also, assemblers plan to expand exports of assembled cars (selected models). The reduction of models, and the expanded exports of thus selected models increase the number of production units per model.
- 3) Thirdly, they are expanding exports of parts and components. At present, they are trying hard to export parts aiming at the use of the IEC. The above mentioned model rationalization and expanded parts export will increase the production of selected parts.

Thus, the government policy has produced the intended results by encouraging exports of automobiles and automotive parts and promoting growth of investment, production and employment.

Future outlook for parts procurement

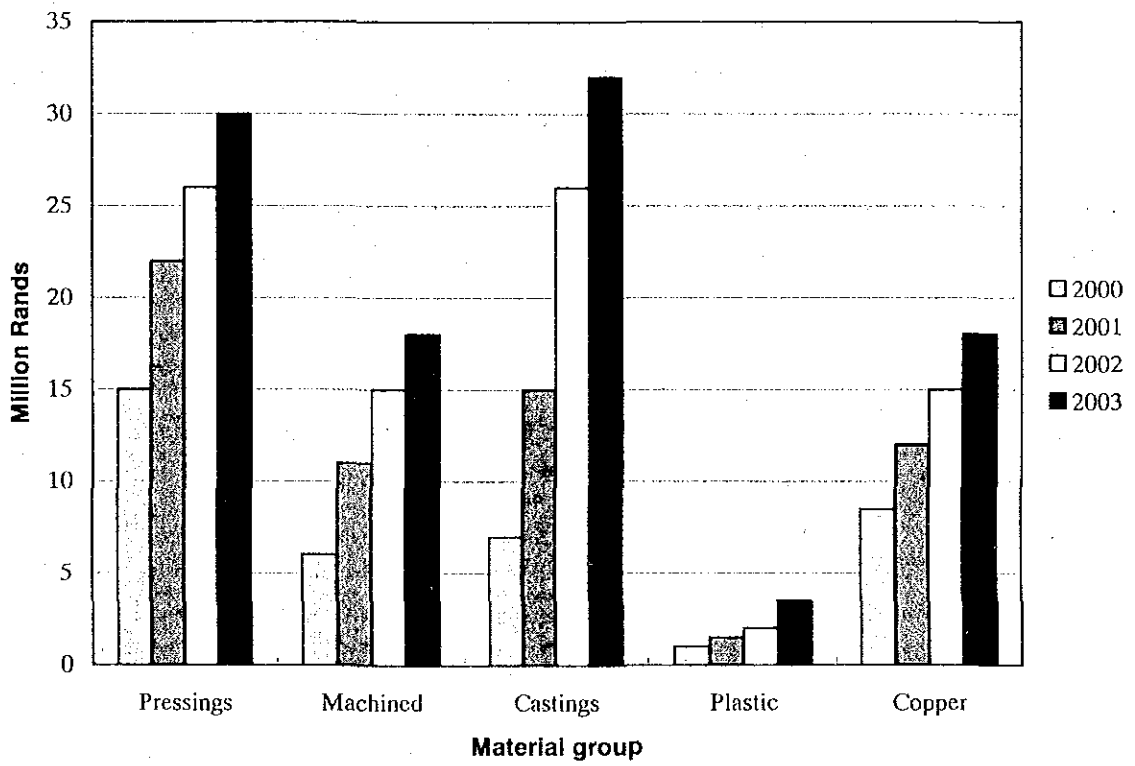
Procurement decisions by automobile assemblers will be increasingly made in the context of the global sourcing strategy. As assemblers concentrate their production to a selected number of models, the kind of parts to be procured locally decreases accordingly. Furthermore, all parts and components for models produced in the country are not necessarily procured locally. There will be the move to focus on specific parts.

At the same time, assembled cars will be imported to meet the market needs and supplement local production. Also, some parts will be imported. Reciprocally, export drives will be generated for finished cars and parts that correspond to the above imports.

Figure II-3-4 shows localization targets for automotive parts set by a first-tier supplier (by type). This more or less reflects the following views shared by automobile assemblers and first-tier suppliers.

- 1) At present, press parts have achieved the highest level of localization among other parts, but further localization is feasible. For large parts, specialized companies and automobile assemblers have large press lines that are being operated far below capacity. On the other hand, further localization of smaller parts will create new outsourcing opportunities.
- 2) Localization is expected to grow very rapidly in the area of casting. However, foundries that have high levels of technology are concentrated in Port Elizabeth and

Figure II-3-4 Targeted Local Content per Group in Automotive Component Parts



Source: An automotive parts manufacturer

Gauteng. In KwaZulu-Natal Province, only manufacturers of smaller die casting products are found.

- 3) For plastic parts, it is difficult to find molding companies with adequate skills. As a result, the industry has been very slow in localization and continues to show difficulty in development of local suppliers. Nevertheless, automobile assemblers and large suppliers are moving to install or boost their own production capacities.

Assemblers are required to improve competitiveness for exportation of assembled cars under the MIDP, while competing with imported cars in the domestic market. Similarly, first-tier suppliers are required to improve international competitiveness, as assemblers are increasingly demanding it in connection with their purchases of domestic OEM parts. Particularly, European assemblers demand the development of parts in modules, and implementation of the JIT system, and if local suppliers fail to respond, they are ready to bring in European suppliers for the improvement of competitiveness. At the same time, REMs are required to make internationally competitive products for direct exports as well as exports through assemblers.

As viewed from the standpoint of expanding the local production of automotive parts, the following characteristics can be pointed out for the South African industries.

- 1) Given the small domestic market and a large number of models, suppliers are expected to improve flexible production capabilities: the ability to supply internationally competitive parts in small lots and in large varieties. For this purpose, many companies have been taking a "benchmarking" approach to assess their current ability in comparison to counterparts in industrialized countries. The results indicate that the South African industries are lagged behind in "lean manufacturing" benchmarks, including quality, cost, production time, and inventory level. They are basically defined as production management issues, which many companies do not understand, as discussed later.
- 2) Looking at the automotive parts industry as a whole, it possesses relatively high levels of production technology. Given the small local market, the larger operation, especially foundries, forging shops and press work shops, will not be viable. Besides, no quality problem related to castings and forgings has been pointed out by assemblers. Similarly, large press parts are made by assemblers or large, foreign suppliers and do not present any problem. On the other hand, smaller press parts have quality (precision) problems partly due to the lack of mold design that takes into account production efficiency and product quality, and partly due to the use of old equipment. Yet, the largest problem is found in the area of production

management. Major problems related to production technology are seen in the plastics molding industry, where not only small companies but large ones as well do not understand basic production techniques.

Under these circumstances, automobile assemblers and first-tier suppliers are in the process of reappraising capabilities of suppliers in terms of quality, cost and delivery schedule and are strictly selecting them on the basis of reevaluation results. They specify quality requirements and standards to suppliers and assist them in efforts to meet the goal.

Nevertheless, there are a large number of suppliers that fail to make the requisite efforts and an assembler believes that more than 30% of suppliers that it deals with will lose the business in the near future. In fact, a survey by Dr. Justin Barnes of Natal University indicates that the highest quarter of automotive parts suppliers in KwaZulu-Natal enjoys increased orders, while the lowest quarter faces the decline in business and feels difficulty to stay in business, when the suppliers are classified into four groups in terms of their recent business trends.

3.5 Opportunities for Development of SMEs in Metalworking and Plastics Molding Subsectors in KwaZulu-Natal

Overview

There are around 40 major automotive parts suppliers in KwaZulu-Natal Province.

In the metalworking industry, there are leading automotive parts suppliers (mostly classified as first tier suppliers). In addition, there are suppliers, mostly stamping shops, which deliver parts or components directly to automakers or first tier suppliers. Also, some companies make small components that are incorporated into automotive parts, although these are minor business for them. Most companies in the metalworking sector do not have any commercial relationship with automobiles and automotive parts.

Similarly, most SMEs in the plastics molding industry are seldom associated with production of automotive parts. Some companies make simply designed and small components, the percentage share of which is very small.

Opportunities and major issues for promotion of SMEs as automotive parts suppliers

Automobile assemblers and first-tier suppliers are increasingly exposed to global competition and strive to improve and maintain competitiveness of the entire supply chain including their suppliers. In fact, they require suppliers to make improvements in the

following four areas:

- 1) quality
- 2) cost
- 3) *delivery schedule*, and
- 4) production technology.

Quality requirements include continuous quality improvement activities, quick responses to customer claims, and implementation of quality control in the production process to prevent any defects from producing in each process. Cost requirements mean productivity improvement and continuous cost reduction activities. Key activities include efficiency improvement, inventory minimization and zero defect campaigns.

The improvement of delivery performance involves reduction of the lead-time, improvement of delivery schedule management and production management, and zero defect campaigns. In fact, quality, cost and delivery schedule are interrelated and interdependent factors. Finally, the upgrading of production technology requires procurement or modification of equipment and latest production know-how.

As for the plastics molding sector, most molded parts and components are supplied by a small number of foreign-affiliated or large local suppliers. SMEs' activities are limited to making simple and small parts, and delivering them to metal parts suppliers. At present, there is a large gap between foreign and large local plastics molding manufacturers and SMEs in terms of production technology and management policy. Furthermore, most foreign and large local suppliers have excess production capacities. Thus, there is little room for those smaller plastics molders to enter the automotive parts market.

In the case of metalworking subsector, leading manufacturers are specialized in specific fields or products which they excel at and tend to subcontract simple and small parts or auxiliary processing that are not suitable for internal operation. For this reason, SMEs in this subsector can survive as second- or third-tier suppliers. Nevertheless, manufacturers that do not have specific levels of production techniques and a pro-active marketing policy will have to go out of business and SMEs will likely be reduced in number.

All in all, the number of companies participating in the automotive parts industry will decline, despite some entries being expected, especially by foreign companies. Thus, the opportunity for SMEs to enter the industry is very limited in the short and mid-term run.

On the other hand, so long as the MIDP is maintained and suppliers make continuous efforts to improve competitiveness, the industry has a good future prospect and will expand,

while the number of suppliers will continue to decline.

In order to survive and grow in the industry, SMEs have to establish production and management systems that can help automobile assemblers or first tier suppliers to improve their international competitiveness.

4 SMEs in South Africa and KwaZulu-Natal Province

4.1 Definitions of SMEs and Their Statistical Significance

Definitions and characteristics

In the country, there is no unified definition of SMEs and various organizations have different definitions of SMEs according to the purpose of their service.

The National Strategy for the Development and Promotion of Small Business in South Africa ("National Strategy"), which sets forth a long-term direction of SME policy for the nation, proposes the following definitions according to the policy objective required for each category.

- 1) Survivalist enterprises
- 2) Micro-enterprises
- 3) Small enterprises
- 4) Medium enterprises

Most SMEs have started as sole proprietorships or owner-operated firms, and many are still managed by families or relatives. In the manufacturing sector, the boundary between medium-sized and large enterprises seems to be around 200 employees. Nevertheless, some small companies have a modern management organization whereas large companies may have strong characteristics of a family concern.

In addition, the issues related to SMEs in South Africa need to be addressed in due consideration of those people who have suffered economic disadvantages under the past racial discrimination policy, in addition to ordinary economic considerations.

Statistical view of SMEs

According to the Annual Review 2000, there are approximately 1,629,000 entrepreneurs throughout the nation, of which 1,140,000 are in the informal sector, while remaining 489,000 are in the formal sector. The total economic population in South Africa is 10,370,000, of which 2,700,000 are in the informal sector and 7,670,000 are in the formal sector.

In many countries, SMEs play the following social and economic roles and their promotion is justified from these viewpoints.

- 1) They are labor intensive and help reduce unemployment.
- 2) They can be established throughout the country and contribute to correction of

regional and/or income disparities.

- 3) The technologies which SMEs use are widely used in industry and can be easily transferred to SMEs (unlike advanced technology which often is proprietary to large corporations), and thereby to promote industrial diversification.
- 4) They are creative, playing a supplementary role by covering fields that are not in the traditional domain of large corporations so as to create synergies in industrial.
- 5) They are flexible enough to engage in small-lot, customized production and can form the supplier base that supports growth of large manufacturers, thereby contributing to economic development in the country as a whole.

SMEs in South Africa make significant contributions in terms of job creation and business promotion. They account for 54.5% of total employment in the country and 97.5% of enterprises of all sizes, in comparison to their GDP share of 34.8%. (Large enterprises account for 45.5%, 2.5% and 65.2%, respectively.)

Nevertheless, there is a clear disparity in employment and entrepreneurship conditions among population groups.

Similarly, SMEs have yet to exploit their potential to contribute to industrial diversification, although they operate in a variety of product and service areas which large corporations find unattractive. As a result, both industries and consumers excessively depend on imports in many areas. With regard to formation of the industrial base, the country has not developed SMEs that have high levels of technology and competitiveness in various industries – i.e., SMEs that are needed to serve as supporting industries. Thus, development of competitive SMEs is one of the most important issues for the country with regard to improvement of international industrial competitiveness.

4.2 SMEs in KwaZulu-Natal Province

Examples of SME operations

SMEs operating in KZN can be classified into the following types that are thought to well reflect the historical background.

(1) SMEs owned and operated by members of the white population

1) SMEs on the rise

There are some enterprises owned by whites who learned skills at other companies and then started their own businesses. Some of them acquired management and technical expertise or found customers before startup and have been successfully

introducing new technology through a technical assistance or licensing agreement with foreign partners or have been exploring new markets. Some have even acquired proprietary development capabilities and niche markets. These enterprises include automotive parts suppliers that have established good reputations among customers and receive a continuous stream of orders. They are mainly small- or medium-sized enterprises.

2) SMEs in stagnation

On the other hand, there are many white-owned enterprises, which do not have sophisticated management or technology expertise, continue to use second-hand machinery and equipment, and are unable to make unique products or establish business strategy to differentiate themselves from others. They suffer low operating rates as the domestic market expands slowly, and most of them wait for customers to place orders. They do not have a modern organization consisting of functional units and owners or managers are responsible for every aspect of operation. They lack willingness to try something new. They believe that automotive parts (first-tier and second-tier) are not their business domain and say that they target low-cost, low-quality products.

3) Creative small and micro businesses

The third type are small enterprises and one-man enterprises owned by whites, which develop unique products including design services that target niche markets, such as furniture, interior decorations, and household consumer goods. In the machinery sector, for example, they design and assemble machines that are suitable for production systems in South Africa. And some companies develop fittings and other tools used in machinery and construction industries. They have secured customers in these markets, although sales are not very large due to the limitation in the domestic market size.

(2) SMEs owned and operated by PDIs

Enterprises established and operated by PDIs are very limited in number, and mostly are in construction, building maintenance, gardening, laundering, catering, security, car remodeling, and furniture businesses. Among them, black-owned enterprises are further limited.

1) SMEs owned and operated by Asian population

The resident Asian population was apparently deprived of business opportunity up to 1994, like blacks, but they managed to operate their own business by using whites as owners. Then, after 1994, they established an increasing number of enterprises because they had a high educational background and were highly motivated to operate their own business. While there is no manufacturer making automotive parts, some manufacturers in this category have successfully won orders by offering unique production capabilities such as the electroplating of large parts. These enterprises generally benefit from government procurement.

2) SMEs owned and operated by black population

There are several black-owned manufacturers that are classified in microenterprises and have the minimum required set of equipment. They sell products to a limited number of customers and can only receive prices after actual sales, so that their cash flow is strained. At the same time, they lack basic business skills and some do not keep accounting records. Some rely on orders from charitable organizations and government, and they do not develop new sales routes.

However, it is also a fact that there are a limited number of successful black-owned enterprises that have established themselves in the manufacturing sector. One example is an automotive parts supplier that has received a good rating from an assembler. The supplier has emerged from CSIR's incubation center and the manager is customer oriented.

4.3 SMEs by the Previously Disadvantaged Individuals (PDI)

Restriction on business undertakings of the PDI enforced in the past

During the apartheid era, the government followed a coordinated policy to restrict the development of black-owned businesses. Blacks were prohibited from conducting any business activities in the urban areas populated by whites. In addition to sector-specific differences of constraints, the legacy of apartheid constitutes an important factor in the inability of black owned or controlled small enterprises to face business development constraints. It should be noted that for decades, the majority of South Africans were deprived of viable business opportunities.

Characteristics of PDI enterprise owners and problems facing them

While some PDI enterprises are achieving success and are recognized as excellent companies, most of them, especially black-owned enterprises, have a number of problems

due to the lack of basic business skills and experience, which is originated in the past unfavorable conditions.

Generally, most PDI enterprises are willing to do business but have little idea about what they can or should actually do. They believe that they can anything. They want to do something and hope that, if a customer tells them what to do, they can. In reality, however, potential customers do not likely find any product that they can purchase from most PDI enterprises. The problem is, PDI enterprises do not understand what customers want or need. They do not even know who can be their customers and which products are demanded in terms of quality, design and other aspects.

This is a matter of business planning.