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FM COVER STORY

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MOTOR INDUSTRY

Breakdown!

By David Furlonger

There's no doubt the global economy is in free fall. But, no-one knows the depth or likely duration of the crisis stalking the motor industry worldwide. Should government let the industry collapse or should it consider rescue?

The clichés roll readily off the tongue when describing the state of the SA motor industry. The wheels have come off. The industry is in reverse gear. It's backfiring. Clichés they may be, but they accurately describe the situation in which the industry finds itself. New-vehicle sales have collapsed, so has export demand; companies are going bust; hundreds of dealers have closed; tens of thousands of jobs have been lost.

Government has been asked to intervene with a rescue package. After emergency talks last week between employers and officials from the department of trade & industry, a task team has been ordered to recommend ways to help the industry survive.

In the face of a global motor industry breakdown, some multinational components companies are talking of possible disinvestment from SA. Though local vehicle manufacturers insist their future is secure, the crisis facing their overseas parents raise an undercurrent of doubt.

David Powels - Rethinking strategy

All SA's motor companies are foreign-owned, thus subject to boardroom decisions in the US, Europe and Asia. Econometrix analyst Tony Twine says: "There is a real risk to the continued future here of local manufacturers, particularly if their global parents begin to implode." Brand Pretorius, chairman of the local McCarthy motor group, concurs: "The time has gone when global companies felt they had to invest in SA out of duty and social conscience."

The SA industry's challenges are not entirely of its own making. Who, locally, could have foreseen the global credit crunch that has destroy economies and consumer confidence?

Vehicle sales are down in nearly every market globally. Governments are being asked to bail out their motor industries. A number of major names face bankruptcy. SA, however, can't escape all blame. Despite a government-designed strategy to create a world-class industry, SA is a high-cost manufacturing base. Volkswagen SA MD David Powels says typical SA production costs are 20% higher than in Europe and 40% higher than in China and India.

SA's task is heightened by the local industry's unremittingly rose-coloured view of market prospects. After BMW's then-MD, Ian Robertson, suggested in 2004 that annual SA new-vehicle sales could hit 1m within 10 years, others jumped on the bandwagon. As the market surged between 2003 and 2006, from 382 000 to more than 700 000, marketers predicted the 1m mark would be hit by 2010.

Ignoring the industry's cyclical history, they gambled that the sales momentum was unstoppable, then planned and invested accordingly - encouraged by trade & industry minister Mandisi Mpahlwa's stated desire that local assembly should hit 1,2m by 2020.

Production investment may well prove justified in the long term but immediate losses are

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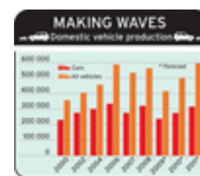

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mounting. After a 32% drop in the market already this year, vehicle sales in 2009 are expected to be back below 450 000, where they were at the time of Robertson's 1m forecast. And though analysts expect the market to pick up from 2010, no-one's betting the house on it.

Then there's the drop in vehicle exports. In 2008, production levels in local plants remained steady as exports hit record highs. But the contraction of the international vehicle market has scuppered that. Vehicle exports this year are forecast to drop by as much as 35%. Components exports are also expected to fall for the first time in years.

If government does intervene, most support is likely to be aimed at the components sector. Since the launch of the motor industry development programme (MIDP) in 1995, vehicle manufacturers have reaped most benefits.

In planning for the MIDP's successor, the automotive production & development programme (APDP) which starts in 2013, the department of trade & industry has placed more emphasis on components. A new investment incentive will come into play later this year. However, the mooted aid package is more urgent.

A priority, says Powels, is to help components companies get investment finance at a time banks have become shy of lending to the auto industry. That's too late for some. Kolbenco, SA's last piston manufacturer, recently closed. Powels, who describes components companies as industry lifeblood, says: "It's unlikely we will ever attract another piston manufacturer to SA."

As talks continue on a rescue package, however, the question is increasingly being asked: is the industry worth saving?

Not everyone thinks so. Canadian academic Frank Flatters, a constant critic of the MIDP/APDP and occasional adviser to national treasury, considers the industry a waste of money.

At the heart of the MIDP is an import-export complementation process that rewards exporters with duty rebates on imports. There's no doubt the MIDP has succeeded in creating an export-focused industry but competitors complain it breaches World Trade Organisation free-trade rules and it will be amended for the APDP, which will run until 2020.

Flatters argues that the MIDP is a state subsidy scheme that has rewarded vehicle manufacturers with well over R100bn in benefits. He claims it has cost consumers at least another R200bn.

After 14 years of incentives and with no immediate prospect of being internationally competitive, he questions the point of throwing more money at it.

The industry denies it is subsidised by the MIDP and argues that, far from being a drain on the consumer purse, it has actually benefited vehicle buyers. Nico Vermeulen, director of the National Association of Automobile Manufacturers of SA (Naamsa), says that in 11 of the 14 years since the MIDP started, vehicle prices have risen slower than inflation.

Not this year. Vehicle and components companies say they can't keep swallowing escalating interest rates or import costs caused by the weakening rand.

WHAT IT MEANS

- Multinationals can't guarantee presence
- Vehicle exports in 2009 may fall 35%

Increases were restrained to about 8% in 2008 because manufacturers and dealers were overstocked and had to shift vehicles whatever the price. Now stock levels have stabilised, 2009 increases are expected to be about 17%. Some companies say they need 25% to match costs.

Vermeulen says cutting the SA industry loose to die would have catastrophic consequences. The automotive sector's trade deficit last year was R4,5bn, down from R37bn in 2007. Though that's expected to rise again this year, he says it would be a pinprick on the potential figure were SA to import all its vehicles and parts.

By writing off most of last year's R97,5bn exports and adding increased exports, he reckons the industry could run up a deficit of R200bn. That would weaken the rand which, in turn, would increase the import bill. SA's trade deficit ballooned to a record R17,4bn in January as exports plunged 25%.

That's just the start, says Twine. Vehicle and components manufacturing accounts for

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about 4% of gross domestic product and directly employs about 107 000 people. To lose the industry would have devastating economic and social consequences in some areas, particularly the Eastern Cape, where Mercedes-Benz, General Motors, Volkswagen and Ford all operate.

Nimrod Zalk, the trade & industry department's chief director of industrial policy, says government is committed to the industry. "The knock-on effects of losing it would be terrible."

The immediate problem, he says, is that no-one understands how the global crisis will affect SA. "We don't know yet the nature and extent of the problem in the SA motor industry or how long these negative conditions may prevail."

As long as the uncertainty remains, the industry will be shy of long-term plans, says Powels. "It's one thing if this is a cyclical downturn. But if it turns out to be a restructuring of the global motor industry, all of us will have to rethink our strategy and investment plans."

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