



Position Paper

DESIGN TOGETHER A STRATEGIC ROADMAP FOR THE COMPLETION OF THE AUTOMOTIVE VALUE CHAIN

South Africa – Italy Summit, Johannesburg, October 18-19, 2016

The Automotive industry is a pillar of the South African economy accounting for 7.5% of the national GDP and for 14.6% of total South African exports. The sector has experienced considerable growth in the past decades becoming a full-scale, globally integrated and export-oriented manufacturing industry, capable of attracting major international OEMs. As of today, the sector keeps growing (+9% production increase between 2014 and 2015), attracting international investments and providing unique opportunities deriving from the need to complete the national value chain (the local content in the final product is no higher than 50%).

In this context, Italian automotive players are lagging behind international competitors in engaging the South African market (Italy is 11th at global level in terms of value of automotive exports towards South Africa and 7th in terms of market share of components and spare parts imported into South Africa), so it is missing out on important opportunities. Major opportunities are available especially for those Italian 2nd- and 3rd-tier producers operating in high-tech sectors of the value chain and/or involved in the production of electronic equipment, interior components, and automotive-grade plastics.

Building on the concept of Techno-Manufacturing Clusters (TMC), a specific park – located at the core of the Gauteng automotive cluster (where 42% of South African vehicles are produced) and conceived according to a plug-and-produce approach – has been identified as a suitable localization option for those Italian (and European) companies willing to engage the South African automotive industry and reap the benefits offered by the South African market.

Important opportunities are arising from the completion of the South African automotive value chain

1. **The Automotive industry is a pillar of South Africa's economy.** The sector has grown stronger in the past decades, from a small assembly hub with excessive foreign exchange burden to a full-scale, export-oriented manufacturing industry, able to attract major international Original Equipment Manufacturers (OEMs) from the U.S., Japan and Europe.

2. As of today, the South African automotive cluster is competitive and integrated in global value chains (GVCs). Furthermore, it is a key industry for the Country. It accounts for over 7.5% of the GDP (almost R300 billion in 2015), proving to be the most important manufacturing sector of South Africa¹ and contributing to 14.6% of total national exports (R151.5 billion, +2.9 p.p. vs. 2014).

3. Moreover, with over 615,000 vehicles produced in 2015, South Africa accounts for 64% of total automotive production in Africa,²

¹ In 2015, vehicle and component production accounted for 33.5% of South Africa's total manufacturing output.

² Its closest competitors, Morocco and Nigeria, produced 288,000 units and 10,000 units respectively in 2015.

also ranking 21st globally (+3 positions vs. 2014).

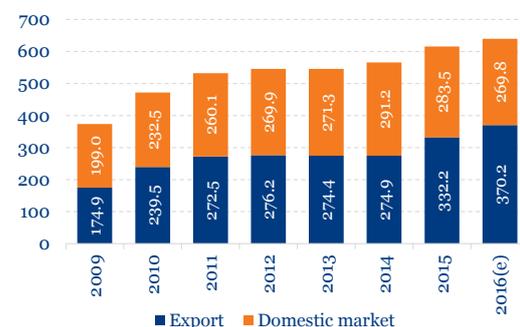


Figure 1. Automotive vehicle production in South Africa by destination (1,000 units), 2009-2016^(e)
(Source: TEH-A elaboration on AIEC data, 2016)

4. The decrease in national sales (-9.5% in August 2016 vs. August 2015), is compensated by a steady increase in exports (+26.7% increase in the same period), confirming the role of South Africa as a **global production hub**. The overall result is a 9% annual increase of total production in 2015.³

5. Production in the Country is characterized by medium-to-high quality and affordable production costs, with

³ The increase was brought about mainly by the passenger car segment (+23% in 2015, from 270,000 to 341,000 units).

internationally integrated clusters and value chains.⁴

6. Considering the component producers sector (>80,000 employees in 2015), in South Africa there are over 120 1st-tier component suppliers, 75% of which are multinationals; on the contrary, 2nd- and 3rd-tier suppliers (more than 200) are mostly local.⁵

7. Despite these figures and notwithstanding the increase in national content and the growing completion of the national automotive value chain, **South Africa's automotive industry still relies on imports of components.**

Imports of original equipment components by South Africa-based OEMs, amounted to \$6.2 billion in 2015, with an increase of +13.4% vs. 2014 (considering the value of the Rand) caused by the growth in vehicle production and the weakening exchange rate of the Rand. These imported original equipment components⁶ are then exported as part of fully built-up vehicles after local value-adding processes.⁷

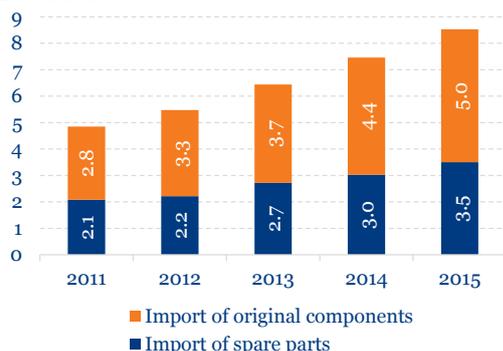


Figure 2. Automotive component imports in South Africa (€ bln), 2011-2015 (Source: TEH-A elaboration on AIEC data, 2016)

8. Moreover, major international automotive players are making sizeable investments in the Country leading to a further increase in production. Ford and BMW announced productive investments in their Rosslyn plants in Gauteng (\$170 million,⁸ and \$417 million, respectively). Furthermore,

⁴ Among others, the Volkswagen Polo and the Toyota Corolla series for the European market are produced in South Africa, as well as the BMW 3-series for the Japanese, Australian and American markets.

⁵ Data refer to 2014.

⁶ Imports of vehicles and aftermarket parts also have to be considered. Imports of aftermarket parts are growing steadily, reaching a value of R55.4 billion in 2015. Imports of light vehicles amounted to 334,338 units in 2015 (-5.3% vs. 2014) for a value of almost R60 billion.

⁷ Capital-intensive-complex components such as engines, gearboxes and interior electronic components are mainly imported by the OEMs and much of the remainder is sourced in the domestic market. Source: AIEC, "Automotive Export Manual 2016", 2016.

⁸ Investment expected to create more than 1,200 new jobs.

BMW plans to expand into seven African countries by 2020 so as to create a ready-market for its Gauteng assembly plant. Toyota made a \$450 million investment expected to create 2,000 new jobs. Nissan will almost double its vehicle production in the Gauteng plant by starting the production of a new model of pick-up in 2017-2018; the facility is intended to become the company's pivot for exports towards Africa, the Middle East and India.

Several other international OEMs (among which Hyundai, Tata and Honda), are planning to localize their production in South Africa as well. The Beijing Automotive International Corporation has already announced a \$759 million investment in a vehicle-production facility in South Africa.⁹

9. However, South Africa's automotive cluster currently maintains shares of local content in the final product estimated to be as low as 35% to 50% in percentage terms.¹⁰ An increase in this share is thus required, opening up great opportunities for investors and foreign producers.

10. In particular, considering the component producers, major opportunities for localization, directly or through local partnerships, exist in **interior electronic components** (which are, currently, mainly imported), **powertrains** (including engine and engine components, the imports of which grew – in Rand – by 70% between 2011 and 2015, reaching \$552 million in 2015), **automotive-grade plastics, and interior components.**¹¹

11. Important opportunities for investors also stem from the Automotive Production Development Programme (APDP) policy scheme. Set in 2013, it is aimed at stimulating local production of automotive components, also maintaining incentives for OEMs manufacturing passenger cars and light commercial vehicles in the Country.

12. The APDP is based on four pillars: stable import tariffs (25% for vehicles, 20% for components); the Vehicle Assembly Allowance (that authorizes OEMs producing at least 50,000 vehicles/year to import 20% of needed

⁹ Expected to create more than 2,500 jobs, with a capacity of 100,000 units a year by 2027.

¹⁰ AIDC estimates a percentage lower than 41%; according to Southern African Business Review's estimates, the share rises to 47%, but no additional estimates surpass the 50% threshold.

¹¹ Source: AIEC, "South Africa Automotive Export Manual 2016" and evidence from The European House - Ambrosetti interviews with experts and players in the sector.

components duty free)¹², production incentives¹³ and the Automotive Investment Scheme (AIS), aimed at stimulating investments, strengthening the value chain, increasing technologically advanced automotive production and fostering job creation.¹⁴

A Techno-Manufacturing Cluster can be an enabling tool for Italian automotive players to localize in South Africa

13. Given the abovementioned elements, **Italian players are missing out on important opportunities.** Italian automotive manufacturers are 11th at global level in terms of value of automotive exports towards South Africa – equal to R3.2 billion in 2015 (+10% vs. 2014) – well behind Germany and the UK. Italy is also 7th in terms of market share of components and spare parts imported by South Africa.

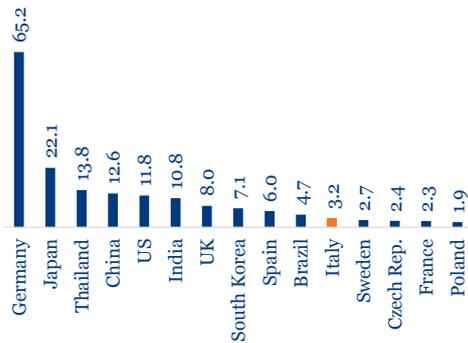


Figure 3. Automotive exports to South Africa by Country of origin (Rand mln), 2015 (Source: TEH-A elaboration on AIEC-SARS data, 2016)

14. In addition, only a few Italian automotive players are currently engaged in South Africa. As of today, a structured presence is provided by Iveco, whose commercial operations managed from South Africa account for over 20% of its total sales in Africa and the Middle East. Regarding the production of components, MA – the CLN Group division specialized in producing and assembling steel and aluminum automotive structural parts and

¹²In 2016, OEMs producing at least 10,000 units/year are allowed to import 10% of components duty free.

¹³An allowance for the duty free importing of vehicles and components calculated at 55% of the added value generated in the SA supply chain. Vulnerable industries (such as aluminum, catalytic converters, etc.) are entitled to a higher reduction (80%). In both cases, the percentage is reduced by 5%/year.

¹⁴Through a non-taxable cash grant (paid over 3 years) equal to a percentage of the productive investments. This percentage is equal to 20% for OEMs and 25% for component suppliers. An additional 5% allowance can be applied to projects maintaining occupational levels. A further 5% allowance can be applied to projects creating added value and jobs.

components – owns a total of 6 plants in South Africa, with a workforce of over 1,500, supplying major European and American OEMs in the Country.

15. However, **the momentum for operators planning to localize in South Africa is unique.** On the one hand, there are great opportunities still untapped by the Italian companies; on the other hand, major international competitors are making long-term investments in the Country.

16. Considering the specific characteristics of the Italian and South African automotive industry and the synergies between the two, important opportunities do exist especially for those **Italian 2nd- and 3rd-tier producers** operating in high-tech sectors of the value chain and/or involved in the production of electronic equipment, interior components, and automotive-grade plastics. Here opportunities for cooperation with South Africa-based OEMs and 1st-tier producers are available, directly or through partnerships with local producers.

17. To fully reap these opportunities, a conducive business environment is needed to address the complexity and lack of knowledge of South Africa.

The European House - Ambrosetti has identified the characteristics of such a pro-investment environment, thus modelling a operational reference framework: the **Techno-Manufacturing Cluster (TMC)** concept.¹⁵

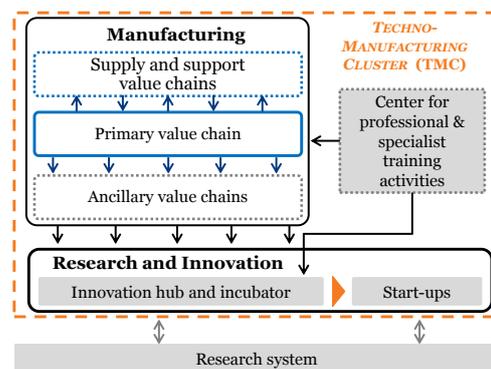


Figure 4. Illustrative scheme of the Techno-Manufacturing Cluster (TMC) concept (Source: TEH-A elaboration, 2016)

A TMC is a productive sectoral cluster, with companies integrated along the entire value-chain together with research centers and technology transfer facilities as well as

¹⁵See also: The European House - Ambrosetti, Position Paper “Collaborative models between Italian and South African manufacturing SMEs to grow together in emerging markets”, October 2015.

professional and specialist training activities and a start-up incubator.

18. Upon an in-depth analysis of the three major South African automotive hubs (in Gauteng, Kwazulu-Natal and Eastern Cape Provinces) and thanks to a dedicated automotive working table along with stakeholders from the two Countries, The European House - Ambrosetti has identified the **Rosslyn Automotive Supplier Park (ASP)** as a cluster that might represent an optimal localization choice for Italian players in South Africa.

19. Located at the core of Gauteng automotive cluster (close to Pretoria), it could exploit the proximity to the final point of consumption (OEMs), benefit from synergy and collaboration, and capitalize on services and shared facilities in a “plug-and-produce” approach.

20. The Gauteng automotive cluster, is managed by the AIDC (Automotive Industry Development Centre), and brings together international OEMs (among which BMW, Nissan, Ford, TATA, Iveco, etc.) and the highest number of the country’s automotive component suppliers.¹⁶ The Province accounts for 40% of total South African manufacturing output and for 42% of total vehicle production, while Gauteng-based automotive companies still spend nearly R8 billion/year (\$0.6 billion in 2015) for imports of automotive parts, components and accessories.

21. Localizing in Rosslyn ASP could provide a supportive environment for investors. The park, conceived to strengthen local production, hosts in its facilities a tenant pool comprising automotive component manufacturers and suppliers in an area of 130 hectares. It also offers proximity to a productive sectoral cluster and integration in the primary value-chain. Moreover, integrated services such as legal consultancy, centralized security, facility management, testing facilities, ICT services, centralized logistic services (e.g., warehousing, container depot and handling and distribution) are available.

22. Regarding the logistics, the ASP is located at the core of the major infrastructural crossroads in South Africa: ports (Durban, Maputo, Port Elizabeth and Cape Town),

junctions (Rainbow Junction, Capital Rail Hub) and airports (Johannesburg, Wonderboom, Gaborone, Windhoek, etc.). This makes the park a functional **platform able to address the whole African market**, worth 1.55 million new vehicles per year with a compound annual growth rate (CAGR) of 3.6% between 2005 and 2015.

23. The ASP also allows tenants to decide the features of their own buildings, developing turnkeys following their own requirements and designing them in order to achieve optimized factory layout and process flows. These plants are then assigned through favorable rental schemes that make access to finance easier and allow companies to focus their capital investments on productive assets (e.g., machinery and equipment).

24. Considering skills development, the **Gauteng Automotive Learning Centre**, jointly developed by AIDC and Nissan, provides upskilling programs on mechatronics, autotronics, ICT, PLC, CNC, welding and aftermarket services. It also includes a forefront Vehicle Assembly Simulator and it is expected to create about 800 direct jobs and 4,000 jobs within the supply chain, providing the required skills and workforce to the cluster. The AIDC has also developed the Winterveld Enterprise Hub and two incubation centers to support Ford and Nissan production.

25. Lastly, the Automotive Supply Park is also a pillar, in a broader long-term investment attraction strategy, developed by national and local Institutions and supported by stakeholders. The goal is to create the **Tshwane Automotive City**, a multi-OEM, globally competitive automotive city. It should provide the required long-term commitment from institutions and stakeholders.

26. In conclusion, given the steady expansion of the automotive sector in South Africa, the need to complete the local value-chain together with the related opportunities in selected sectors where Italian companies have distinctive excellences, **the momentum for Italian players to make productive investments in the Country is now**. This is true also considering the growing international competition and the policy incentives available. In this context, strategic locations conceived according to a “plug-and-produce” setting, such as Rosslyn ASP, can reduce complexity and ease the localization process.

¹⁶ Over 200 in 2016. Source: AIEC, “South Africa Automotive Export Manual 2016”.

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